# STRATEGIC MANAGEMENT

## STUDY GUIDE

Mancosa [GSB]

Education Reimagin[ed]

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## INTRODUCTION

Welcome to the Strategic Management module.

Strategic management is seen as the process that links an organisation with its dynamic business environment. Strategy development, essentially the formulation of competitive strategies, is part of the strategic management process. The other part relates to strategy implementation, evaluation and control.

Strategic management as well as strategy development decisions and actions are based on the concepts of strategy and strategic thinking. More specifically, strategy development involves the formulation and choice of strategies that will enable the organisation to effectively align its capabilities and resources with the organisation's long-term objectives, and reconcile them with existing as well as potential opportunities and threats in the dynamic external business environment.

Potential opportunities and threats may arise from dramatic technological breakthroughs, increasingly volatile financial and foreign exchange markets, rapidly-expanding e-commerce and e-business initiatives, the establishment of cyber organisations, consumers turning to virtual shopping, more intense global, regional and local competition, increasing regional integration and formation of free trade areas, changing demographics, increasing geopolitical pressures regarding energy, ecological issues, uncertainty about the oil price and issues of global warming, changing work ethics and new perspectives on corporate governance, to name but a few.

It is within this context, and the increasing complexity of the demands on strategic management and leadership, that strategy development has become critically important.

In this module, the following topics are discussed with regard to strategy development:

- the concepts of strategy, strategic alignment and strategic management
- the vision, mission and strategic intent of organisations
- the constantly changing external business environment
- the organisation, its resources and competitive capabilities
- alignment of the organisation with the changing business environment through the development of viable and appropriate competitive business strategies

The ability or inability of an organisation to be proactive and adapt to change in the environment can either make or break the organisation. The focus of strategy development, therefore, is on the future, not on the past or the present. Although an understanding of past developments and present concerns are important, long-term survival depends on a view of the future – of getting actively involved in what the future holds for the organisation as it shapes and adapts to the new realities.

## Outcomes of the Module

Once you have completed this module, you should be able to:

- Critically apply the concepts of strategy, strategy development and strategic management;
- Demonstrate the need for and importance of competitive and comparative strategies with regards to strategic alignment;
- Explain and interpret vision and mission statements as a basis for creating the future of an organisation;
- Analyse and interpret the results of an assessment of opportunities and threats in the external environment for a business;
- Analyse and interpret the results of an assessment of the internal environment of an organisation in terms of its resources and competitive and comparative capabilities;
- Interpret the grand and generic competitive strategies;
- Defend the choice of strategy or strategies in given industry, competitive, comparative and organisation situations;
- Suggest ways to build an organisation capable of effective strategy execution and sound strategic alignment;
- Explain the importance of leadership, culture and teamwork in strategy development and its implementation; and
- Evaluate the role of corporate governance and ethics in strategy development and implementation.

**STRUCTURE OF EACH CHAPTER**

Each chapter is structured as follows:

- Specific Learning Outcomes
- Essential (Prescribed) Reading
- Brief Overview of Relevant Theory
- Questions for Reflection

## SPECIFIC LEARNING OUTCOMES

These are listed at the beginning of each chapter. These detail the specific outcomes that you will be able to competently demonstrate on successful completion of the learning that each particular chapter requires.

## ESSENTIAL (PRESCRIBED) READING

Your essential (prescribed) reading comprises the following:

Hough, J, Thompson, Arthur A. Jr., Strickland, A.J. III and Gamble JE. (2011). Crafting and Executing Strategy. Creating Sustainable High Performance in South Africa 2nd Edition. London: McGraw-Hill.

## QUESTIONS FOR REFLECTION

There are questions for reflection at the end of each chapter. The questions are designed to enable you to reflect on what you have learnt, and consider how what you have learnt should be applied in practice.

## CASE STUDIES

Case Studies form an integral part of developing competence in Strategic Management. The Case Studies, for this module, are located at the end of each chapter.

# CHAPTER 1: INTRODUCING STRATEGY

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

- Define and explain the concepts of strategy and strategic management
- Describe the strategic management process
- Outline the central importance of strategy to an organisation.

**READING**

Hough et al (2011) Chapters 1 and 2

Reading 01 (*Can you say what your strategy is*?)

Managing an organisation in an increasingly competitive and globalised landscape is a highly complex task (Louw and Venter, 2011:6)

When thinking about the current situation of an organisation and its future prospects for sustainability and growth, management is faced with three critical questions:

- Where are we now?
- Where do we want to go?
- How will we get there?

In considering the first question (Where are we now?) management must reflect on the following:

- The competitive position of the organisation
- The resources and dynamic capabilities of the organisation
- The appeal and value-add of the products/services of the organisation, and
- The current performance of the organisation.

The second question (Where do we want to go?) requires management to consider the strategic direction that the organisation should adopt.

The answer to the third question (How will we get there?) is the strategy that the organisation will formulate.

Hough, Thompson, Strickland and Gamble (2011:5) contend that the crafting of a strategy represents the commitment of management to pursue a particular set of actions in growing the business, attracting pleasing and retaining customers competing successfully, conducting operations and improving the financial and market performance of the organisation.

Thus the strategy of an organisation is all about how:

- management intends to grow the business
- management will build a loyal clientele
- management will outcompete rivals and competitors
- each functional part of the organisation (production, sales, marketing, distribution, finance, human resources) will be operated
- organisational performance will be boosted.

Some definitions of strategy:

- Hill and Jones (2009:35) define a strategy as an action plan that an organisation takes to attain one or more of its goals.
- Hough *et al* (2011:5) refer to strategy as management's action plan for running the business and conducting operations.
- According to Lazenby (2014:3), a strategy can be defined as a deliberate course of action that an organisation must implement to outperform its rivals.
- Lynch (2006:5) states that corporate strategy can be described as the identification of the purpose of the organisation and plans to achieve that purpose.

  An alternate view (Lynch, 2006:7) is that corporate strategy can be described as finding market opportunities, experimenting and developing competitive advantage over time.

- Lazenby (2014:3) explains that the concept 'strategy' originates from the Greek word "strategos" – a military commander. In a military context, war and war-making is all about "winning" and, in a management context, strategy can be thought of as having something to do with "winning".

  Lazenby (2014:4) emphasises that the purpose of a strategy is to add value to the stakeholders of an organisation and allow the organisation to compete successfully in the market environment.

- Johnson, Whittington and Scholes (2011:3) maintain that strategy is the long term direction of an organisation. Strategy involves managing people, relationships and processes.

Lazenby (2014:4) describes the key elements of strategy as:

- **Sustainability** – strategic decisions must be maintained over a long time as organisations want to survive in the long term.
- **Competitive advantage** – the purpose of strategy is to outsmart the competition. The achievement of sustainable competitive advantage is of paramount importance.
- **Alignment with the environment** – the internal environment of the organisation must be aligned with the challenges and opportunities from the external environment
- **Processes development to deliver the strategy** – business processes must be developed to undertake the task(s) of outsmarting the competition
- **Adding of value** – a strategy must add value to all the different stakeholders of an organisation, including the owners.

Louw and Venter (2011:10) provide a 'vocabulary' of strategy (adapted from Johnson and Scholes, 2002:13)

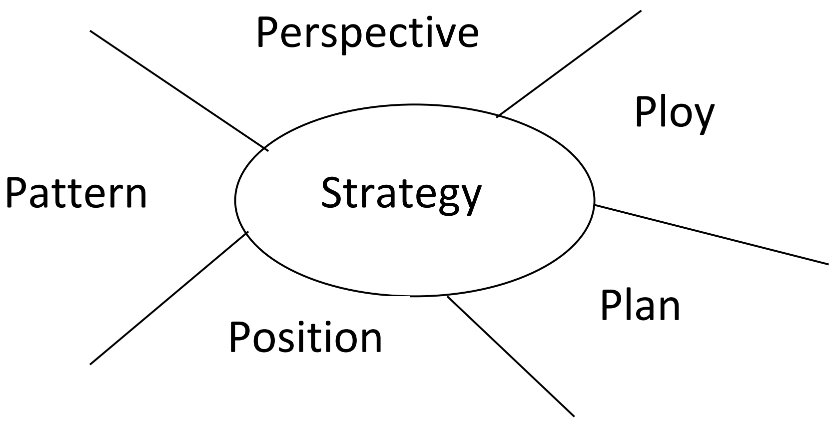
| **Term** | **Definition** |
|---|---|
| Vision | Desired future state<br><br>The aspiration of the organisation |
| Mission | Overriding purpose of the organisation |
| Goal | General statement of aim or purpose |
| Objective | Quantification or more precise statement of the goal |
| Competitive advantage | Unique resources, capabilities, skills and processes |
| Control | Monitor actions to assess effectiveness |

Mintzberg, Ahlstrand and Lampel (1998) offer five perspectives on strategy (the five Ps of strategy):


These perspectives can be explained as follows:

- Perspective – the "big picture". Strategy in a visionary context. Strategy as a clear strategic purpose, intent and direction for the organisation, but without detail.
- Pattern – making sense of the past; a foundation for future decisions, plans and actions.
- Position – a clear understanding of the present; a statement of what is happening, so that future changes are based on clear knowledge, not assumption.
- Plan – thinking ahead as far as it might be sensible; this view makes strategy and planning synonymous. Looking ahead and trying to discern a clear picture of possible courses of action
- Tactic – activities at the "little picture" level in a dynamic and competitive world; the tactical view is about the immediate future.

Louw and Venter (2011:16) consider the five Ps of strategy as follows:



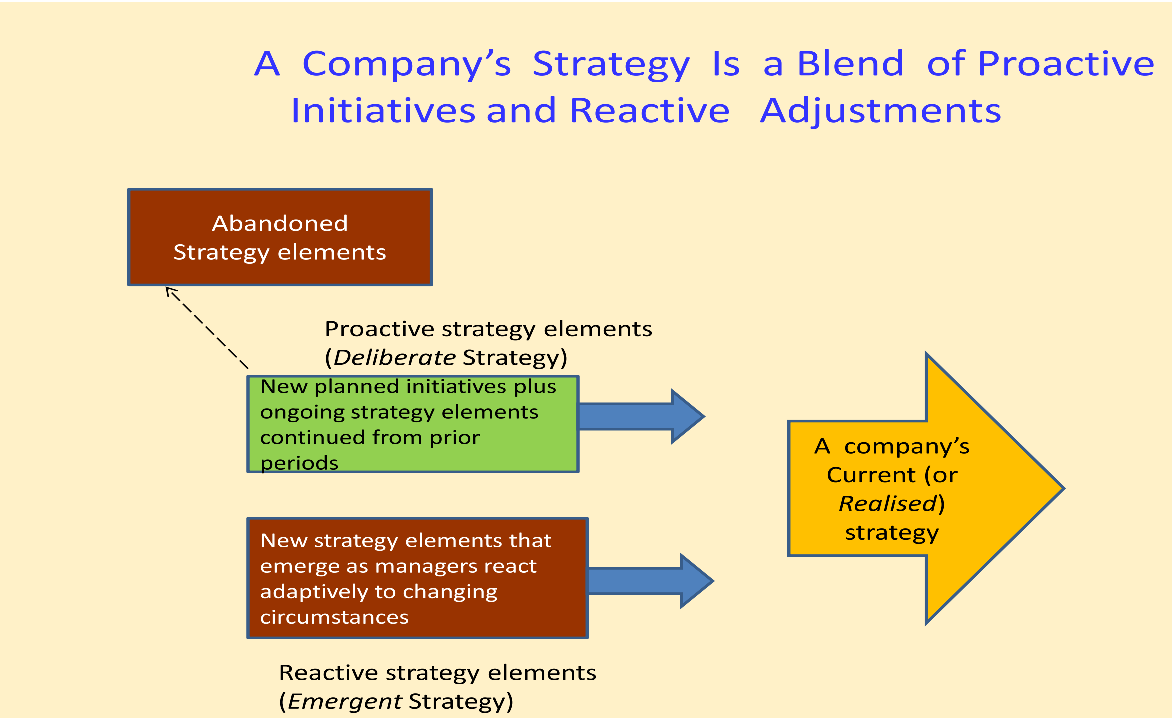
- Strategy as a *plan* provides overall direction and a course of action. As a plan, strategy formulation is a formal process implemented through organisational layers, structure and control systems.
- Strategy as a *position* looks downwards towards meeting customer needs and outwards towards the external competitive market.
- Strategy as a *perspective* refers to the organisation's way of doing things and is the experience of the organisation. As a perspective, strategy looks inside the organisation and the collective mindset of the 'strategists'.
- Strategy as a *ploy* is a specific manoeuvre to outwit a competitor.
- Strategy as a *pattern* concerns consistent behaviour over time.

**THINK POINT**

Louw and Venter (2011:18) contend that the essence of strategy is complex and unstructured; "strategies can be deliberate, intended but unrealised, or emergent, and exist on different levels"

Distinguish between deliberate and emergent strategies and examine the three levels of strategy.

Reflection Perspective 1




Reflection Perspective 2

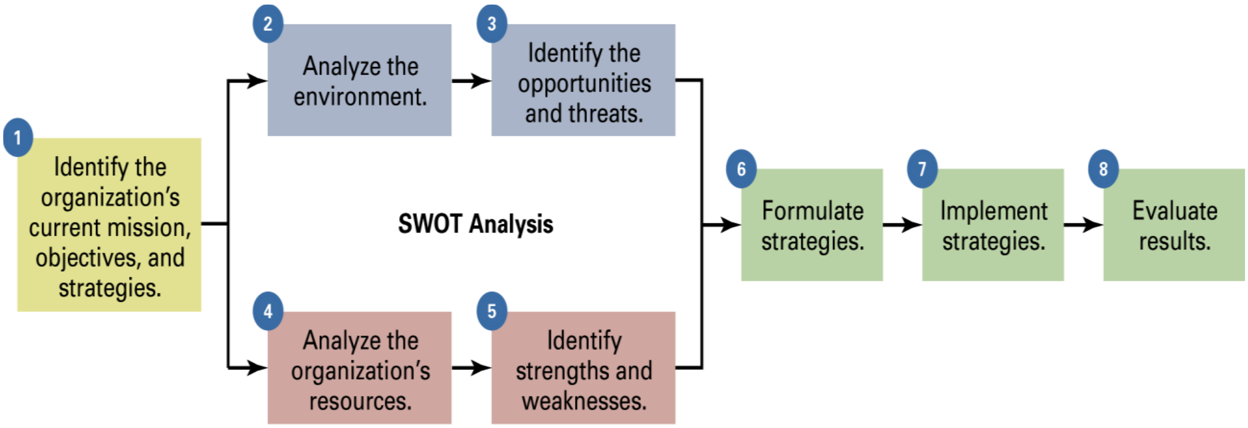

Strategic management is concerned with the overall effectiveness and choice of direction of the organisation in a dynamic, complex and ambiguous environment. It is the process by which organisations determine what value is needed and how to add that value (Louw and Venter, 2011:20).

David and David (2015:39) define strategic management as the art and science of formulating, implementing and evaluating cross-functional decisions that enable an organisation to achieve its objectives. This implies that strategic management focuses on integrating management, marketing, finance and accounting, production and operations, research and development and information systems to achieve organisational success.

Strategic management essentially involves
- managing the interaction between the firm and its external environment, and
- strategic alignment, a dynamic process whereby an organisation's strategy is calibrated with its culture, leadership, organisational structure, and governance

An integrated strategic management process comprises the following three phases:
(1) Strategy development or strategy formulation
(2) Strategy implementation or execution
(3) Strategy evaluation and control

According to David (2003), the strategic-management process consists of three stages: strategy formulation, strategy implementation and strategy evaluation.

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According to Hough et al., (2011:23), the managerial process of crafting and executing a company's strategy consists of five interrelated and integrated phases.

These are:

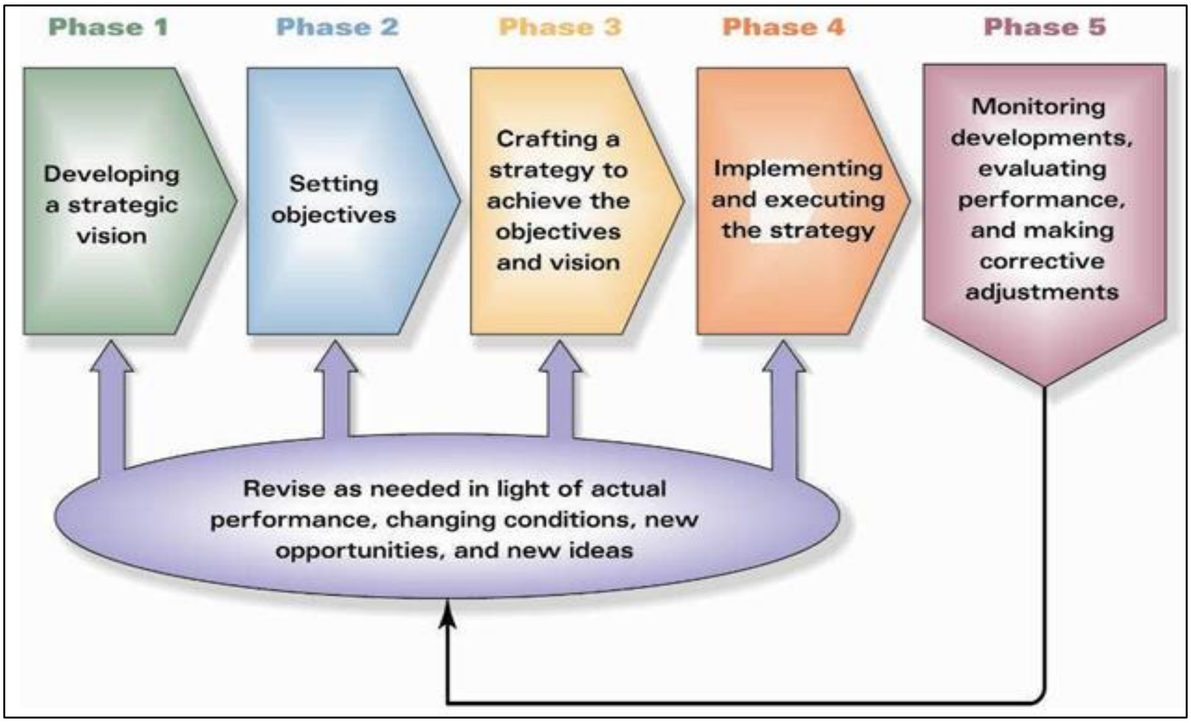
1. **Developing a strategic vision** of where the company need to head and what its future product/market/customer technology focus should be.

2. **Setting objectives** and using them as yardsticks for measuring the company's performance and progress.

3. **Crafting a strategy to achieve the objectives** and move the company along the strategic course that management has chartered.

4. **Implementing and executing the chosen strategy efficiently and effectively.**

5. **Evaluating performance and initiating corrective adjustments** in the company's long-term direction, objectives, strategy, or execution in light of actual experience, changing conditions, new ideas and new opportunities.




The Strategy-Making, Strategy-Executing Process Hough et al (2011:23)

Hough et al (2011:51) summarise the above process as follows:

1. *Developing a strategic vision* of where the organisation needs to head and what its future product/market/customer/technology focus should be.
2. *Setting objectives* to spell out for the organisation how much of what kind of performance is expected, by when. The objectives need to require a significant amount of organisational stretch.
3. *Crafting a strategy* to achieve the objectives and move the organisation along the strategic course that has been defined by management. This is concerned primarily with devising competitive moves and market approaches aimed at producing sustainable competitive advantage and building competencies and capabilities. A business organisation has three levels of strategy – business strategy for the organisation as a whole, functional area strategies for each area within the business and operating strategies.
4. *Implementing and executing* the chosen strategy efficiently and effectively. This is an operations-oriented, make-things-happen activity.
5. *Evaluating performance* and initiating corrective adjustments in light of actual experience, changing conditions, new ideas and new opportunities.

**SUMMARY:**

The term “strategy” derives from the Greek word *strategia.* This term means “generalship”. In this sense, strategy can almost be thought of as “the art and task of the general” in a military context. In a military context, war and war-making is all about “winning”. In a management context, strategy is therefore also supposed to have something to do with “winning”.

Strategy has to do with the “war as a whole” much more than any single “battle” as such. The day to day “battles” to be “fought” refer to operational management – the practice of management.

Strategy focuses on the “big picture”: *who* the organisation is (defining its scope/domain in specific context and setting); *what* it is trying to achieve and *where* it is aiming to go over the long term; *how* it intends to achieve this in the context of the organisation’s competitive and general external environment.

Strategy emphasises the organisation as a whole and the ultimate object, purpose or ‘mission’ of an organisation. It relates to the primary concern of senior management in an organisation – namely to be successful.

The characteristics, therefore, of strategy are that:

- It is long-term and future oriented.
- It is holistic and integrating in nature
- It focuses on matching or creating the necessary fit between the organisation (its internal environment and resources and capabilities) and its external environment (which is uncertain, competitive and constantly changing); and
- It is concerned with the mission and direction of the organisation as a whole and thus with its success within an environment of scarce resources, competition and change; and
- It is complex and incorporates many ‘uncertainty’ elements.

Corporate strategy essentially revolves around the type(s) or line(s) of business in which an organisation is engaged in, or wishes to engage in. According to Johnson and Scholes (2002), corporate strategy is concerned with “the overall purpose and scope of an organisation and how value will be added to the different parts of the organisation”.

Business strategy can be described as the particular broad approach which the senior management of a business organisation adopts in order to be successful.

Functional strategies relate to the strategies used in functional areas (such as marketing, production, product development and public relations). Because the primary objective of an organisation is to become and remain successful in a competitive environment, these functional strategies are secondary or downstream to corporate and business strategy. They do, however, form an integrated part of strategic management.

**Strategic Management**

Management as a process essentially entails functions such as planning, organising, leading or directing and controlling the resources of an organisation. Strategic management is thus the application of this management process at the top level of an organisation. At this level, the focus is on the resources, capabilities and core or distinctive competencies of the organisation as a whole and on the ways to achieve success as a total organisation over the long term, within the context of changing and competitive environments.

The process of strategic management includes "understanding the strategic position of an organisation, strategic choices for the future and turning strategy into action" (Johnson and Scholes, 2002). Strategic position is about matching, balancing and integrating the organisation's internal environment, its internal competences and resources, and the influence and expectations of its stakeholders. Strategic choices relate options and decisions for steering the organisation in particular directions through the use of particular methods. Strategy into action is "concerned with ensuring that strategies are working in practice.

Strategic management therefore entails two basic tasks – strategy making and making strategy work. Strategy making involves analytical, conceptual and visionary thinking skills aimed at making decisions after considering various positions, options and environmental issues and dynamics. To make strategy work involves the rolling out of appropriate processes, systems, practices and the 'active management' of the formulated strategy as it gets implemented over time in a changing and dynamic environment.

The whole process of strategic management is thus described as consisting of strategy *formulation* and strategy *implementation*. Although the distinction between the two is not watertight and they are interdependent, there are two different types of activities – shaping has to do with finding strategy and implementing has to do with using strategy.

In defining these two broad activities, different tasks in the strategic management process can be identified. These tasks are often performed simultaneously, making the whole process interactive and dynamic by nature. The tasks making up the strategic management process are as follows:

- *Environmental scanning and analysis* entails a thorough study of all the factors or variables both external and internal to the organisation. The ultimate aim is to create the necessary match or fit between the two. This often takes the form of a SWOT- analysis, and involves the process of analysing and synchronising the organisation's internal strengths and weaknesses and the opportunities and threats coming from the external environment.  This process is aimed at understanding the strategic position of the organisation.
- *Developing a vision and/or mission* is an important facet of strategy-making. This direction-setting task concerns determining exactly what business the organisation is in and what business the organisation wants to be in.
- *Formulation of long-term objectives* is another task relating to, for example, market share, profitability and competitive market positioning.
- *Making decisions about which different types of strategy to use* is another component or task of the strategy making process. In this regard choices and decisions are made about appropriate generic business strategies, corporate grand strategies as well as functional strategies.

The formalised strategy-making process typically culminates in the drafting of strategy documents, such as vision and mission statements, strategic and business plans (containing clear signposts and measurable such as objectives to guide strategic direction) and often also relevant policy documents to facilitate the process of strategy implementation.

The implementation of a strategy entails creating the necessary architecture, including structures and establishing a culture in which all the role layers actually work towards overall mission accomplishment. It is all about orchestrating and mobilising the resources towards mission accomplishment.

Throughout the process it is important continuously to monitor and evaluate the extent to which strategic decisions match or fit the changing circumstances, as well as the extent to which they are actually being implemented.

Finally, strategic management cannot be regarded simply as a neatly packaged set of rational decisions and related behaviour. The role of the socio-organisational side (the 'political' or 'softer' side of management) has become increasingly important. Aspects such as ideologies of managers, the motivations and frames of reference that they have, their perceptions and the role of so-called cognitive processes all play a significant part in the process of strategic management.

## CHAPTER ONE CASE STUDY

Read the following and answer the questions that follow

**So who needs a strategy?**

Semco is a diversified Brazilian corporation that has a range of international businesses which include marine engineering, facilities management, internet services and software development. Since the 1980s growth has been impressive and over the last ten years turnover has grown from $35 million to $1 000 million. Its principal shareholder (he owns 90 percent of the firm) is Ricardo Semler. He inherited Semco in 1980 from his father, an engineer who had founded the marine pumps company in 1954, although engineering now accounts for only 30% of sales. It has 3 000 employees (ten times as many as in 1980) and is structured as a federation of ten companies 'all of which are premium providers and market leaders in their fields'.

Semler describes its principal purpose as 'selling intelligence, the capacity to think out service solutions, and to look at things from an intellectual standpoint. Our rationale for everything we do is that it's heavily engineered or complex... businesses that have high entry barriers and which people can't get into easily and can't get out of easily.'

Mr Semler's reputation as an unconventional businessman rests on books, articles and seminars that describe his unusual approach to doing business. On taking over from his father, Mr Semler quickly started making changes. He fired two-thirds of his father's senior managers, dismantled the company's 'very conservative' structure, abandoned the practice of searching employees as they left at the end of each day, and did away with time clocks and controls over working hours.

His shaking up of the company continued. Semco has no official structure. It has no organisational chart. There's no business plan or company strategy, no two-year or five-year plan, no goal or mission statement, no long-term budget. The company does not have a fixed CEO. There are no chief officers for information technology or operations. There are no standards or practices. There's no human resource department. There are no career plans, job descriptions or employee contracts.

No one approves reports or expense accounts. Supervision or monitoring of workers is rare.

In addition:

- Attendance at all company meetings is voluntary
- Employees have no set working hours and can decide when to take holidays and how much time off they need.
- Staff can choose from a range of ways that they can get paid – including a fixed salary, royalties on sales or profits, share options and commissions or bonuses.
- Employees choose their own training, and Semco's Work n' Stop programme allows them to take up to three years off for any purpose.
- Its 'Lost in Space' programme makes its young recruits roam the company for a year to discover what they want to do.

Mr Semler sees it as his role to be disruptive and to encourage divergent thinking, and claims that this is a bedrock for all the company's practices – "... ask why. Ask it all the time, ask it any day, every day, and always ask it three time in a row", even though this is something that he recognises is often very difficult for people to do. However, Mr Semler is adamant that this is necessary to prevent 'calcified thinking'. This ethos means that the company has few written plans, which he believes encourages people to follow them 'like a Pied Piper – mindlessly'.

This philosophy means that the company has no written mission statement or written statements of strategic objectives – although Semler says the firm does have a mission: 'to find a gratifying way of spending your life doing something you like that is useful and fills a need'. By not writing strategic objectives down he claims that employees are forced to constantly re-think what they are doing. Mr Semler even says he resists any attempts to make him define what the firm does: "once you say what business you're in, you put your employees into a mental straitjacket, blocking them from thinking opportunistically. So rather than trying to dictate Semco's direction, he encourages employees to shape it themselves through their own interests and initiatives.

Every six months, Semco is 'shut down' and started again. Through a budgeting and planning process all business units have to justify their continued existence. Executives similarly are forced to resign and be rehired in an anonymous assessment process by subordinates whose results are then made public. Such a ruthless focus leads to some being moved ‘sideways, downwards or out’. Mr Semler says, ‘ultimately, all we care about is performance’. How this is achieved is down to the individual.

Semco judges its businesses on their ability to generate profits and therefore survive in the long term. But Semco does not set sales targets for its businesses, as long as their profits remain healthy. And if profitability tails off employees are encouraged to start anew. The company makes it ‘as easy as possible’ for employees to propose new business ideas, and to get fast and clear decisions. Proposals go through an executive board that includes representatives from the major business units and the first two employees that turn up to the board meeting, and which all employees can attend. **Adapted from Haberberg A and Rieple A (2013) Strategic Management Theory and Application. Oxford University Press**

**QUESTIONS**

1. Does Semco have a strategy? Justify your answer
2. What modes of strategy-making appear to be apparent at Semco?

# CHAPTER 2: STRATEGIC INTENT

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

- Explain what strategic intent is
- Justify the role of the vision statement as a basis of organisational strategy
- Expound on the components of a mission statement
- Explain why a mission statement is an important management tool
- Describe the link between strategy and ethical behaviour in an organisation
- Explain the role of corporate governance

**READING**

Hough et al (2011) Chapter 10

Reading 02 (*Enabling bold vision*)

<u>Strategic intent and Vision, Mission and Value Statements</u>

Strategic intent is what an organisation plans to strive for in the future. The strategic direction of an organisation informs and shapes how the organisation defines itself, and where it finds its unique strategic advantage.

It requires organisations to ask themselves: "What is our fundamental purpose?"

Strategic intent, and vision, mission and value statements can be considered to be the tools used to determine the strategic direction of an organisation.

Hamel and Prahalad (2005) observed that organisations that had risen to global leadership began with ambitions that were all out of proportion to their resources and capabilities. They observed that these organisations succeeded by creating an obsession with winning at all levels; they termed this obsession 'strategic intent'.

Louw and Venter (2011:109) contend that organisations need a driving force or strategic intent that will inform and shape how they define their business, and where the organisation finds its unique strategic advantage.

A clear strategic intent therefore gives managers a point of departure from which they can make decisions about the future of their organisation and to assess product and market options. Organisations that lack a clear strategic intent often face conflicting priorities, wasted resources, indecision, frustration among the workforce and confusion in the marketplace (Louw and Venter, 2011:109).

As Hamel and Prahalad (2005) express it, managers require a touch point “which shapes the future and explains the past.”

A vision can be regarded as a dream or a mental image of a desired future, i.e. what the organisation can become.

Lazenby (2014:30-32) outlines the reasons why vision is a valuable tool:

- The strategic vision articulates the strategic intent of the organisation because it focuses attention, capacity and energy on the purpose of the organisation. It is a description of the future direction of the organisation.
- A good strategic vision encourages the organisation to stretch and challenge practices and mind-sets in the organisation.
- A strategic vision serves as an important guiding star for future direction and positioning.
- A strategic vision can be the driving force for effective communication with all stakeholders of the organisation.
- A strategic vision provides the basis for dealing with complex challenges; managers cannot problem solve effectively without a clear vision.
- A strategic vision guides all employees in an organisation towards a shared purpose.

Flowing from the vision, the mission statement represents the overriding purpose or *raison d’être* of the organisation. Lazenby (2014: 35) contends that mission statements still form a very popular part of most strategic planning because they assist in aligning thought processes.

A mission is a direction-setting guideline that is normally written by answering key questions:

- What business are we in?
- What purpose do we serve?

- What customers are we targeting?
- What are we doing – our products/ services?
- Why does this organisation exist?

The mission statement thus provides clarity about:

- Who we are,
- What we do,
- Who our customers are, and
- The way things are done.

A vision statement is a verbalised picture of where the organisation is heading towards while the mission guides the organisation in terms of what needs to be done. The core values of an organisation explain how things will be done.

Core values indicate standards of behaviour. They exert influence on the behaviour and attitude of employees. Thus, a statement of core values is a written declaration of how the organisation will deal with the internal and external community.

Thompson, Scott and Martin (2014:73) illustrate the relationship between vision, mission and objectives (strategic intent) as follows:

VISION

*to become*

MISSION

*To be in order to become*

*how the organisation will make a difference*

VALUES

*behaviours to support the vision and mission*

BROAD AIMS AND OBJECTIVES

*to deliver the mission and vision*

ENABLING FACTORS

*things that need to be in place to support this process and achievement*

KEY PERFORMANCE INDICATORS

*specific targets and milestones for a defined period linked to each*

*and every aim, objective and enabler*

Louw and Venter (2011:121) summarise the benefits of a clear strategic direction:

- It guides human behaviour and defines working relationships
- It contributes to shaping employee relationships with each other and with customers
- It can lead to better performance by aiding strategy formulation, and implementation.
- It serves as a benchmark for resource allocation.
- It can inspire employees throughout the organisation.

Corporate Social Responsibility, Business Ethics and Corporate Governance

While organisations focus on achieving their purpose, they must acknowledge that the organisation exists in a wider social environment. Organisations have a responsibility to a range of stakeholders.

A stakeholder is any group or person within or outside the organisation that has a stake or interest in the performance of the organisation. Investors, shareholders, employees, customers and suppliers are regarded as primary stakeholders. Secondary stakeholders include the government, community and special interest groups like trade associations and trade unions.

Corporate Social responsibility (CSR) refers to the responsibility that business organisations have to creating a healthy and prosperous society. The organisation also has a responsibility to protect the environment. This responsibility is reflected through ethical practices.

Ethics and social responsibility influence the way in which organisations develop their strategies as well as how strategies are implemented.

Ethics refers to moral principles guiding individuals in terms of what is right or wrong. Business ethics involve the application of standards of moral behaviour to business situations (Lazenby 2014:57).

Ethical conduct in organisations is shaped by four main forces:

- Individual forces – each employee has their own values and sense of right and wrong
- Organisational forces – organisational practices and culture have a direct impact on the behaviour of employees
- Social norms and culture – the society in which the organisation operates influences the behaviour of employees
- Laws and regulations – governments regulate business activities through various forms of legislation in areas such as competition and consumer protection.

(Lazenby 2014:59)

According to Lazenby (2014:69), corporate social responsibility involves organisations behaving ethically and contributing to economic development while improving the quality of life of all its stakeholders.

Carroll and Buchholtz (2003) identify four types of social responsibilities:

- Economic responsibilities (be profitable) – profit maximisation for owners and shareholders
- Legal responsibilities (obey the law) – comply with laws and regulations that society deems important
- Ethical responsibilities (be ethical) – embrace activities and practices expected or prohibited by society even if they are not codified into laws.
- Philanthropic or discretionary responsibilities (be a good corporate citizen) – make social contributions not mandated by laws or ethics

The two important issues of corporate social responsibility and ethical behaviour have led to the importance of corporate governance.

Ethics and corporate social responsibility are important and much-debated management issues because of the scale and influence of the modern organisation on society.

Organisations and their managers have a real and potential impact on a wide variety of issues that extend beyond their normal business and which affect individuals, communities, the environment, countries and the entire world.

Modern organisations have power and authority - more than ever before - to pursue their own interests. However, associated with this power is an increased responsibility towards the stakeholders of the organisation and to society; this is the domain of ethics, corporate social responsibility, and corporate governance.

Although ethics and social responsibility are not synonymous concepts, they relate to one another because socially responsible decisions often require ethical judgements that fall outside the field of prescribed laws, procedures, and previous experience. Managers have the responsibility to judge the fairness and consequences of every demand that stakeholders make on the organisation; ethics forms the foundation on which these decisions are based.

Closely related to ethics and corporate social responsibility is corporate governance – the system underpinning the way in which organisations are managed and controlled and from which the values and ethics of the organisation emerge.

The economy comprises organisations interacting and competing with one another for the use of the resources of society, such as people (human resources), money (financial resources), raw materials and land (physical resources) and knowledge (information resources).

Organisations use these societal resources to produce products and services that meet the needs of society. To a certain extent, the collective resources of society therefore pass into the custodianship of organisations. Organisations accrue certain rights for their contribution to society in developing products and services, but also incur obligations and responsibilities to society for the privilege of using societal resources.

Organisations are therefore expected to be good corporate citizens and to fulfil their obligations and responsibilities to society.

Corporate Citizenship is therefore based on the concept that organisations have a duty to serve not only the financial interests of shareholders, but also the interests of society.

Corporate citizenship comprises the extent to which an organisation:

- makes a positive contribution to society by showing consideration to its stakeholders,
- has high ethical values,
- adheres to legislation, rules and regulations, and
- has a high regard for the natural environment.

Corporate citizenship focuses on numerous issues:

- governance
- human rights
- transformation
- economic value
- company control
- employees
- workplace equity
- environment
- skills and training
- health and safety
- HIV / AIDS
- Procurement
- Supply chain
- Product stewardship
- Product support
- Stakeholders
- Society
- Social investment

All organisations operate within the broader society and the natural environment. What an organisation can and cannot do in terms of its strategy or strategies is constrained not only by legislation, government policies and regulatory requirements but also by what is considered ethical and in accordance with the expectations of society and community standards.

Five issues are of importance in this regard:

**Corporate Social Responsibility –** is based on the concept that organisations have a duty to serve not only the financial interests of shareholders, but also the interests of society. It can be described as organisational decision making linked to ethical values, compliance with legal requirements, and respect for communities and the environment.

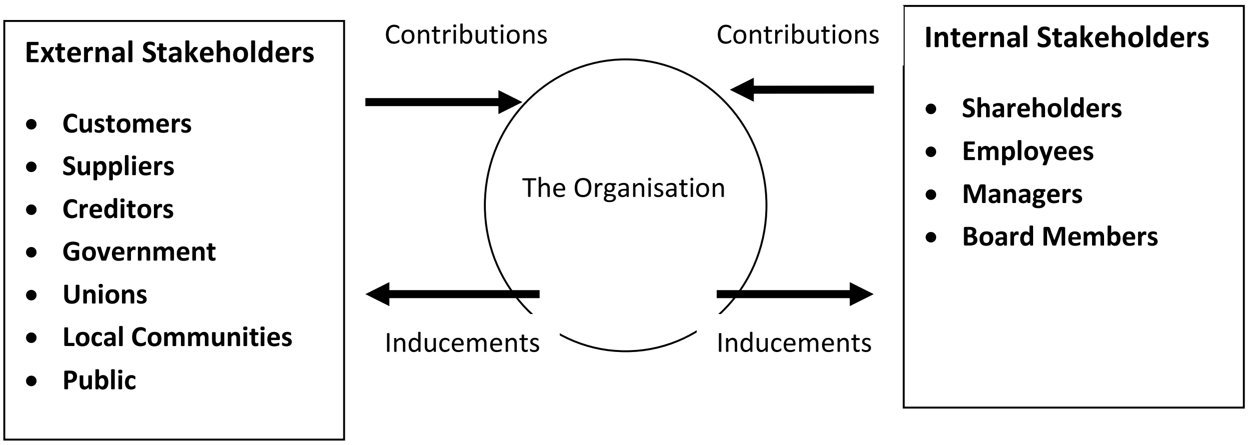
**Environmental responsibility -** the issue of environmental responsibility exceeds the mandate and capabilities of any organisation, but economic activity is threatened by the way resources are extracted, processed, transported and disposed of.

**Sustainability** – sustainable development is defined as development that meets the needs of the present generation without compromising the ability of future generations to meet their needs. Organisations need to consider how their strategies impact on wider economic systems, the environment and the communities in which they operate.

**Sustainability reporting –** traditionally organisations were required by law to report on financial or economic matters. In line with the importance of good corporate citizenship, there is a move from this single bottom line to the triple bottom line. The triple bottom line approach embraces the economic, environmental and social aspects of the activities of an organisation. Organisations will report on the effect of the environment (environmental issues), and the values, ethics and relationships with stakeholders (social issues) as well as financial matters (economic issues). Reporting on the triple bottom line is referred to as sustainability reporting.

**Stakeholder engagement** – anyone who is directly or indirectly influenced by the acts of the organisation is seen as a stakeholder. An organisation's stakeholders are individuals or groups with an interest, claim or stake in the organisation, in what it does, and in how well it performs.

Stakeholders can be divided into internal and external stakeholders:




Corporate Governance has become an increasingly dominant topic worldwide due to various events and factors:

- Corporate scandals and disasters such as those involving Enron and Parmalat
- Fraudulent and unethical practices and behaviour of directors of companies (Leisure Net, Regal, Fidentia, Masterbond)

- The King Reports on Corporate Governance (King I in 1194, King II in 2002 and King III in 2009.

In its narrowest sense, corporate governance refers to the formal system of accountability of the board of directors of an organisation to its shareholders. In its broadest sense, corporate governance refers to the formal and informal relationships between the corporate sector and its stakeholders, and the impact of the corporate sector on society in general.

Corporate Governance deals with the way an organisation aligns its own goals with those of its stakeholders and manages its relationship with both its internal and external stakeholders. This relationship impacts on the strategic direction of the organisation and subsequently on its performance.

The approach of an organisation to corporate governance is reflected and enforced by its values, actions and standards.

The word governance is derived from the Latin “gubernare” which means to steer.

The concept of governance refers to the process of running an organisation. This process consists of mechanisms and institutions through which organisations articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.

Governance represents the means by which direction and control are applied to the stewardship of the assets of an organisation – tangible and intangible, financial and non-financial – in the pursuit and delivery of the primary objective of sustainable value creation.

Governance is essentially a function of leadership and direction within an organisation; appropriate risk management and control over its activities; and the manner in which meaningful disclosure relating to its activities is made to stakeholders.

Corporate governance goes beyond the financial and regulation aspects of governance. It addresses the interests of a wide range of stakeholders and it espouses the fundamental principle of social, ethical, environmental and good financial practices. Corporate governance is the mechanism by which values, principles and management policies and procedures of an organisation are manifested in the real world.

Corporate governance refers to the entire system by which organisations are managed and monitored and encompasses the manifestations of personal beliefs, values and ethics which configure the organisational values, beliefs and ethics and hence the actions of parties internal and external to the organisation.

Thus, governance is related to how organisations are run.

Governance is also closely related to the way an organisation is directed. This mainly includes issues on strategies, policies and procedures that directly impact on organisational performance.

Governance consists of decisions and actions linked to defining an organisation's mission, establishment of policies and determining the controls used to allocate power.

The main purpose of business governance is to match business behaviour and management conduct with corporate intentions, mission and objectives of the organisation. Directors and management need some guiding principles to optimise resources and minimise risks and the abuse of power by leaders.

Good governance will ensure sensitivity to the needs of society, the balance of interest from different parties, transparency in the business environment, and will assist in establishing the principles that underlie a good code of conduct based on equitable and ethical values. This is important as it contributes to organisational success.

The benefits of business governance can be tabulated as follows:

- Increases the value of the organisation
- Nurtures a spirit of enterprise
- Gives confidence to the market
- Enhances the reputation of the organisation
- Enhances empowerment of all stakeholders
- Improves efficiency
- Encourages innovation
- Enhances competitive advantages
- Meets financial, legal and statutory obligations.

The reasons for good corporate/business governance can be tabulated as follows:

- Directors become responsible to all stakeholders
- The affairs of an organisation are conducted with honesty and integrity
- There is sensitivity to the needs of all stakeholders

- It ensures that there are necessary built-in checks and balances from the top of an organisation to the bottom – not to constrain, but to control success.
- It ensures that the organisation is under control and encourages open and transparent communication within and outside the organisation.
- Governance forms the basis for rewards based on performance and results and not based on individual presence, position or title.
- Governance punishes those who defraud the organisation and holds them personally liable for their misconduct.
- Governance encourages the establishment of high principles that drive the code of conduct based on ethical and equitable values.
- Governance is aimed at encouraging participative, performance based leadership.
- Governance creates an over-arching goal for all – sustainable development is achieved when there is performance with conformance.
- Governance, while no being a guarantee of success, will produce better operating results.

Corporate governance is related to strategy in several ways:

- The organisational vision and mission should be reflected in its strategy – by doing so an organisation sets the scene for responsible business aims, practices and general conduct.
- Economic, social and environmental objectives have to be formulated as part of the organisational strategy ( a balanced view of performance).
- Execution of strategy should be monitored and controlled by management and the board of directors.
- The board should ensure that executives are appropriately penalised for failure or rewarded for success.

Corporate governance is about strategic leadership impelling management to lead responsibly with the view to a better future for all stakeholders.

The one critical element of governance in organisations is that of ethics.

Ethics is defined as the science of using moral criteria to guide human conduct.

Morals are defined as accepted values and standards of human behaviour.

Ethics is also defined as a system of accepted beliefs and principles of conduct typically based on moral imperatives that govern the behaviour individuals and the groups and organisation to which they belong.

The term ethics refers to accepted principles of right or wrong that govern the conduct of people or the actions of an organisation.

Business ethics are the accepted principles of right or wrong governing the conduct of business people. Many principles of right and wrong are universally recognised and codified into law, e.g. contract law, intellectual property law, and anti-trust law.

The strategies of an organisation must be consistent with the laws that govern business behaviour.

Unethical behaviour arises in a corporate setting when managers put the attainment of personal goals above the fundamental rights of one or more stakeholder groups (i.e. unethical behaviour may arise from agency problems).

Examples of unethical behaviour are:

- Self dealing
- Information manipulation
- Anti-competitive behaviour
- Opportunistic exploitation
- Substandard working conditions
- Environmental degradation
- Corruption

The root causes of unethical behaviour are:

- Business ethics are not divorced from personal ethics
- Business people do not realise that they are behaving unethically, primarily because they fail to ask the relevant question: “Is this decision or action unethical?”
- An organisation culture that de-emphasises business ethics and consider all decisions to be purely economic ones.
- Pressure from top management to meet performance goals that are unrealistic and can only be attained by cutting corners or acting unethically.
- Unethical leadership – it is not what leaders say that matters, but what they do.

Ethics can be defined as the values an individual uses to interpret whether any particular action or behaviour is considered acceptable and appropriate. Some questions that could be asked to help identify the values needed to interpret the particular action or behaviour could be the following:

- Is the behaviour or action consistent with the basic duties of the individual in question?
- Does the behaviour or action acknowledge and respect the underlying rights of all the individuals who will be impacted by the action?
- Would the behaviour or action be considered the best practice in that specific set of circumstances?
- Does the behaviour or action match the overall entrenched beliefs of the individuals?

Normative philosophy is the study of the ethical requirements that constitute good ethical behaviour. It attempts to establish a principle that is critical in judging whether a deed or action is good or bad. This raises the issue of ethical relativity – the fact that moral standards differ between groups of people from different backgrounds and cultures, which means that what is acceptable to one group might not be acceptable to another.

The establishment of an analytical framework is important so that ethical skills can be developed and incorporated into managerial decision-making.

The philosophical approaches to ethics (ethical models) can be described as follows:

- **Utilitarian Model –** the moral worth of actions is determined by the consequences. An action is judged to be desirable if it leads to the best possible balance of good consequences over bad consequences. Utilitarianism is committed to the maximisation of good and the minimisation of harm. Actions have many consequences. The best decisions from a utilitarian perspective are those that produce the greatest good for the greatest number of people. A decision is good and right if it benefits the largest number of people and causes a minimum of pain and suffering.
- **Deontological model** – the basic principle is one of consistency. A decision or action is good when it can be determined with a fair degree of certainty that anybody in similar circumstances would decide or act in the same manner.
- **Moral rights model** – this theory holds that decisions should be consistent with a set of fundamental rights and privileges. Human beings have fundamental rights and privileges. Rights establish levels of morally acceptable behaviour. Moral theorists argue that fundamental human rights form the basis for the moral compass managers should navigate by when making decisions.

- **The fairness model** – the theory of fairness deals with norms rather than principles. Moral standards are measured in terms of a single norm: fairness. Fairness should be the most important virtue.
- **The personal freedom model** – this theory is based upon a single norm: freedom. An institution or an act that limits the personal freedom of the individual, even if it improves the happiness of others in general, must be rejected as unjust.
- **The justice model** – justice theories focus on a just distribution of economic goods and services. The justice model evaluates decisions and behaviour with regard to the equitable distribution of benefits and costs among individuals and groups.

The ethical nature of governance is reflected in what has become known as the four cardinal values of good governance. These values are:

- **Fairness** – in its decisions and actions the board has to ensure that gives consideration to the interests of all stakeholders of the organisation.
- **Accountability** – the board must explain its decisions and actions to stakeholders affected by the organisation and account to stakeholders.
- **Responsibility** – the board should assume responsibility for all actions of the organisation and be willing to take corrective actions to keep the organisation on its strategic path.
- **Transparency** – the board should disclose information in a manner that enables stakeholders to make meaningful analysis of the actions of the organisation.

Ethics must be incorporated into the strategies of the organisation by adhering to the following guidelines (Schulman, 2012 cited by Lazenby 2014:81):

- Obey the law and the spirit of the law wherever business is done
- Articulate a complete strategy, including its purpose
- Explicitly articulate real values as a key component of the strategy
- Emphasise principles more than rules
- Be totally transparent with stakeholders
- Have a framework and process for the resolution of ethical issues
- Have the right organisational structure
- Make ethics training part of employee development

Ethics must therefore be embedded in the business models, strategies, and decision-making processes of the organisation.

| **THINK POINT** |
|---|
| Is there a clear business case for the sustainable organisation? |

Reflection perspective

The notion of the sustainable organisation as a key element of business strategy is related to a broad array of other concepts such as corporate social responsibility and stakeholder engagement. At its core is the need to understand the relationship between strategy and an organisation's social and environmental context, to mitigate associated risks, and to exploit opportunities for value creation effectively.  There are direct economic benefits that can be derived from a proactive approach to sustainable development. The sustainable organisation recognises that long-term business success is tied to the success if the communities and societies in which businesses operate (Louw and Venter, 2011:48)

## CHAPTER TWO CASE STUDY

Read the following and answer the question that follows:

**Three views on the purpose of a business**

**Milton Friedman and profit maximisation**

Milton Friedman, a renowned economist wrote:

In a free enterprise, private property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society...What does it mean to say that the corporate executive has a 'social responsibility'?... If the statement is not purer rhetoric, it must mean that he is to act in some way that is not in the interests of his employers...Insofar as his actions in accordance with his 'social responsibility' reduce returns to stockholders (shareholders), he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money.

Milton Friedman's maxim was that 'the business of business is business', and that the 'only social responsibility of business is to increase its profit'. Market mechanisms are then adequate in themselves. If customers are not satisfied, they take their business elsewhere. If employees are not satisfied they work elsewhere. It is the job of government to ensure that there is a free market to allow those conditions to take effect.

**Charles Handy's stakeholder view**

Citing the corporate scandals of the last decade, Charles handy argues that the driving for shareholder value linked to stock (share) options for executives, has resulted in the system 'creating value where none existed'. He accepts that there is, first, a clear and important need to meet the expectations of a company's theoretical owners: the shareholders. It would, however, be more accurate to call them investors, perhaps even gamblers. They have none of the pride or responsibility of ownership and are ...only there for the money...But to turn shareholder's needs into a purpose is to be guilty of a logical confusion. To mistake a necessary condition for a sufficient one. We need to eat to live; food is a necessary condition of life. But if we lived mainly to eat, making food a sufficient or sole purpose of life, we would become gross. The purpose of a business, in other words, is not to make a profit. It is to make a profit so that the business can do something more or better. That 'something' becomes the real justification for the business.

**The new capitalists' argument: 'Society and share owners are becoming one and the same'**

In their book, *The New Capitalists*, the authors (Davies, Lukommik and Pitt-Watson) also recognise that 'a corporation is the property of its stock owners and should serve their interests'. However it is the 'millions of pension holders and other savers ... [who]...own the world's giant corporations'. These 'new capitalists are likely to be highly diversified in their investments'. Investment funds such as pension funds are their representatives and 'hold a tiny share in hundreds, perhaps even thousands, of companies around the world'. They then argue:

Imagine that all your savings were invested in one company. The success of that company alone would be your only interest. You would want it to survive, prosper and grow, even if that did damage to the economic system as a whole. But your perspective would change if you had investments in lots of companies. [Then] it is to your disadvantage that nay business should seek to behave socially irresponsibly towards other businesses, the customers, employees or society generally. By doing so they will damage the interests of other firms in which you have an interest.

The new capitalist has an interest in all the firms in which he or she is investing behaving responsibly: 'in creating rules that lead to the success of the economic system as a whole, even if, in particular circumstances, those rules may tie the hands of an individual company'... managers of a business should quite properly 'concentrate single mindedly on the success of their own organisations ... however they will not be serving their share owners' interest if they undertake activities that may be good for them individually , but damaging to the larger economic system. **Adapted from Johnson G, Whittington R and Scholes K (2011) Exploring Strategy Ninth edition. Pearson**

Critically discuss the implications of the different views of the purpose of a business organisation for the development of organisational strategy.

# CHAPTER 3: ORGANISATION ENVIRONMENT ANALYSIS

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

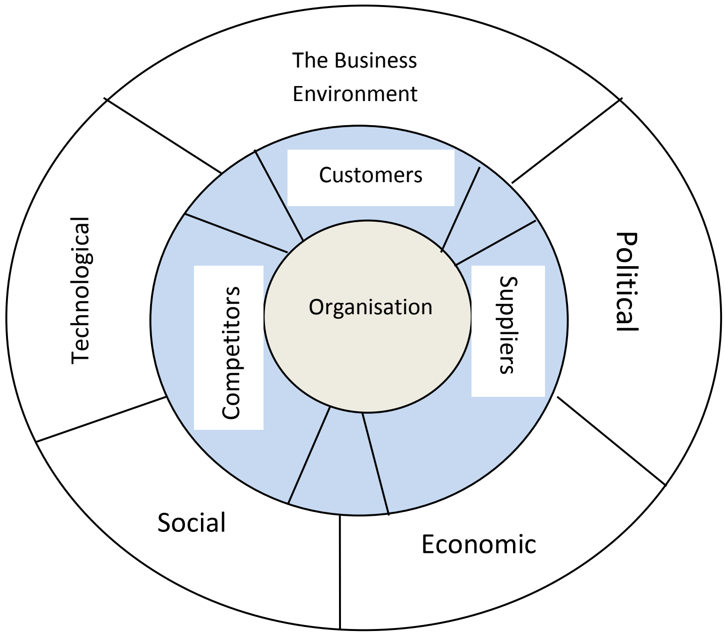
- Explain the structure of the external environment that organisations face
- Evaluate relevant macroenvironmental factors and forces
- Analyse the industry environment
- Identify the strategic resources and capabilities of an organisation
- Evaluate the potential for the resources and capabilities of an organisation to confer sustainable competitive advantage

**READING**

Hough et al (2011) Chapters 3 and 4

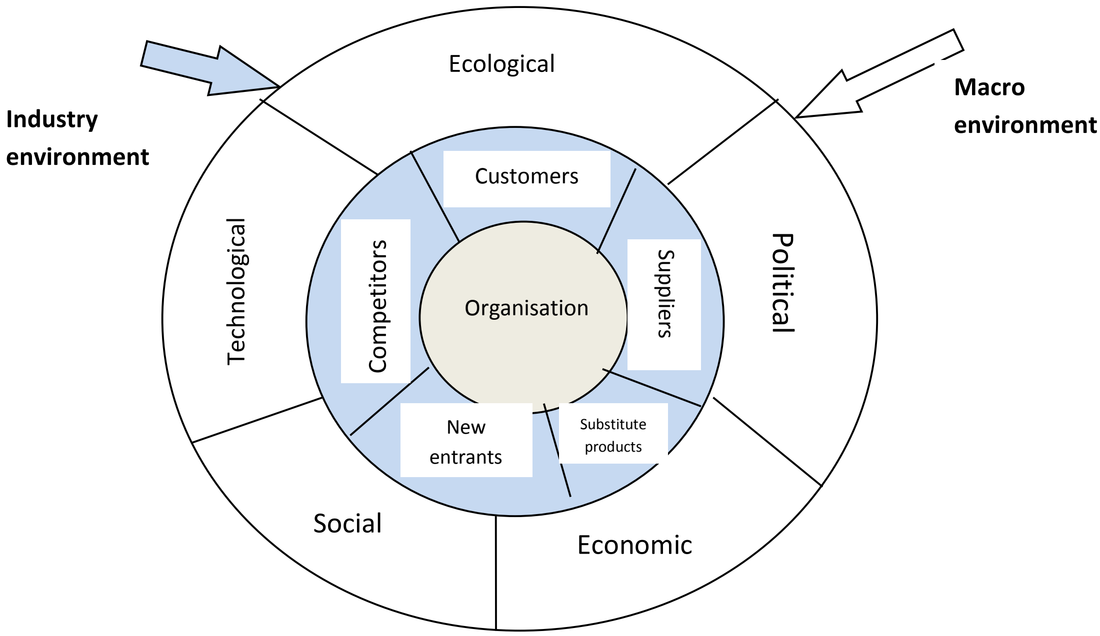
Matching, exploiting and changing the linkages between resource competency and environmental opportunity is an expression of organisational competitiveness, and the presence (or absence) of competitive advantage.

Thomson, Scott and Martin (2104:112) illustrate the organisation in the context of its external environment as follows:




This illustration shows how suppliers and customers (upon whom the organisation depends) and competitors (existing and new-in-future) have an impact on the organisation.

Lazenby (2014:116) illustrates the major areas of the external environment of an organisation (macro- and industry environments) as follows:




For organisations to be able to understand the present and predict the future, an integrated understanding of the external and internal environments of an organisation is essential.

The strategic management process is a way of aligning the unique resources and capabilities of an organisation with the constantly changing and increasingly competitive external environment in pursuance of its goals. External environment forces present themselves as opportunities for or threats to the competitiveness, sustainable growth and profitability of an organisation in the same way that internal forces represent inherent competitive strengths or weaknesses in an organisation (Louw and Venter, 2011:172).

Organisations need to know and understand their external as well as their internal environments in order to respond effectively to external challenges.

Louw and Venter (2011:173) provide definitions of the external and internal environments of the organisation as:

- The *external environment* includes everything outside the organisation (global, country and industry levels) that might affect the ability of the organisation to attain its goals.
  - the *macroenvironment* includes political-legal, economic, sociocultural, demographic, technological and natural environment forces. These forces originate beyond and are usually irrespective of any organisation's operating situation.
  - the *industry environment* includes actual and potential competitors, suppliers, buyers (customers or distributors), organisations that supply substitute products and organisations that provide complementary products.
- The *Internal environment* constitutes everything inside the organisation, in particular, its resources and capabilities that affect the ability of managers to pursue strategies, and over which management has control.

Analysing the macroenvironment

The organisation and the environment in which it operates influence each other as parts of an open system. An organisation cannot be successful if it is not in step and aligned with its environment. The underlying challenge for the successful survival of an organisation is the fact that the environment usually changes faster than the organisation can adjust to it.

Macroenvironmental factors have the potential to exert forces that have an influence on industries and the organisations operating in those industries. These macroenvironmental forces do not affect all industries, and organisations in those industries, in the same way. The forces emanating from macroenvironmental factors can influence the strategic direction, competitiveness, profitability and even survival of an organisation.

External environmental analysis focuses attention on identifying and evaluating trends and events beyond the control of the organisation, and also revealing key opportunities and threats confronting the organisation that influence the strategic actions of the organisation.

A continuous process of external environmental analysis includes four inter-related activities:

- Scanning: to identify early signals of any environmental changes and trends
- Monitoring: detecting the meaning of environmental changes and trends through observation.
- Forecasting: developing projections and outcomes based on monitored changes and trends.
- Assessing: determining the influence on the strategy of the organisation by evaluating the environmental changes and trends. (Lazenby, 2014:115)

The macro-environment refers to larger political, economic, legal social, technological, environmental and demographic issues that confront business firms. A fundamental analysis and evaluation of the macroenvironment helps managers gain a better understanding of the opportunities and threats they face and consequently helps them, first, in developing a realistic vision of the future competitive business landscape and, second, provides useful guidelines for strategy development. The primary focus of this analysis is on the potential future impact of macro-environmental factors.

Typical macro-environmental factors and issues are presented in the following table:

| **Political / Legal** | **Economic** |
|---|---|
| • Political stability<br>• Regulation of industries<br>• Competition policy<br>• Tax laws<br>• Exchange controls<br>• Labour legislation<br>• Intellectual property rights<br>• Government bureaucracy | • Economic growth<br>• Monetary and fiscal policy<br>• Level of interest rates<br>• Inflation levels<br>• Level of disposable income<br>• Labour unions<br>• Productivity<br>• Tax rates<br>• Import/export factors |
| **Social / Socio-economic** | **Technological** |
| • Per capita income<br>• Level of disposable income<br>• Social structures<br>• Equal opportunity<br>• Levels of saving<br>• Social security programmes<br>• Levels of education<br>• Levels of crime and corruption | • Levels of infrastructure<br>• Level of technology<br>• Extent of e-business<br>• Extent of e-commerce<br>• Internet marketing<br>• General ICT levels<br>• Technological literacy<br>• Extent f mobile telephony |
| **Environmental** | **Demographic** |
| • Pollution levels<br>• Anti-pollution programmes<br>• Waste management<br>• Water recycling<br>• Deforestation<br>• Water pollution<br>• Air pollution<br>• Carbon footprints<br>• Ozone depletion | • Lifestyle and leisure<br>• Age distribution<br>• Gender distribution<br>• Religious orientation<br>• Consumer behaviour<br>• Consumption patterns<br>• Geographic factors<br>• Special groups |

The above list of macro-environmental variables is not an exhaustive one. It merely serves as typical examples of possible events and trends. It should also be kept in mind that not all macro-environmental factors will affect all industries in the same way, to the same extent, and at the same time.

The importance of the external analysis lies in the way management evaluates and interprets the relevant information, where the macro-environmental variables identified in the table could be opportunities or threats from the point of view of an individual organisation.

Louw and Venter (2011:196) outline the potential benefits of performing macroenvironment analysis:

- It increases managerial awareness of environmental changes
- It increases understanding of the context in which industries and markets function
- It improves understanding of relevant multinational and global issuchange.es
- It enables management to identify and reduce risk due to greater awareness and understanding of potential environmental threats
- It focuses importance on the importance of actual and potential strategic change.

Macroenvironmental analysis does, however, have limitations. The macroenvironment can be complex, and there may be conflicting and contradictory changes taking place. In addition, the pace of change has lead to turbulence in many macroenvironmental situations and this unpredictability has cast doubt over the value of macroenvironmental analysis. Thus, managers engaged in strategic analysis must:

- be aware of the limitations and inaccuracies of macroenvironmental analysis
- understand the complexity of the environment in which they operate
- understand the sources of information on which the analysis is based
- carry out the analysis continuously because changes occur frequently
- constantly seek to identify more appropriate sources of information and techniques for analysis.

(Louw and Venter, 2011:197)

The environment is defined as to include the following (this is not necessarily regarded as an all-inclusive list; each organisation should identify its own comprehensive range of environments):

- The natural environment. Those things in creation or origin in which played no role. For example, water, air, soil etc.
- The intellectual environment. This involves the intellectual ability of people such as intellectual capital, application of knowledge systems and creativity, but also aspects relating to the feelings of safety, comfort and self-actualization.

- The social environment. Society and social aspects such as education, recreation, social interaction etc.
- The economic environment. Economic systems or combinations thereof. Monetary, fiscal, trade aspects that may impact on the organisation and its functioning. Here it is important to consider local, regional as well as international economic environments.
- The political environment. Politics plays a significant role in the public sector strategic management arena. Often, political decisions are not compatible with economic realities (as dictated by the economic environment). Public management (aspects of economy, efficiency and effectiveness) occurs against the backdrop of political decisions.
- The policy/legal environment. The policy/legal environment impacts on the organisation in that it provides guidelines as well as mandatory imperatives that impact on the organisation.
- The institutional environment. This environment could include the organisation itself, or other organisations that collaborate or generally impact on the particular organisation engaging in environmental scoping. Consideration should be afforded to the fact that such other organisations may be within, as well as outside (or a combination of) the public sector.
- The technological environment. This environment involves all technology-related aspect that may impact on the organisation. Computer technology, improved mechanics, developments in bio-chemicals or even communications technology could be cited as examples in this regard.

Thompson, Peteraf, Gamble and Strickland (2012:100) illustrate the seven components of the macroenvironment as follows:

| Component | Description |
|---|---|
| Demographics | Demographics includes the size, growth rate, and age distribution of different sectors of the population. It includes the geographic distribution of the population, the distribution of income across the population, and trends in these factors. |
| Social forces | Social forces include the societal values, attitudes, cultural factors and lifestyles that impact businesses. Social forces vary by locality and change over time. |
| Political, legal and regulatory factors | These factors include political policies and processes, as well as the regulations and laws with which companies must comply. |
| Natural environment | This includes ecological and environmental forces such as weather, climate and climate change, and associated factors like water shortages. |
| Technological factors | Technological factors include the pace of technological change and technical developments that have the potential for wide-ranging effects on society. They |

| | |
|---|---|
| | include activities and institutions involved in creating new knowledge and controlling the use of technology. |
| Global forces | Global forces include conditions and changes in global markets, including political events and policies toward international trade. They also include sociocultural practices and the institutional environment in which global markets operate |
| General economic conditions | General economic conditions include economic factors at the local, national or international level that affect organisations and industries. These include the rate of economic growth, unemployment rates, inflation rates, interest rates, trade deficits or surpluses, savings rates and per capita domestic product. |

Analysing the industry environment

Johnson, Whittington and Scholes (2011: 54) define an industry as a group of organisations producing products and services that are essentially the same (e.g. the airline industry). They also define a market as a group of customers for specific products or services that are essentially the same (e.g. a particular geographical market).

Louw and Venter (2011:209) state that industry analysis necessitates defining the industry, understanding industry key success factors, the effects of industry evolution, industry structure, and competitive and co-operative dynamics.

Industry structure depends on enduring characteristics that give the industry its distinctive character and can be identified by examining four variables:

- Concentration – the extent to which a few organisations dominate
- Economies of scale – savings within an industry due to increased volume which may result in price reduction and a greater market share.
- Product differentiation – the extent to which goods and services are perceived as different from organisations in an industry
- Barriers to entry – obstacles to entering the industry'

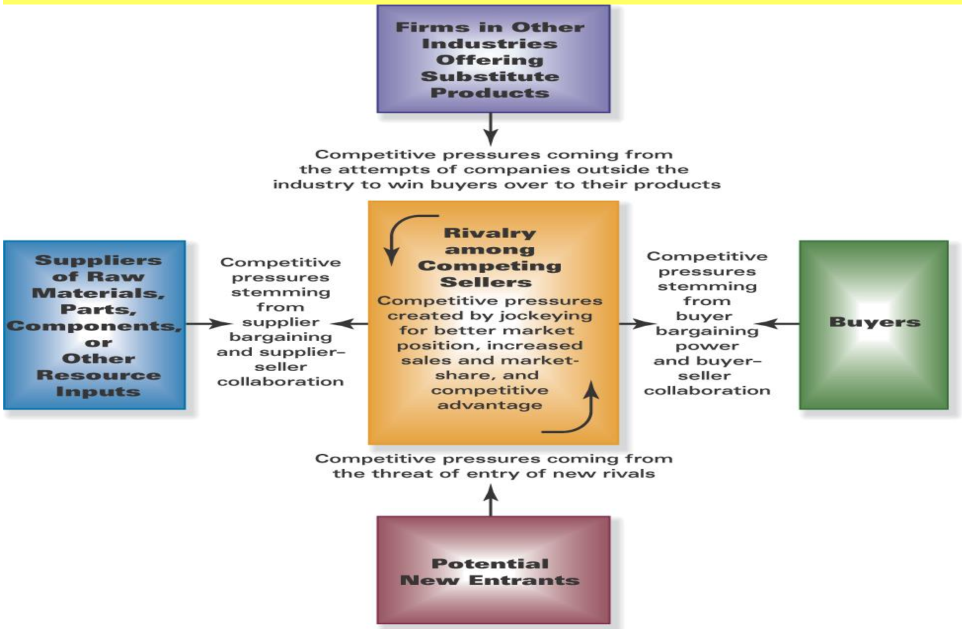
Industry competitive forces vary from one industry to the next. To analyse the impact of competitive forces in any given industry, Porter's five-force model of industry competition is by far the most widely-used approach in industry and competitive analysis.

Porter's model is based on a composite of five forces that in combination determine the state and extent of competition in a given industry. These five forces are:

- The extent of rivalry among industry members
- The threat of new entrants
- The bargaining power of buyers
- The bargaining power of suppliers
- The threat of substitute products

Hough et al (2011:62) illustrate this model as follows:

## The Five Forces Model of Competition




To determine the nature and strength of competitive pressures in a given industry requires that the model be applied in three consecutive steps:

Step 1: Identify specific competitive pressures associated with each one of the five forces

Step 2: Evaluate the strength of each of the five forces

Step 3: Determine the collective strength of the five forces to determine the attractiveness or otherwise of an industry

When all five factors are rated low, industry attractiveness is indicated, and vice versa.
When looking at each of the industry competitive forces:

1. **Competitive pressures associated with the jockeying among rival sellers:**
   This factor is by far the most significant (strongest) of the five forces, because this factor or force involves the innovative competitive strategies, marketing initiatives and other means of obtaining customer patronage and loyalty, relentlessly deployed by industry members. In most industries, competitive forces are extremely volatile, and strategic positioning of firms rely strongly on their sustainable competitive advantage.

2. **Competitive pressures associated with the threat of new entrants:**
   Both outsiders as well as current industry participants can pose a threat of entry, the latter often looking for growth opportunities and/or locations in new geographical areas. Several factors determine whether potential new entrants do pose a threat. An important issue is whether likely entry candidates face high or low entry barriers, the former reducing the threat of entry, the latter making entry attractive. Furthermore, companies with large financial resources and the requisite capabilities may find it easier to enter an industry compared to a small, resource-poor organisation. From an incumbent point of view, evaluating whether the threat of additional entry is weak or strong, management must look at (1) how formidable or daunting the entry barriers are for each type of potential entrant, and (2) how attractive the growth and profit prospects are for new entrants.
   Lastly, the threat of entry changes as the industry's prospects grow brighter or dimmer, and as entry barriers rise or fall.
3. **Competitive pressures from the sellers of substitute products:**
   Companies in one industry face competitive pressures when companies in closely-related industries provide products or services regarded as substitutes. Some of the examples in this section include the threat of artificial sweeteners for sugar, mobile phones for landlines, newspapers for electronic data, and DVDs for VCRs.

The following three factors determine the strength of competitive pressures arising from substitute products:

- Whether substitutes are available and attractively priced
- Whether buyers view the substitutes as being comparable or better in terms of quality, performance, or other attributes
- Whether costs that buyers incur in switching to substitutes are high or low

As a rule: the lower the price of substitutes, the higher their quality and performance, and the lower the switching costs of buyers, the greater the threat of substitute products.

**4. Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration:**

As point of departure, whether supplier-seller relationships represent a weak or strong competitive force depends on the following:

(1) Whether major suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favour, and

(2) The nature and extent of supplier-seller collaboration in the industry

*How supplier bargaining power can create competitive pressure*

Suppliers to an industry that have considerable leverage in determining the terms or conditions of supply will exert much competitive pressure on rival sellers, a situation confirmed by the example of Microsoft and Intel. Note also the influence of trade unions on labour costs and industry costs which also affect industry competitiveness.

*How seller-supplier partnerships can create competitive pressures*

Industry members are increasingly forging strategic partnerships with select suppliers with the purpose of (1) reducing inventory and logistics costs, (2) speeding up the availability of next generation components, (3) enhancing the quality of the parts and components being supplied, and (4) trying to attain important cost savings for themselves and their suppliers.

These partnerships can be a source of competitive advantage where firms manage their supply chain relationships.

**5. Competitive pressures stemming from buyer bargaining power and seller-buyer collaboration:**

The following will determine whether seller-buyer relationships represent a weak or a strong competitive force:

(1) Whether some or many buyers have sufficient bargaining leverage to obtain price concessions and favourable price conditions, and

(2) the extent and competitive importance of buyer-seller partnerships.

***How buyer bargaining power can create competitive pressures***

As with suppliers, the leverage that certain types of buyers have in negotiating favourable terms can also range from weak to strong. For most consumer goods, individual buyers have no bargaining leverage. Large retail chains however, generally have much negotiating leverage.

*How seller-buyer partnerships can crate competitive pressures.*

These partnerships are becoming increasingly important in business-to-business relationships.

Analysing the competitive impact of each one of the five forces, and then their combined impact, provide invaluable information on industry competitiveness and industry profitability for industry members. The following broad guidelines apply in this regard:

(1) As a rule, the stronger the collective impact of the five competitive forces, the lower the combined profitability of industry participants.

(2) When the collective impact of the five competitive forces is moderate to weak, an industry is competitively attractive and industry members can earn good to reasonable profits.

When matching company strategy to competitive conditions, it has been found that where a company's strategy "protects" a company from the competitive pressures to some extent, and where company strategies produce sustainable competitive advantage, they enjoy a favourable competitive position in their industry.

Industry competitive analysis provides a cross-section perspective at a certain point in time, but does not reveal much as far as dynamic industry change and emerging industry trends over time are concerned - all of which are extremely important in strategy development. Industries are dynamic in nature and evolve over time passing through the identifiable, consecutive stages of inception, rapid growth, maturity and decline. The industry lifecycle is a model that describes this evolution from the initial introduction of new products or services through to their current market state and possible future states. The industry life-cycle as such is a powerful driver of industry dynamics because of its inherent characteristic of change over time. Although it obviously does not provide all the answers concerning industry change and growth, it does provide a valuable framework for analysing its dynamics as such.

Driving forces are forces that continually reshape the industry landscape and can originate from global or "outer ring" macroenvironmental forces, but more readily from the more immediate industry environment of a company.

Most drivers of industry and competitive change fall into one of the following categories:

1. Emerging new Internet capabilities and applications

2. Increasing globalisation
3. Changes in an industry's long-term growth rate
4. Changes in who buys the product and how they use it
5. Product innovation
6. Technological change and manufacturing process innovation
7. Marketing innovation
8. Entry or exit of major organisations
9. Diffusion of technical know-how across more companies and more countries
10. Changes in cost and efficiency
11. Growing buyer preferences for differentiated products instead of commodity products
12. Reductions in uncertainty and business risk
13. Regulatory influences and government policy changes
14. Changing societal concerns, attitudes and lifestyle (Hough et al 2011:89)

An industry's key success factors (KSFS) are those competitive factors that most affect the ability of industry members to prosper in the marketplace – the particular strategy elements, product attributes, resources, competencies, competitive capabilities and market achievements that spell the difference between profit and loss. Identifying KSFs, in the light of prevailing and anticipated industry and competitive conditions, is always a top priority analytical and strategy-making consideration.

An industry's key success factors can usually be deduced from an analysis of the industry and competitive environment. The factors that are most important to future competitive success flow directly from the industry's dominant characteristics, what competition is like, the impacts of the driving forces, the comparative market positions of industry members and the likely next moves of rivals.

In addition, the answers to three questions help identify an industry's key success factors:

- On what basis do buyers choose between the competing brands of sellers? That is, what product attributes are crucial?
- Given the nature of competitive rivalry and the competitive forces prevailing in the marketplace, what resources and competitive capabilities does a company need to have to be competitively successful?
- What shortcomings are almost certain to put a company at a significant competitive disadvantage?

**Common types of KSFs**

| | |
|---|---|
| Technology-related KSFs | • Expertise in a particular technology<br>• Expertise in scientific research<br>• Proven ability to improve production processes |
| Manufacturing-related KSFs | • Ability to achieve scale economies<br>• Ability to capture learning/experience<br>• Quality control know-how<br>• High utilisation of fixed assets<br>• Access to skilled labour supplies<br>• High labour productivity<br>• Low cost product design and engineering<br>• Ability to manufacture or assemble products customised to buyer specifications |
| Distribution-related KSFs | • A strong network of wholesale distributors / dealers<br>• Strong direct sales capabilities |
| Marketing related KSFs | • Breadth of product line and product selection<br>• Well known and respected brand name<br>• Fast, accurate technical assistance<br>• Courteous, personalised customer service<br>• Accurate filling of buyer orders<br>• Customer guarantees and warranties<br>• Clever advertising |
| Skills and capability-related KSFs | • A talented workforce<br>• National or global distribution capabilities<br>• Product innovation capabilities<br>• Design expertise<br>• Short delivery time capability<br>• Supply chain management capabilities<br>• Strong e-commerce capabilities |
| Other types of KSFs | • Overall low costs<br>• Convenient locations |

| | |
|---|---|
| | • Ability to provide fast, convenient after-sale repairs and service<br>• A strong balance sheet<br>• Access to financial capital<br>• Patent protection |

Companies that stand out or excel on a particular KSF are likely to enjoy a stronger market position; being distinctively better than rivals on one or two key success factors tends to translate into competitive advantage.

Key success factors are the product attributes, competencies, competitive capabilities, and market achievements with the greatest impact on future competitive success in the marketplace. (Hough et al 2011:101)

**Analysing the internal environment**

Lazenby (2014:87) contends that one of the critical factors for success of an organisation is that the strategy must place realistic requirements on the resources of the organisation. The pursuit of opportunities in the external environment depends on the competitive advantage that organisations experience from their resources and capabilities.

Internal analysis is the process in which management identifies what is good and what is lacking in the organisation by an evaluation of the organisation's assets, skills and work activities (Lazenby, 2014:88). An organisation cannot pursue a specific strategic direction if it does not know what it can and cannot do, and what assets it has and does not have. When an organisation is able to match what it can do with what it might do, this allows it to pursue its vision and its strategic intent, its strategic mission, and to select and implement its strategies. The outcome resulting from internal analysis will determine what an organisation can do, while the outcome of external environmental analysis will identify what the organisation may choose to do.

Managers should therefore view the organisation as a bundle of resources, capabilities and core competencies that can be used to create an exclusive position in the market. The implication of this is that the organisation has some resources and capabilities that other organisations do not have. The presence of these resources and capabilities leads to strategic competitiveness when an organisation is able to use them to satisfy the demands of its external environment.

The strategic resources of an organisation can be categorised into three broad classes:

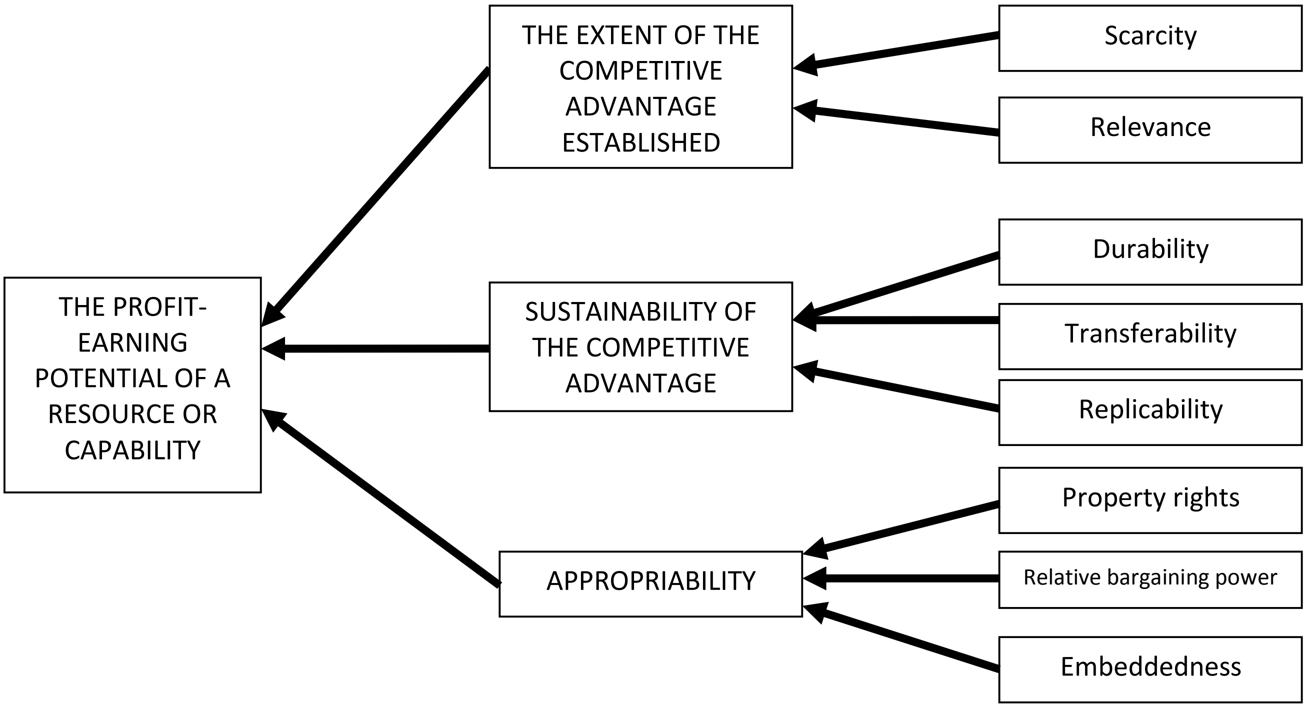
- Physical resources – the tangible assets that appear on the balance sheet of the organisation. Tangible assets are used by organisations to create value.
- Intangible resources – include brand value, culture and intellectual capital (patents, brands, business systems and customer databases). These are often not extensively measured or reported.
- Human resources – the individual skills and competencies to which the organisation has access. They are unique in that the organisation does not own them, but they contribute significantly to value creation in the organisation.

Organisational capabilities refer to the capacity of the organisation to combine resources into productive capacities. Capabilities represent combinations of assets, people and processes and, as such, are a higher order resource than factor inputs. There are three broad categories of organisational capabilities:

- Threshold capabilities – the minimum capabilities needed by an organisation to compete in a market.
- Distinctive capabilities – are unique and valuable and provide the basis for competitive advantage. They also form the basis of strategic innovation, the ability to develop new markets and products.
- Dynamic capabilities – refer to the ability of the organisation to develop new capabilities. Dynamic capabilities relates to the organisation’s ability to build, integrate and restructure capabilities to address the rapidly changing environment.

The role of resources and capabilities as the primary basis for the strategy of an organisation and the primary source of profitability has become known as the resource-based view (RBV).
Strategically important resources and capabilities are those with the potential to generate substantial streams of profit for the organisation that owns them. This depends on three factors: establishing a competitive advantage, sustaining that competitive advantage and appropriating the returns from the competitive advantage.
For a resources or capability to establish a competitive advantage, two conditions must be present: scarcity and relevance (to the KSFs in the market). Once established, competitive advantage tends to diminish over time; three characteristics determine the sustainability of competitive advantage: durability, transferability and replicability.

Grant and Jordan (2015:101) illustrate the strategic importance of resources and capabilities as follows:



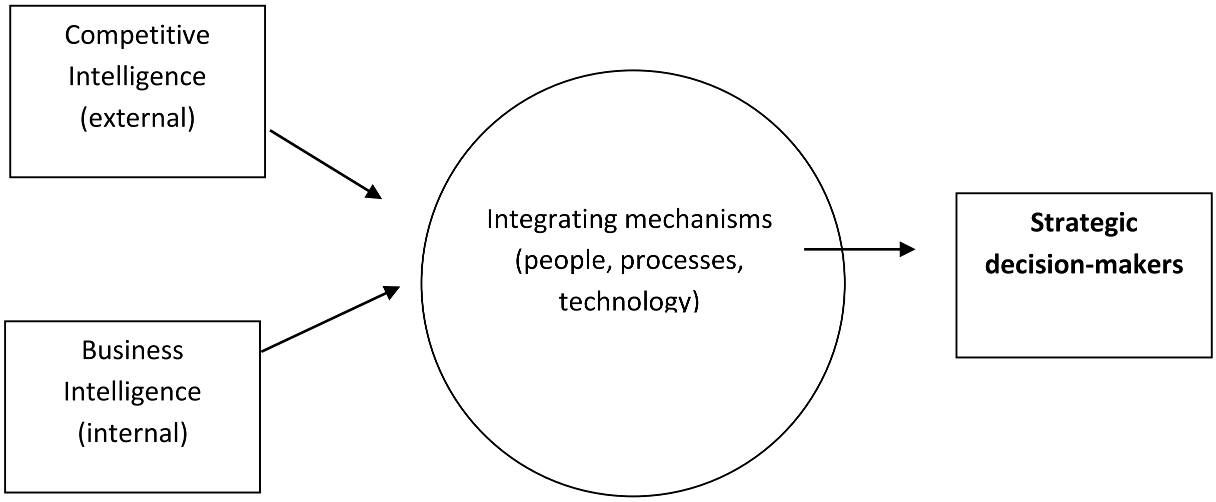

## THINK POINT

Examine the link between competitive intelligence, business intelligence and knowledge management

**Reflection perspective**

Information required for strategic decision *making* reflects the complexities of the strategic management process. Competitive intelligence (CI) and business intelligence (BI) are strategic decision enablers. Competitive intelligence relate to scanning activities that focus on the external environment and generate data about competitors and other external factors. Business intelligence refers to internal information on the historical performance of the organisation.

These two streams provide disparate and different information and an integrating mechanism is required to analyse and integrate the information. These mechanisms may be people, processes or technologies that add value to information. Knowledge management (KM) is the process of finding, selecting, organising and presenting information that improves comprehension in a specific area. (Louw and Venter, 2011: 147)




**SWOT Analysis**

SWOT is one of the best-known techniques for doing an environmental analysis. SWOT is an acronym for strengths, weaknesses, opportunities and threats, and provides a framework for analysing these elements in the external and internal environment of the organisation.

Environmental analysis is about the internal and external assessment of the organisation –what the organisation has or does not have in terms of resources and capabilities, and what is happening in the external environment. The success of a strategy for the organisation depends on the fit between the internal situation of the organisation and the external conditions.

The strengths and weaknesses relate to the internal environment, while the opportunities and threats are the identified external factors in the industry environment and the macroenvironment.

Practitioners of the SWOT analysis often refer to the PESTLEND approach in this regard. PESTLEND referring to the following:

- Political/Legislative environment.
- Economic environment
- Social environment
- Technological environment
- Legal environment
- Educational environment
- Natural environment
- Demographic environment

**Conclusion**

Thinking strategically about an organisation's industry and competitive environment entails obtaining answers to seven questions:

1. What are the industry's dominant features?
2. What kinds of competitive forces are industry members facing and how strong is each force?
3. What forces are driving industry change and what impacts will they have on competitive intensity and industry profitability?
4. What market positions do industry rivals occupy – who is strongly positioned and who is not?
5. What strategic moves are rivals likely to make next?
6. What are the key factors for future competitive success?
7. Does the outlook for the industry present the organisation with sufficiently attractive prospects for profitability? (Hough et al 2011: 58)

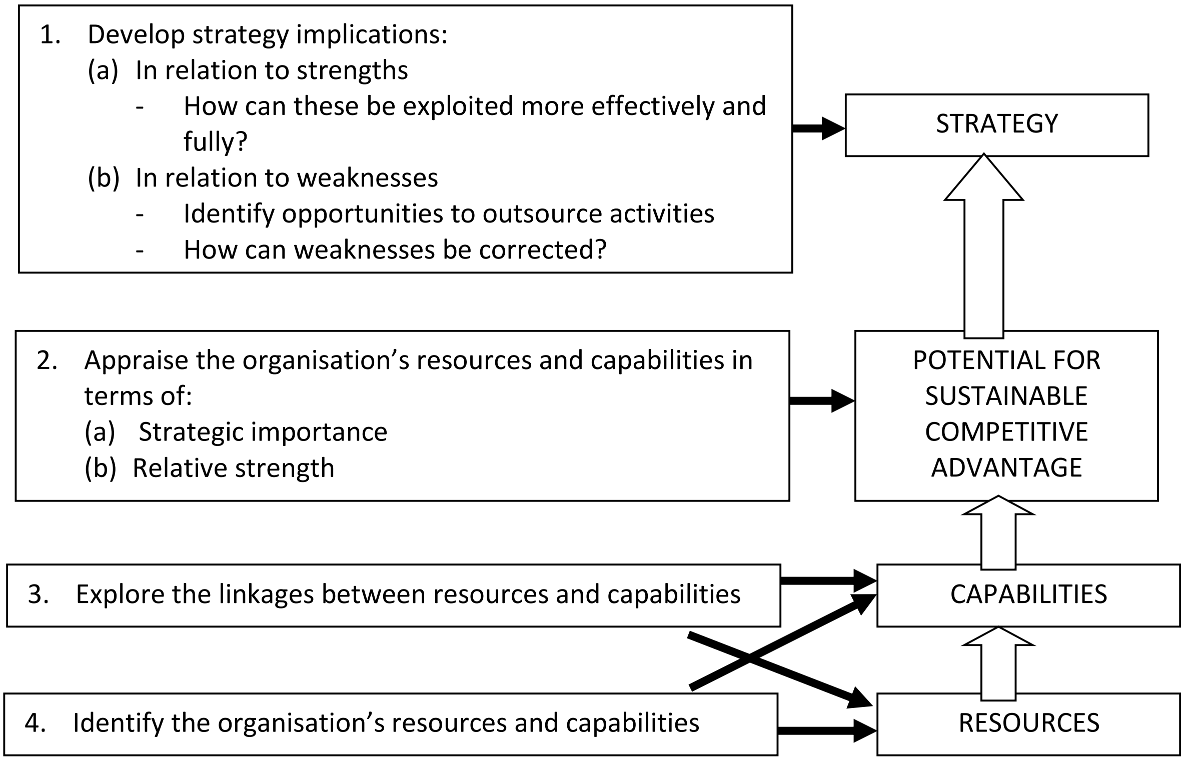
There are five key questions to consider in analysing an organisations own particular competitive circumstances and its competitive position compared to key rivals:

1. How well is the organisation's present strategy working?
2. What are the organisation's resource strengths and weaknesses, and its external opportunities and threats?
3. Are the organisation's prices and costs competitive?
4. Is the organisation competitively stronger or weaker than key rivals?
5. What strategic issues and problems merit managerial attention?

(Hough et al 2011: 58)

Good organisation situation analysis like good industry and competitive analysis is a precondition for good strategy making. Systematic appraisal of an organisation's resources and capabilities provides the basis for formulating (or reformulating) strategy.

Grant and Jordan (2015:111) provide the following framework for analysing resources and capabilities:.




**CHAPTER 3 CASE STUDY**

Read the following and answer the questions that follow

**Sony Shock**

All is not well in the Sony dynasty. The company's performance in recent years has been less than stellar for this global brand icon.

The Sony brand was once a byword for innovation; now it is seen as failing to tap new opportunities, being complacent and over-reliant on past successes. Its share price has fallen by two thirds in the space of five years, and its credit rating has been downgraded. Its pioneering electronics division is struggling, sales have plummeted and profits are in decline.

Aggressive competitors are stealing market share in key markets where it once dominated. The company is being criticised for its lack of focus and for failing to take advantage of strategic windows of opportunity that its competitors have rapidly exploited. In the wake of this "Sony Shock", the company has initiated a raft of changes to turn around its performance, including the replacement of its leader by Sony's first non-Japanese chief executive, in the wake of poor results.

Following the ravages of the second world war, Akito Morita and Masaru Ibuka joined together to form a small electronics firm; it was destined to become a global colossus. The pair started to make radio components and repair radios. Both guided the firm for over 50 years. In the early years, the company set itself an innovation focus, always looking for potentially lucrative markets and exploiting new technology. The company went from strength to strength through a combination of leading-edge technology products and miniaturisation. Sony became the embodiment of post war Japanese industry: entrepreneurial, creative, pioneering and highly successful. The company was always at the forefront of technology, entering untested new markets and creating one hit product after the other.

**Sony at a glance**

- Headquarters based in Tokyo, Japan
- Sony employs over 158 500 people worldwide
- Annual sales exceed over 55 billion Euros per year
- One of the world's most valuable brands
- Pioneers of groundbreaking technology such as the Walkman, PlayStation, transistor radios, tape recorders, video recorders, CD players and video cameras.
- Owns second largest music company in the world
- Large investment in the motion picture and television industry, with Sony Pictures.
- Company has 1035 subsidiaries worldwide and is listed on 16 international stock exchanges.

From these humble origins, Sony has become a highly respected global brand name, manufacturing audio, video, communications and information technology products for both consumer and industrial markets worldwide. Its products have a reputation for being highly innovative, extremely reliable and possessing high quality standards. The company has evolved to become more than just an electronics business. It has a large presence in the music, movie and television business, as well as banking, insurance and internet services. The company has several key divisions within the group. Some of these divisions are owned outright, while others are joint ventures with leading multinationals.

**The major divisions of Sony**

| | |
|---|---|
| **Sony Electronics** | Manufactures a wide variety of electronic products to both consumer and industrial markets; products include DVD players, plasma screens, digital audio players, semiconductors, camcorders, notebook computers and a variety of other electronic products. |
| **Sony Computer Entertainment** | Markets the Sony PlayStation family of products and produces gaming content for these devices. |
| **Sony DADC** | Manufactures media storage discs such as CD, DVD, Blu-ray, and Universal Media Discs |
| **Sony Ericsson** | A 50:50 joint venture with Swedish firm Ericsson focused on the mobile telephony industry. Established in 2001, the division develops innovative mobile phones, integrating camera, digital audio and gaming technology; uses links with Sony BMG and Sony Pictures with regard to content. |
| **Sony Pictures** | Produces and distributes motion pictures and television programmes worldwide. Owns several studios and a variety of television stations |
| **Sony BMG Music Entertainment** | Second largest music publisher in the world; 50:50 joint venture with Bertelsmann AG; a music colossus owning several music labels in a variety of genres. |

One of the biggest areas of concern for Sony is its electronics business. This accounts for nearly 70 percent of its revenues and is the cornerstone of the company. In 2005, the electronic division lost \$1.2 billion on revenues of \$44.6 billion, while other electronics firms such as Samsung Electronics (\$8.1 billion profit) were making considerable profits.

The firm appeared to be over-reliant on the success of the PlayStation games console business. Sony has lost ground to its competitors, and its iconic status as the world's leading electronic brand is losing its lustre; other firms have taken the lead, such as the Korean Samsung and Apple Computers.

Some blame Sony's problems on its past successes, making it complacent to the changing needs of the market. The company is facing intense competition from several key competitors in the diverse markets in which it operates. In televisions, where it was once so dominant, it lost its impetus. Losing market leadership in the television sector could have serious detrimental implications for the Sony brand and sales of other products. Typically a television is the centrepiece of the home where other electronics peripherals would be attached, such as camcorders and DVD players. Consumers buy devices that work well with their television. Having a Sony branded television had a knock-on effect for the sale of other peripherals.

In other markets, Sony is feeling the pressures of intense competition on multiple fronts. Competitors are offering very high quality technology products at competitive price points. Apple Computer's iPod became the 'new' Walkman. While Apple pioneered this market, Sony was more concerned with the piracy and copyright issues associated with the digital revolution. It was reluctant to manufacture devices that could impinge on its music business. The company ultimately failed to rekindle the Walkman brand as a digital music device. It is fighting Dell, Toshiba and HP in its mobile computing business. Nikon and Canon have retaken their lead in the digital photography market. Sony faces strenuous competition in the games console market against the Microsoft Xbox 360 and Nintendo's Wii. Nokia and Motorola continue to dominate the mobile telephone market.

Traditionally, Sony was regarded as a premium brand because of its reputation for quality, higher specifications, reliability and innovation. This strong reputation enabled it to charge consumers premium prices. However, consumers are being enticed by the competition's high quality and competitive pricing, leaving Sony unable to justify its higher prices.

The company has widely diversified from being solely an electronics firm. The purchase of Columbia Pictures ($3.4 billion) and CBS Records ($2 billion) were regarded as bold moves for an electronics company. The company decided to diversify into entertainment in the hope that synergies could emerge between both the hardware and software aspects of the business. The entertainment division has been viewed as an unnecessary distraction for Sony; the argument being that it has curtailed the development of digital technology at Sony because Sony was too concerned with the effects of piracy and copyright of its Entertainment division. Other rival electronic firms have no such problems.

In the wake of 'Sony shock', and after several years in charge, Sony's president steeped down, and, for the first time, a non-Japanese executive took over the reins of Japans leading company. Sir Howard Stringer, who headed up Sony's Entertainment division, was the surprise choice of CE. He speaks little Japanese and has the onerous task of turning around the fortunes of Sony.

**Adapted from Jobber D (2007) <u>Principles and Practice of Marketing 5th edition</u> McGraw-Hill**

**QUESTIONS**

1 Conduct a SWOT analysis of Sony

2 Outline the challenges facing Stringer at the helm of Sony

3 Identify the strategic options available to Sony, in the wake of ‘Sony shock’.

4 Recommend a course of action for Sony, giving reasons for your answer

# CHAPTER 4: FORMULATING STRATEGY

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

- Describe what strategic innovation means
- Explain the notion of competitive advantage
- Differentiate between the corporate strategic options
- Critically evaluate the generic strategies
- Link business-level strategies to corporate-level strategies
- Explain the use of mergers, acquisitions and strategic alliances to further business expansion
- Discuss the international strategies that organisations can pursue
- Identify and compare the various modes of foreign market entry

**READING**

Hough et al (2011) Chapters 5 and 6

Strategic Innovation

Any competitive advantage by organisations in their quest to achieve sustainable growth can be regarded as temporary. Organisations need strategic innovation as a means of creating new markets and new sources of competitive advantage.

Market creation strategies (which involve ‘competing for tomorrow’) are required in addition to market share strategies which involve ‘competing for today’. Such market creation strategies focus on innovation as a means of making competitors irrelevant and thereby dominating new markets (Louw and Venter, 2011:320).

Louw and Venter (2011:322) describe three ‘schools of thought’ relating to strategic innovation:

- Value innovation – the search for new ways of competing on the basis of customer value in existing industries. The underlying principle of value innovation is the search for uncontested market space in existing industries. Louw and Venter (2011:326) illustrate how value innovation differs from conventional strategic logic:

| CONVENTIONAL STRATEGIC LOGIC | VALUE INNOVATION LOGIC |
|---|---|
| Compete in existing market space | Create uncontested market space |
| Beat the competition | Make the competition irrelevant |
| Exploit existing demand | Create and capture new demand |
| Align the organisation's activities with differentiation **or** cost | Align the organisation's activities in pursuit of differentiation and cost |

- Disruptive innovation – refer to innovation that change the way in which competition takes place in an industry. Disruptive innovation focuses on the effects of technology and new business models on innovation.
- Bottom of the pyramid – the realisation that the 'poor young billions' in developing countries have considerable spending power if affordable and suitable products and services can be delivered.

**<u>Competitive Advantage</u>**

Thompson, Scott and Martin (2014:195) maintain that few organisations have the luxury of not having any serious competitors or the likelihood of not changing their competitive strategy. Organisations must seek opportunities to create – and sustain – a competitive edge over their rivals and build customer loyalty.

A clear competitive strategy does <u>not</u> constitute competitive advantage – advantage comes from being better or different in some meaningful way.

> **"Competitive strategy is about being different. It means deliberately choosing to perform activities differently or to perform different activities than rivals to deliver a unique mix of value."**
>
> **Michael E. Porter**

Causes generate effects and actions lead to outcomes. Thus, an organisation introducing an innovation affects the relative success of rivals and provokes several reactions, depending on the extent of the impact and the nature of the competition. Each reaction, in turn, further affects the other rival competitors in the industry, and new responses follow. Thompson et al (2014:195) describe this a competitive chaos.

Two sets of competitive decisions become apparent:

- One competitor acts upon a perceived opportunity ahead of its rivals and opens up a gap.
- Organisations adapt their strategies as they see new opportunities to exploit or possible future threats they are seeking to avoid.

Obtaining a sustainable and strong edge over competitors can be done in four ways:

- Identify the key success factors in an industry and concentrate resources in a particular area which has the most significant competitive advantage potential.
- Exploit any area where the organisation enjoys relative superiority.
- Aggressively attempt to change the key success factors by challenging the accepted assumptions concerning the ways in which business is conducted.
- Innovate – open up new markets or develop new products.
  (Ohmae, 1982 in Thompson et al, 2014:99)

According to Lazenby (2014:157) sustainable competitive advantage is the result of implementing a strategic differentiator. It is the effect of an organisation doing something different in terms of its strategy or strategic approach. A sustainable competitive strategy is a strategy that cannot be imitated easily by competitors. A sustainable competitive strategy should be based on the organisation's resources, strengths, and distinctive competencies relative to its competitors.

An organisation has a sustainable competitive advantage when it implements a strategy that competitors are not able to duplicate or find too costly to imitate. Organisations must also remember that no competitive advantage is permanent.

Corporate-Level Strategies

Strategy formulation includes developing a vision and mission, identifying an organisation's external opportunities and threats, determining internal strengths and weaknesses, establishing long-term objectives, generating alternative strategies and choosing particular strategies to pursue. Strategy formulation issues include deciding what new businesses to enter, what businesses to abandon, how to allocate resources, whether to expand operations or diversify, whether to enter international markets, whether to merge or form a joint venture, and how to avoid a hostile takeover.

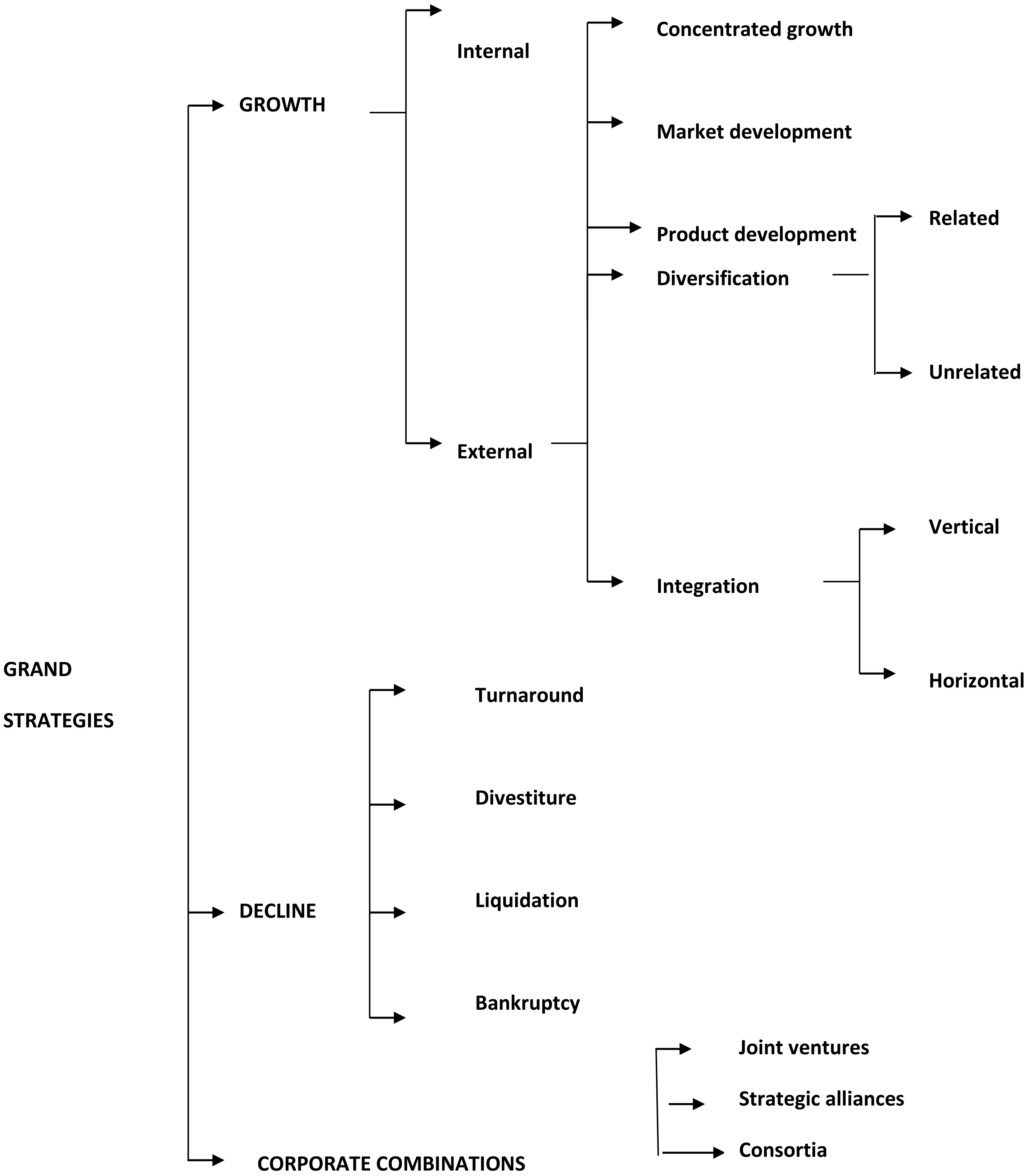
Because no organisation has unlimited resources, strategists must decide which alternative strategies will benefit the organisation most. Strategy formulation decisions commit an organisation to specific products, markets, resources and technologies over an extended period of time. Strategies determine long-term competitive advantages. For better or worse, strategic decisions have major multifunctional consequences and enduring effects on an organisation. Top managers have the best perspective to understand fully the ramifications of strategy formulation decisions; they have the authority to commit the resources necessary for implementation.

Strategy formulation is a deliberate course of action to create, or sustain, a competitive advantage. Strategies are the routes that will take an organisation to its destination – the strategic intent of the organisation. A realistic strategy, or combination of strategies, is one where there is a strategic fit between the internal strengths and the external opportunities (Louw and Venter, 2011:355).
Corporate-level strategy is about identifying the industry or industries in which an organisation should participate to maximize its long term profitability. Corporate-level strategy is also known as the master or grand strategy of the organisation. Organisations focus on apply corporate-level strategies for two reasons:

- The creation of shareholder value
- Maximising long-term profitability and value (Lazenby 2014:16-177)

Grand strategies provide basic direction for strategic actions. They use as a point of departure a selected generic strategy with its associated competitive advantage. They form the basis of coordinated and sustained efforts directed towards achieving long-term objectives. A **grand strategy** can be described as a comprehensive general approach that guides an organisation's major actions.

Fifteen principal grand strategies are defined and classified under four broad categories – external growth strategies, internal growth strategies, decline strategies and corporate combinations strategies.



Grand strategies are pursued by organisations to achieve competitive advantage based on cost leadership, differentiation or focus and to coordinate their efforts towards the attainment of long-term objectives. Most organisations integrate two or more grand strategies in order to achieve their long-term objectives.

The grand strategies that organisations identify to achieve their objectives have to be implemented at both functional and operational level. This means that functional strategies and action plans have to be formulated to ensure that all units, divisions, departments and project teams do what is required in order to implement the strategy successfully.

Generic Business-level strategies

Michael Porter (1980, 1985, 1989) states that strategy enables organisations to achieve competitive advantage from three different bases: cost leadership; differentiation and focus. Strategic scholars have now also identified a best cost approach to competitive advantage that combines that combines cost leadership and differentiation

**Cost leadership:**

Organisations that pursue cost leadership aim to become the lowest-cost provider of a specific product or service in a particular market. These organisations usually sell a product or service that appeals to a broad target market. A primary reason for pursuing forward, backward and horizontal integration strategies is to gain cost leadership benefits. But cost leadership generally must be pursued in conjunction with differentiation. A number of cost elements affect the relative attractiveness of generic strategies, including economies or diseconomies of scale achieved, learning and experience curve effects, the percentage of capacity utilisation achieved and linkages with suppliers and distributors. Other cost elements to consider in choosing among alternative strategies include the potential for sharing costs and knowledge within the organisation, research and design costs associated with new product development or modification of existing products, labour costs, tax rates, energy costs and shipping costs.

Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power. Thus the basic principle is to under price competitors and thereby gain market share and sales, driving some competitors out of the market entirely. A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead, limited perks, intolerance of waste, intensive screening of budget requests, wide spans of control, rewards linked to cost containment and broad employee participation in cost control efforts.

Pursuing cost leadership as a strategy has potential for success if:

- The market that the organisation pursues is price-sensitive
- The product or service that the organisation provides is standardized and appeals to a broad market
- The market is large enough to provide the organisation with economies-of-scale advantages
- The organisation had the capital resources to invest in cost-reducing technologies and processes
- The organisation has capital resources to invest in market research to ensure that it keeps abreast of changes in consumer behaviour and in research and development to ensure that its technology and product remain relevant and competitive

Advantages of cost leadership

Pursuing a cost leadership strategy increases the potential of an organisation to increase its market share as well as its profitability. In cases where high profitability is obtained, the capital reserves that are accumulated also provide the organisation with a greater variety of strategic alternatives when it comes to defending or expanding the market share of the organisation. For this reason competitors are not very likely to start a price war in an industry where there is a dominant cost leader. Customers that are familiar with the products and services of low-cost leaders are unlikely to switch to a competing brand, unless the competing brand has something very different or unique to offer. Customers often prefer to buy from a well-known, established organisation, especially when after-sales service is important. Customer loyalty is therefore often an advantage of a prolonged cost leadership strategy. One of the most important advantages that cost leaders have is their ability to keep new entrants from entering the market. Establishing a new organisation usually requires vast capital investment in fixed assets. These new organisations usually do not have the turnover to create economies of scale and are too young to enjoy the benefits of economies of learning and experience. They thus find it very difficult to attain market share in a market where a dominant cost leader already has a majority of the market share as well as price-cutting power.

Risks of cost leadership:

One of the most important disadvantages of a low-cost strategy is the risk of imitation. Cost advantages, particularly in standardised production or service delivery processes, are often short lived. A high level of asset commitment and capital processes, are often short lived. A high level of asset commitment and capital intensive activities are also associated with this strategy. Cost leaders run the risk of making large investments in plants, equipment and processes, only to see them become obsolete because of technological breakthroughs by competitors. One of the biggest risks of cost leadership is that an organisation can focus so much on cost-cutting activities that it loses sight of changes in the market with regard to consumer behaviour, competitor activities and customer needs.

**Differentiation:**

Organisations that pursue differentiation aim to distinguish themselves from competitors by providing consumers with a product or service that is considered unique. The uniqueness of their products often lies in quality, technological superiority or the image of the product.

Organisations that consider a differentiation strategy should carefully study consumer needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features desired attributes. Consumers who value certain attributes more than others are willing to pay a premium for the product that satisfies their preference for the particular attribute. Differentiation does not guarantee competitive advantage, especially if standard products sufficiently meet customer needs or if rapid imitation by competitors is possible.

Pursuing differentiation as a strategy has potential for success if:

- Consumers are willing to pay more for the uniqueness of the product or service than the organisation had to invest to create it
- The differentiated product or service can be designed so that it has wide appeal to many market sectors
- The organisation can reduce costs in value chain activities that are not directly related to the sources of differentiation
- The organisation has a durable source of uniqueness that cannot be imitated quickly and cheaply by competitors.

Advantages of differentiation:

Differentiation leads to brand loyalty and customer retention, which insulates the organisation partially from competitive rivalry in the industry. An organisation with a distinctive, highly sought-after product does not have to engage in destructive price wars with competitors. Customers of differentiated products are brand loyal and less sensitive to prices. These loyalty barriers make it substantially more difficult for new competitors to enter the mark.

**Risk of differentiation:**

The major risk associated with a differentiation strategy centres on the difference between added costs and the premium price customers are willing to pay. Investing too much in differentiation could result in costs that are too high relative to those of competitors, and the organisation might find itself in a situation where customers will sacrifice some of the features, services, or image possessed by the unique product or service because it costs too much. Imitation is a very real risk for an organisation that pursues a differentiating strategy. As competitors imitate, the formerly differentiating features become commodity features. It is therefore difficult to sustain a competitive advantage through innovation for very long. Staying ahead of the competition in product development requires constant innovation, which could result in added costs, to achieve differentiation, outweighing incremental price.

**Focus strategies:**

A successful focus strategy depends on an industry segment that is of sufficient size, has good growth potential and is not crucial to the success of other major competitors. Strategies such as market penetration and market development offer substantial focusing advantages. Midsize and large firms can effectively pursue focus-based strategies only in conjunction with differentiation or cost leadership-based strategies. All firms in essence follow a differentiated strategy. Because only one firm can differentiate itself with the lowest cost, the remaining firms in the industry must find other ways to differentiate their products. Selecting a particular market and catering for the very specific needs of consumers in this market is the basis of a focus strategy. Focus strategies can be based on differentiation and lowest cost. The key to a successful focus strategy is being able to identify a target market segment in which the organisation can meet the needs and desires of buyers better than any other competitor. A focus strategy based on differentiation implies that the products and services provided to this niche market come at a high price premium. Because a niche market is relatively small, sales figures are relatively low compared with those of mass producers. Furthermore extensive differentiation is usually accompanied by high costs.

Pursuing a focus strategy based on differentiation has potential for success if:

- The market segment that the organisation wants to focus on has sufficient size and growth potential to provide adequate long-term profit potential

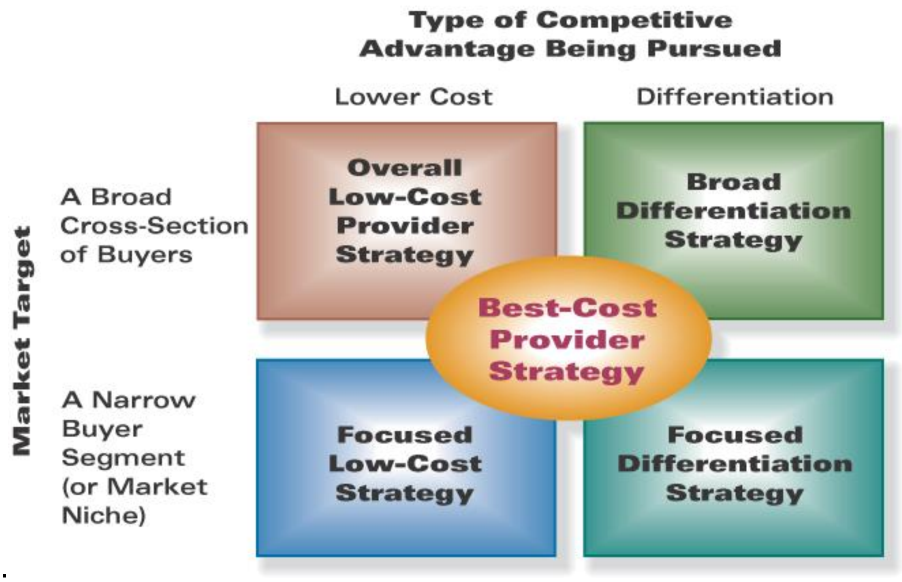
- The market segment identified by the organisation is not crucial to the success of other major competitors
- Consumers are willing to pay a high premium for the perceived value that they attach to a differentiated product or service
- Consumers are very brand loyal and are unlikely to shift their loyalty to a competing brand, regardless of the price they have to pay for the particular product or service
- Consumers identify strongly with the specific brand or product/ service because it personifies a certain image or lifestyle

**Advantages of pursuing a focus strategy:**

The biggest advantage of a focus strategy is the ability of the organisation to carve a niche market against larger, broader-line competitors. In many cases a focus strategy enables a firm to utilize its specialised distinctive competence or assets to create new niches.

**Risks of pursuing a focus strategy**

The needs, expectations and characteristics of the market may gradually shift towards those of the broader market, which will decrease the profit potential of this segment. Competitors may develop technologies or innovative products that may redefine the preferences of the niche the organisation has been concentrating on. The most important risk associated with a focus strategy based on lowest cost is sacrificing quality and service in the pursuit of lowest cost and in the process losing market share.

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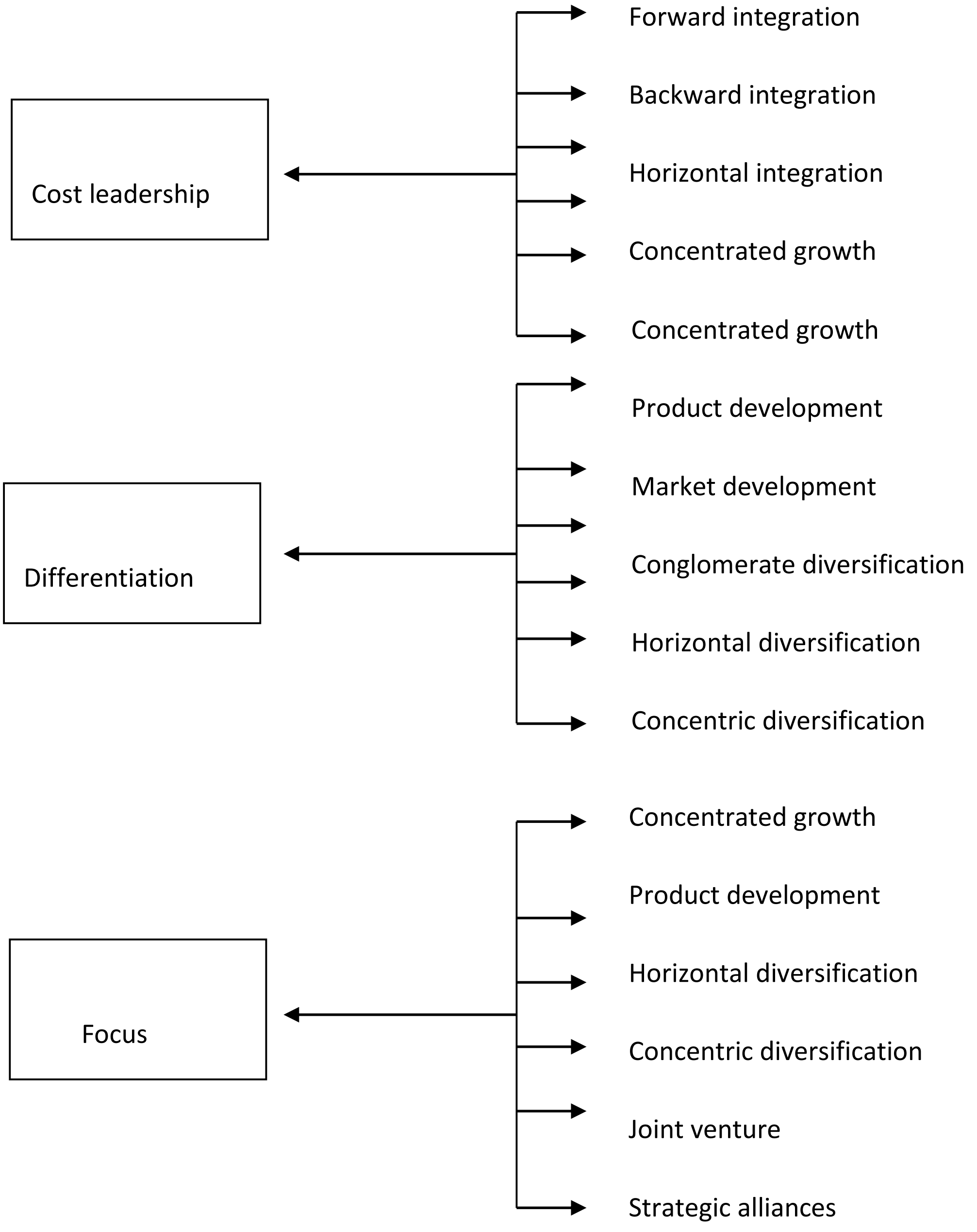
Hough et al (2011:149)

Porter's generic strategies identify bases from which organisations can pursue competitive advantage. However, it is not always clear how a particular competitive advantage is achieved practically.

The interrelationship between the generic strategies (Porter) and the grand strategies can be illustrated as follows




**THE FIVE GENERIC STRATEGIES**

No two companies are bound to have the exact same strategies. The countless variations of competitive strategies that are found, even within the same industry, are mainly due to differences in leadership style, in the strategic approaches that companies adopt, and to their own unique circumstances.

However, when it gets down to basics, the most important differences between competitive strategies depend on

(1) whether a company's market target is broad or narrow, and
(2) whether the company is pursuing a strategy based on low costs or on product differentiation.

The five generic competitive strategies are:

1. A low-cost provider strategy
2. A broad differentiation strategy
3. A best-cost provider strategy
4. A focused (or market niche) strategy based on low costs
5. A focused (or market niche) strategy based on differentiation

Each of these five generic strategies relates to a different market position.

**LOW-COST PROVIDER STRATEGIES**

A low-cost provider's strategic aim is significantly lower costs than competitors, while still ensuring to include product features and services that buyers consider essential. The key, however, is to achieve sustainable cost advantages that rivals find difficult to copy, imitate or match.

A company has the following two options to achieve low costs over rivals and still retain profitability:

(1) To use the lower cost base to underprice competitors and attract cost-sensitive buyers in greater volume.
(2) To maintain present price and market share, and use lower cost to earn a higher profit margin on units sold.

Two ways of achieving a low-cost advantage over rivals exist:

(1) Do a better job than rivals of performing value-chain activities more cost-effectively
(2) Revamp the organisation’s overall value chain to eliminate or bypass some cost-producing activities.

The first approach, to outcompete rivals on cost, could involve the following actions:

1. Attempting to capture all possible economies of scale.
2. Taking full advantage of learning/experience effects.
3. Trying to operate facilities at full capacity.
4. Pursuing efforts to boost sales volumes.

5. Improving supply chain efficiency
6. Substituting the use of low-cost for high-cost raw materials and component parts
7. Using online systems and sophisticated software to achieve operating efficiencies
8. Adopting labour-saving operating methods
9. Using the company's bargaining power vis-a-viz suppliers to gain concessions
10. Being alert to the cost advantages of outsourcing and vertical integration

Apart from the above, further actions to reduce cost levels could include:

- Having lower specifications for purchased materials, parts, and components compared to rivals
- Using only low-cost distribution channels, and avoiding high-cost distribution channels
- Deciding to use the most economical delivery methods for customer orders.

Cost advantages can be achieved by reconfiguring the value chain in the following six ways:

1. Cutting out distributors and dealers by selling directly to customers
2. Replacing certain value-chain activities with faster and cheaper online technologies
3. Streamlining operations by eliminating low value-added or unnecessary work
4. Relocating facilities so as to reduce the need for shipping and handling activities
5. Offering a frills-free product
6. Offering a limited product line as opposed to a full product line

Unlike the first approach of cost-saving, reconfiguring the value chain in any of the above ways could well eliminate costs, but also require some cost to execute. Any such action(s) should thus have a net advantage to be beneficial from a competitiveness point of view, and managers would be advised to conduct a cost-benefit analysis before implementing any of the above action plans.

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The keys to success in achieving low-cost leadership

"Success in achieving a low-cost edge over rivals comes from outmanaging rivals in figuring out how to perform value-chain activities most cost-effectively and eliminating or curbing non-essential value chain activities".

Apart from the requirement of a thorough analysis of all the company's value chain activities, key words in the above quotation are "outmanaging" and "figuring out". To be effective in a strategy context, "figuring out" should imply "strategic thinking", and "outmanaging" the exceptional execution of unique, winning strategies by management.

According to Hough et al, a low-cost provider strategy is particularly powerful when:

1. Price competition among rival sellers is particularly vigorous
2. The products of rival sellers are essentially identical and suppliers are readily available from any of several eager sellers
3. There are few ways to achieve product differentiation that have value to buyers
4. Most buyers use the product in the same ways.
5. Buyers incur low costs in switching their purchases from one seller to another
6. Buyer numbers are large and they have significant power to bargain down prices
7. Industry newcomers use introductory low prices to attract buyers and build a customer base

The importance of the above factors should not be underestimated – they reflect the conditions for success when pursuing a low-cost provider strategy. The more price sensitive the buyers are the more appealing a low-cost provider strategy becomes, and companies basically compete on the basis of cost and price – not product differentiation. The key here is for the company to remain competitive and profitable within these parameters.

The pitfalls of a low-cost provider strategy

The major danger of a low-cost provider strategy is over-eager price-cutting that will lower overall profitability. A low-cost provider strategy will only lead to higher profitability when

(1) price-cuts are less than the size of the cost advantage, and

(2) the gain in sales volume is large enough to generate a bigger total profit despite lower profit margins per unit sold.

A second danger is not emphasising possibilities of cost-advantages that are unique and difficult for rivals to imitate or match – cost advantages should preferably be sustainable.

A third danger is becoming too fixated on cost reduction. There must be a balance between low costs and prices on the one hand, and products that have sufficient attributes to make them attractive to buyers.

Even if these dangers are avoided, there still is risk. Unexpected technological break-throughs or reconfigured industry value chains could neutralise a low-cost provider's cost advantages and profitability. Continuous environmental scanning and an alert management will go a long way in ensuring that companies are not totally caught off guard.

## BROAD DIFFERENTIATION STRATEGIES

Differentiation of products become necessary when buyers' preferences and needs for certain types of products are too diverse to be satisfied by standardised products with minimal differentiating features or attributes.

The essence of a broad differentiation strategy is to be unique in ways that are valuable to and satisfy the varying needs of a wide range of customers while providing a sustainable competitive advantage over the product offerings of rivals. As Hough et al (2011: 152) state, successful differentiation allows a firm to

- command a premium price for its product, and/or
- increase unit sales based on product differentiating features that will attract new buyers away from rivals, and/or
- gain buyer loyalty to the firm's brand (based on some buyers bonding with the company and its products)

Differentiation enhances profitability when the added product price due to differentiation is greater than the cost of achieving the differentiation, and especially where rivals cannot easily copy or match the differentiating features.

### Types of differentiation themes

Whatever differentiation theme is ultimately adopted the differentiation features should either be too costly or too difficult for rivals to imitate or copy. This is where unique product innovation and technical as well as quality superiority could play a major role in attaining a sustainable competitive advantage (Dobni, 2008:43-50).

Where along the value chain to create the differentiating attributes

Differentiating opportunities can occur in activities along the entire value chain of the company, and include the following:

1. Supply chain activities that spill over and affect the performance or quality of the company's products.
2. Product R & D activities that aim at improved product designs and performance features, wider product selections, and expanded end-use applications.
3. Production R & D and technology-related activities that permit custom-order manufacturing at efficient cost levels.

4. Manufacturing activities that reduce product defects, prevent premature product failure and extend product life.
5. Distribution and shipping activities that allow for fewer warehouse and on-the-shelf stock outs
6. Marketing, sales and customer service activities that result in superior technical assistance to buyers, and more efficient maintenance, repair services, and dissemination of information to customers.

A broad differentiation strategy can deliver unique buyer value in four basic ways:

1. By incorporating product attributes and user features that lower the buyer's overall costs
2. By incorporating features that increase product performance
3. By incorporating features that enhance buyer satisfaction in non-economic or intangible ways.
4. By delivering value to customers through product differentiation on the basis of competencies and competitive capabilities that rivals do not have, or find too costly or difficult to match, or cannot match.

**The importance of perceived value and signalling value**

The relatively higher prices of differentiated products reflect the value actually delivered to the buyer and the value perceived by the buyer. However, a variety of factors exist that signal price to the consumer. Such signals of value may be as important as actual value in cases where

(1) buyers are first-time purchasers,
(2) repurchases are infrequent, and
(3) buyers are unsophisticated.

**Broad differentiation strategies work best where:**

1. Buyer needs and the uses of the product are diverse.
2. There are many ways to differentiate the product or service, and many buyers perceive these differences as having value.
3. Few rival firms are following a similar differentiation approach.
4. Technological change is fast-paced and competition revolves around rapidly-introduced product features.

Major reasons why differentiation strategies can fail include the following:

1. When competitors are able to copy most or all the appealing features or attributes quickly

2. The company's differentiation strategy produces a "so what?" market reception because buyers see little value in the unique attributes of a company's product.
3. Overspending on efforts to differentiate the company's product offering, thus eroding profitability.

In addition, other dangers or mistakes can include:

- Over differentiating so that product quality or service levels actually exceed buyer's needs and expectations
- Attempting to charge too high a price, where the premium for differentiation is too high.
- Being too conservative (timid) and not striving to open up meaningful gaps of quality or service performance compared to rivals.

Once again, management should be informed on and be sensitive to these potential pitfalls in order to pre-empt their potential disadvantages and devise strategies to eliminate or overcome such deficiencies.

**BEST- COST PROVIDER STRATEGIES**

Best-cost provider strategies aim at giving customers relatively more value for money than with low-cost provider strategies. A company achieves best-cost status through an ability to incorporate attractive or upmarket attributes and features at a lower cost than rivals can – it is essentially the low-cost provider of relatively upmarket products. The competitive advantage of a best-cost provider is based on lower cost than rivals in incorporating upmarket attributes, and under pricing rivals whose products have similar upmarket attributes, where the best-cost provider operates in the middle ground between low-cost and broad differentiation strategies, as well as between broad market and narrow market niche strategies.

Best-cost provider strategies are accordingly seen as a type of hybrid strategy.

Hough et al (2011:159) state that a best-cost provider strategy works best in markets where buyer diversity makes product differentiation the norm, and where many buyers are also sensitive to price and value, the strategic options being:

- medium quality product at a below-average price, or
- a high quality product at an average or slightly higher price

Note that a winning strategy, even in this case, must always be matched to a company's resource strengths and capabilities.

The biggest danger of a best-cost provider is becoming trapped between firms pursuing low-cost provider strategies and differentiation strategies. The optimal balance between low or affordable costs and value attributes is therefore critical for a best-cost provider to remain competitive and profitable.

## FOCUSED (OR MARKET NICHE) STRATEGIES

Concentrated attention on a narrow segment of the total market distinguishes focused strategies from broad low cost leadership or broad differentiation strategies. The target market segment, or niche, can be based on geographic uniqueness, specialised requirements, or special product attributes.

### A focused low-cost strategy

A focused strategy based on low cost aims at securing competitive advantage by serving buyers in target markets or niche markets at a lower cost and price than competitors. The methods and ways of achieving cost advantage are very similar to those for low-cost leadership – keeping the costs of value chain activities lower than rivals do, and eliminating or bypassing certain value chain activities to lower costs better than rivals can do. The real difference between a low-cost provider strategy and a focused low-cost strategy is the size of the buyer group.

### A focused differentiation strategy

A focused differentiation strategy aims at securing a competitive advantage with a product offering carefully designed to appeal to the unique preferences and needs of a narrow, well-defined group of buyers (as opposed to a broad differentiation strategy aimed at many buyers). To attain competitive advantage, the company must perform better than its rivals in serving the needs of small buyer groups looking for special product attributes.

These two focused strategies are appropriate when one or more of the following conditions are met:

1. The target market niche is big enough to be profitable and offers good growth potential.
2. Industry leaders do not see that having a presence in the niche is crucial to their own success.
3. It is costly or difficult for multi-segment competitors to make resources and capabilities available to meet the specialised needs of a small group of buyers while at the same time having to satisfy the expectations of their mainstream customers.
4. The industry has many different niches and segments, allowing firms with focused strategies to selectively pick lucrative, small market niches for themselves, and the more uncontested these market segments, the better.
5. Few, if any, other rivals are attempting to specialise in the same market segment or niche.
6. The firm with a focused strategy has a reservoir of customer goodwill and loyalty.

The advantages of focusing all energy and efforts on a single market niche can be considerable, especially where smaller firms cannot compete with large firms on their terms in the broader markets they serve. However, organisations with a focused strategy are vulnerable and at risk if anything goes wrong in the small market segment they serve.

Focused strategies involve a number of risks, which include the following:

1. The chance that competitors will find effective ways to match the focused firm's capabilities in serving the niche market.
2. Employing a focus strategy runs the risk that preferences and needs of niche members can shift over time to other product or service attributes.
3. The market segment or niche may become so attractive that it draws competitors, intensifying the rivalry and splintering the segment profit.

### Merger and Acquisitions

Generic motives for seeking some form of co-operation can be seen in terms of the strategic importance of a business in the parent company's portfolio and its business market position. This is shown diagrammatically below.

| | | Leader | Follower |
|---|---|---|---|
| **Strategic Importance in Parent's Portfolio** | Core | **Defend** | **Catch-up** |
| | Peripheral | **Remain** | **Restructure** |

**Source**: Lorange and Roos, 1992

Defend strategies are where leading companies want new technology, business opportunities or to secure the sourcing of raw materials.

**Catch-up strategies** are employed by leaders in their non-core activities, aiming to gain maximum efficiency from the company's position.

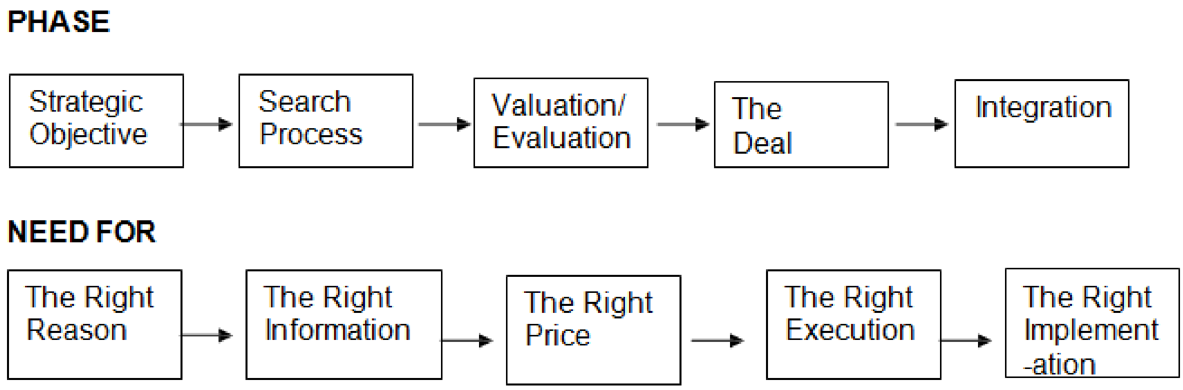
Restructure strategies are used where a follower has some peripheral business and needs to set about recreating a strong position by restructuring and reconfiguring. This may eventually lead to adding value in order to sell off non-core activities.

The terms mergers and acquisitions are self-explanatory. When two companies are of equal strength they merge to form a new corporate hierarchy. When one is dominant over the other, the dominant company buys or acquires and absorbs the other into its own corporate hierarchy.

In a world of large multinational companies it is possible to acquire or sell off parts of a business within the corporate whole. This is essentially the issue of core business, competitive advantage and merger/acquisition, or de- invest/hive-off to achieve this, as we discussed under the conceptual framework.

Expansion by merger and acquisition goes in waves. The 1980s saw much activity with strong companies working to expand at the expense of others. However, there can be over-eagerness. Over-expansion can lead to financial problems and erosion of competitive advantage. When this happens it can lead into another part of the business cycle on this issue, disinvestment and restructuring. This is happening to some of the 1980s excesses. On the other hand, acquisition to subsequently hive off part of the business can be a carefully planned move. Some companies have done very well out of asset stripping.

The process by which this activity is carried out can be represented diagrammatically




Mergers and Acquisitions Process (Grundy, 1995)

Acquisitions have a much better chance of being successful if they are undertaken for the **right reasons**. As a means of growth this method is faster than internal growth but it does have greater risks. That is why care is needed in the early steps of the management process.

One categorisation of objectives has already been seen in terms of:

- Defend
- Catch up
- Remain
- Restructure

Haspelagh and Jeminson (1991) categorise strategic objectives in terms of:

- Domain strengthening (capability)
- Domain extension (new platform)
- Domain exploration (new business position)

When clear objectives have been set and understood, the next step is to choose the right partner for a merger or target for an acquisition.

In order to access the **right information** required to make decisions regarding potential target companies, it is important to understand the likely source of information.

**Internal Sources**

In many instances it is possible to access relevant information from sources within the organisation. Market research data can be made available from within the marketing function and can provide valuable information that might help to form the basis for decision making with regard to potential target companies

In addition to this, there is a multitude of market information that is inherent in the company's value chain. Information from the company's sales forces, from customers or trade buyers and from suppliers provide a useful set of data which will help the decision making process.

**External Sources**

Many external sources exist which will enhance the information available within the organisation. Some examples are:

- Chamber of Commerce Analyses
- Trade associations: Industry publications
- Fairs and exhibition catalogues
- Intermediaries' data bases

The key to a good acquisition strategy is to ensure that the potential target meets the overall corporate objectives of value creation (that is, it adds value to the enterprise by way of present value of future cash flows).

In order to achieve these objectives, various options or alternative courses of action must be evaluated and the necessary steps required to fulfil the objectives should be assessed in order to make a realistic forecast of likely outcomes or risks.

The acquisition strategy process should consider a stand-alone assessment of the target, the likely effect of synergies as a result of the acquisition and what management and cultural factors are in evidence which are potential barriers to successful implementation.

The assessment of the proposed target should evaluate its position with regard to the industry within which it operates and what marketing variables may impact upon future profitability. The following questions should be addressed:

- How is value created in the industry?
- Are the trends for "value added" favourable?
- How is the market segmented?
- How important is the product to the customer?
- Are some customers more important than others are?
- Are new products being introduced?
- Are distribution channels changing?
- How important is brand strength?

These questions related to the competitive position of the company plus a financial evaluation and an assessment of the incumbent management should be evaluated in order to review the potential for the base business in the future.

A thorough evaluation of all activities in the "Value Chain" must be undertaken in order to identify potential synergies as a result of the acquisition. These may include the following:

**Cost Management**

- Productivity improvements
- Purchasing power
- Shared resources

**Economies of Scale**

- Manufacturing
- Sales and service
- Distribution
- Overheads

**Marketing**

- New customers/products
- Branding of new sales
- Service provision

The key in this evaluation process is to compile a reality check and to uncover any hidden issues.

It is essential to assess the incumbent management, culture and style of the potential target in order to identify likely implementation issues. Pre- acquisition planning is a necessary prerequisite to successful post acquisition management.

It is essential that the purchaser negotiates from a basis of strength and evaluates the target company rigorously. The acquisition team should be involved in all aspects of the deal and should negotiate a pre-offer price prior to compilation of "Heads of Agreement" (letter of intent to the purchase).

At this stage in the acquisition process, the prospective purchaser will then insist on a full financial and commercial **Due Diligence** to be carried out in order to ensure that there are no hidden surprises likely to appear after the deal has been completed.

The financial, legal and business advisors will take full responsibility for a rigorous **Due Diligence** process to be enacted. Following this, a Purchase Agreement should be drawn up highlighting the terms and conditions agreed by both parties.

The financial, legal and business advisors will take full responsibility for a rigorous **Due Diligence** process to be enacted. Following this, a Purchase Agreement should be drawn up highlighting the terms and conditions agreed by both parties.

Responsibility for post-acquisition implementation should be allocated to a Board Director of the acquirer. In addition, it is essential to decide whether to integrate the newly acquired company into the parent organisation or to allow it to maintain autonomy.

An implementation plan should be compiled which indicates the course of action to be undertaken from immediate possession of the newly acquired company. The implementation plan must be clearly communicated to all affected parties.

In addition to planning activities, it is essential for the new management to take immediate control of:

- Reporting systems
- People and communications
- Cash and financial management

A clear focus on strategy and performance objectives must be in evidence coupled with fast, decisive action.

There are a number of key issues that must be addressed in order to ensure successful implementation. A checklist of these issues may be as follows:

- Culture and style of the organisation
- Business objectives
- People
- Customer satisfaction
- Sales/marketing/product development
- Financial controls/reporting/systems
- Communications
- Legal considerations

In making acquisitions, companies are seeking to add value to their organisation. In order to achieve "value added" objectives, the parent organisation must ensure that the relationships between the two organisations are in harmony and that decision making styles focus on value drivers in order that the anticipated synergies are realised.

### Strategic Alliances

Strategic alliances of this form can be seen as partnerships or co-operative activity. This raises another issue – the extent to which there is a dominant partner or there is an alliance of equals. The nature of the alliance, which is established or emerges, and the extent of its success, will depend on the reasons for its establishment and the objectives of the partners.

Lorange and Roos (1992) categorise the types of strategic alliance according to the resources a parent puts in and the output it takes out. This is shown diagrammatically below:

| | | Parents' Input of Resources | |
|---|---|---|---|
| | | Sufficient for Short-term | Sufficient for Long-term |
| **Parents' Retrieval of Output** | To parents | Ad hoc Pool | Consortium |
| | Retain | Project Based Joint Venture | Full Blown Joint Venture |

Types of Strategic Alliances (Lorange and Roos, 1992)

These activities, of course can take place across borders on a global scale. Many organisations build up networks of partnerships and do not restrict themselves to one partner or strategic alliance.

Also, strong multinational companies (MNCs) may form alliances with another MNC in one area of business – probably as an equal rather than on a dominant basis in this case – and still compete with the MNC in other areas of business.

M. Cauley de la Sierra (1995) lists ten reasons why companies enter strategic alliances rather than rely on internal growth:

1. Build global market capabilities
2. Cope with escalating research and development costs
3. Pre-empt competitive threats
4. Speed up product innovation
5. Cope with the integration of technologies and markets
6. Build world class capabilities
7. Establish global standards
8. Jump market barriers in emerging markets and regional trading areas
9. Cut exit costs
10. Take opportunities from the greening of global business

Whilst there may be a dominant relationship in strategic alliances, it can be argued that alliances as opposed to acquisitions lessen the chance of problems associated with supervisor – subordinate relationships. The argument is that MNCs need strong partners, not weak ones, to be successful in global competition.

M. Cauley de la Sierra (1995) refers to the three Cs when choosing an alliance partner:

- Compatibility
- Capability
- Commitment

**Compatibility**

Partners in strategic alliances have to be able to work together. This does not mean that there will be no friction or cultural differences. It does mean that there has to be sufficient respect, understanding and goodwill to overcome these.

Where a company has existing allies, this can be a good place to start when considering a partner for a new alliance. However, there are limitations to this. In a world of expanding business networks there are advantages in spreading alliances.

Compatibility can be judged in terms of hard and soft factors. The hard data will be in relation to:

- existing network and track record
- complementary strategies
- management practices and organisation
- manufacturing capability and systems
- marketing and distribution
- finance
- corporate safety, health and environment policies

The soft factors are concerned with culture and the intangible but crucial element of trust.

**Capability**

Companies want capable partners. Beyond that they want partners who have capability in a **complementary** area that can add value to the alliance. Testing this should involve a full evaluation of the potential candidate (they will be doing the same to you, if they are serious).

**Commitment**

There are two key questions that will help to assess the commitment of a potential partner:

- Does the alliance fall within a core business or product line of the partner?
- How difficult would it be for a partner to withdraw from the alliance?

The formation of an alliance goes through the choice of partner phase through to the signing of a contract. Working with the three Cs will involve an initial search phase and an intensive phase when the deal is being finalised with the short listed partner. In the initial phase it is important to have an awareness of strategic match and blessing from the shareholders. In the intensive phase this must move to a strategic plan and internal support on both sides.

Lorange and Roos (1992) discuss the strategic alliance formation process in relation to their four types:

- ad hoc pool
- consortium
- project based joint venture
- full blown joint ventures

**Ad hoc Pool Alliance**

There is generally a dominant partner who expects outputs to flow back to the parent and the motivation is defensive. The smaller partner can be faced with opportunities of expansion but must be aware of being dominated. In these circumstances, finding a strategic match and gaining shareholder blessing can be difficult.

**Consortium**

Here it is important to assess complementaries between approximately equal partners where the parent expects returns. For example, it could be to share research programmes where each partner has insufficient resources. Planning has to be detailed to avoid duplication and ensure that internal support is gained.

**Project Based Joint Venture**

An example of this type of project is where two companies want to enter a new market, which could be in a different country. One has the marketing skill, the other has the technology. As this fits into the short-term type of alliance, it may be disbanded as learning takes place and objectives change.

**Full Blown Joint Venture**

These alliances are intended to last but they are often motivated by a catch- up strategy. Both parties have to realise that neither of them will be dominant and that they need to co-operate.

Managing Strategic Alliances brings difficulties and raises issues that have to be dealt with for the alliance to be successful. The partners will have come together because they can achieve jointly what they could not achieve alone. However, they will still have their own interests and will often not want to give too much to their partners. Cultural differences at the organisational and national level can create difficulties and lead to the need for cultural understanding.

**Planning and Control**

Partners need to establish management processes that meet their needs and the needs of the alliance. In the objective-setting phase it is crucial to establish a common outlook and common information base in order to achieve a consensus and congruence. Senior management should be giving the commitment and support in order to convert strategic intent into strategic reality.

Setting a budget and implementing a strategic programme involves the need for co-ordination from a variety of functional disciplines. Care is needed to ensure that responsibilities are understood; senior management should reduce ambiguity. To make this work partners should commit adequate and realistic budgets.

Partners need to ensure adequate control of the alliance venture itself. They will also want to control their own input. For example, if their main business has competitive advantage from unique ownership of a core competency they will want to protect it from leakage into the market place. The skill is to devise and agree control systems that meet this balance.

**Human Resource Management**

Choosing the right people to work with as partners in a strategic alliance can be a crucial element in determining its degree of success. Senior managers should give thought to this, rather than merely allocating people on a functional basis.

Giving training and support, particularly when the situation involves new cultural relationships, could make a valuable contribution.

The people assigned to work with or in alliances must be capable of working both with the alliance and in their own company. They must be prepared to transfer in and out at some stage. Above all, they should avoid value judgments about the people they are working with.

**Cultural Differences**

The question of value judgments raises the issue of culture. Cultural misunderstanding can be the main cause of problems in carrying out the management functions discussed above. It is crucial that people involved in the management of alliances seek to understand their own and their partners' views and predisposition without jumping to conclusions or making value judgments.

**Challenges and Obstacles**

Some alliances are successful; others fail. Others serve a purpose for a time to meet the needs of the partners, and are then consciously discarded. Management should seek to avoid alliances breaking up whilst they could still serve a useful purpose.

As alliances become more global, the management challenges become greater and the cultural issues more important. This can also focus attention on the issue of equal partners or an alliance with a dominant partner. Many commentators argue that alliances have a stronger chance of success if they are between partners of equal strength, each offering something complementary.

Lorange and Roos (1992) identify seven challenges which managers have to meet:

- how to overcome reluctance to give up autonomy over partner's own resources
- how to achieve operating momentum
- how to focus on external environment (customers, competition) rather than internal friction
- how to avoid unnecessary politicking
- how to maintain energy and commitment over time

- how to increase the willingness to learn
- how to prevent particular individuals from becoming bottlenecks

When two companies merge they form a new hierarchy. When one company acquires another it absorbs it into its hierarchy. When there is a strategic alliance, two or more corporate hierarchies co-operate with each other.

**Global Strategies**

According to Hill (2013) , organisations that compete internationally generally face two types of conflicting competitive pressures – pressures to be locally responsive and pressures for cost reduction.

Pressures for local responsiveness stem from differences in consumer tastes and preferences. The pressure for cost reductions is inherent in global industries and can be achieved through standardised products.

When competing internationally, organisations can use any of the following four strategies:

- International
- Multidomestic
- Global Standardisation
- Transnational

Hill (2013: 353) states that organisations typically choose among these four main strategic postures when competing internationally. The illustration below shows the conditions under which each of these strategies is most appropriate:


These strategies can be described as follows:

International strategy

- Create value by transferring valuable skills and products to foreign markets.
- There is a tendency of centralising research and development functions at home.
- There is also a tendency of establishing manufacturing and marketing functions in each major country in which business is done.

- Multidomestic strategy
  - These organisations try to achieve maximum local responsiveness.
  - There is also a tendency of transferring skills and products developed at home to foreign markets.
- Global strategy
  - Pursuing a standardised product worldwide
- Transnational strategy
  - Low-cost and differentiation drive.

A summary of the relative advantages and disadvantages of each strategy is presented in the following Table:

| **Strategy** | **Advantages** | **Disadvantages** |
|---|---|---|
| Global | • Exploit experience curve effects<br>• Exploit location economies | • Lack of local responsiveness |
| International | • Transfer core competencies to foreign markets. | • Lack of local responsiveness<br>• Inability to realise location economies.<br>• Failure to exploit experience curve effects. |
| Multi-domestic | • Customise product offerings and marketing according to local responsiveness. | • Inability to realise location economies.<br>• Failure to exploit experience curve effects.<br>• Failure to transfer core competencies to foreign markets |
| Transnational | • Exploit experience curve effects<br>• Exploit location economies<br>• Transfer core competencies to foreign markets.<br>• Reap benefits of global learning. | • Difficult to implement due to organisational problems. |

**Strategies for entering Foreign Markets**

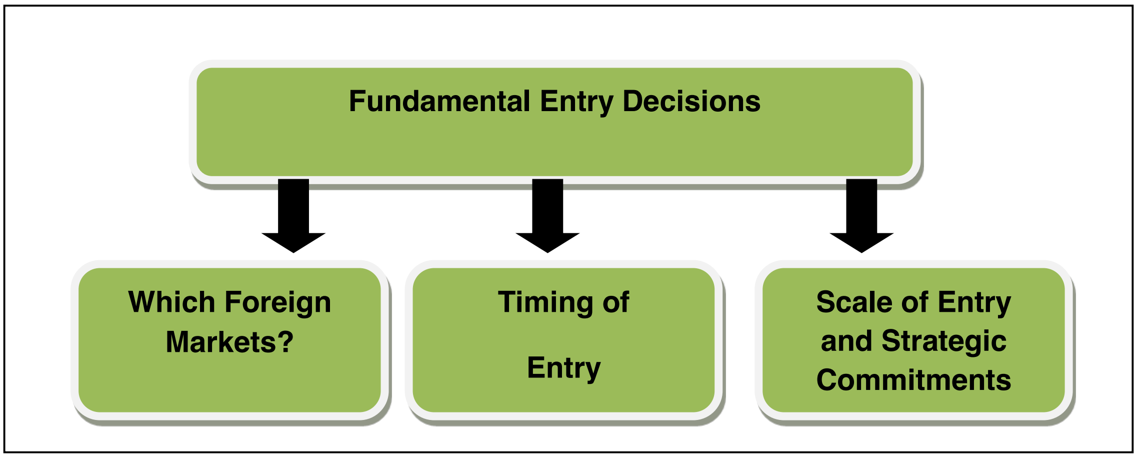
The decision to invest in a foreign country is based on three issues:

(1) the decision of *which* foreign market to enter, *when* to enter them, and on *what scale*;

(2) the choice of entry mode; and

(3) the role of strategic alliances.

Each of these issues can either 'make or break' a firm's global expansion success rate and therefore it is important to understand each of these issues thoroughly.




Which Foreign Markets? – The choice of foreign markets will essentially be determined by their perceived long term profit potential (Hill 2013: 486). This means that the factors that drive profitability will need to be considered. These factors will include issues such as economic factors, socio-political factors, demand factors, and regulatory factors.

Timing of Entry - once attractive markets for entry have been identified, the timing of the entry needs to be considered. Entry is considered to be early when a foreign entity enters the market prior to other foreign firms, while entry is considered to be late when it takes place after the establishment of other foreign firms (Hill 2013: 487).

Scale of Entry and Strategic Alliances - entry into a foreign market may be on a large scale, which is rapid and involves the commitment of significant resources (Hill 2013: 489).
To enter a foreign market on a large scale is a considerable strategic commitment and can impact the nature of competition within the market, making it easier for the firm to attract customers and distributors. Such large scale entry could also deter other foreign entities from entering the market.

However, a potential disadvantage of the strategic commitment of a large scale entry is that it may leave the firm with insufficient resources to enter into other attractive foreign markets, thereby limiting the firm's strategic flexibility (Hill 2013: 490). In contrast to the large scale entry, the small scale entry is regarded to be less risky as it provides the firm with an opportunity to learn and adjust to the foreign market.

| | |
|---|---|
| **Which Foreign Markets?** | •Demand Factors - adequate demand for product, size of market, etc<br>•Strategic Factors - infrastruture, labour skills, tax, etc<br>•Regulatory / Economic Factors - interest rates, competition, etc<br>•Socio-Political Factors - political stability, cultural barriers, etc |
| **Timing of Entry** | •First-mover Advantage - advantages and disadvantages of such a stratgey<br>or<br>Enter when product demand is well established - advantages and disadvantages of such a strategy. |
| **Scale of Entry and Strategic Alliances** | •Large Scale Entry - advantages and disadvantages of such a stratgey<br>or<br>Small Scale Entry - advantages and disadvantages of such a strategy. |

Entry modes into foreign markets include exporting, turnkey projects, licensing, franchising, joint ventures and wholly owned subsidiaries (Hill 2013: 491).

| Entry Mode | Advantages | Disadvantages |
|---|---|---|
| Exporting | Ability to realize location and experience curve economies | High transport costs<br>Trade barriers<br>Problems with local marketing agents |
| Turnkey contracts | Ability to earn returns from process technology skills in countries where FDI is restricted | Creating efficient competitors<br>Lack of long-term market presence |
| Licensing | Low development costs and risks | Lack of control over technology<br>Inability to realize location and experience curve economies<br>Inability to engage in global strategic coordination |
| Franchising | Low development costs and risks | Lack of control over quality<br>Inability to engage in global strategic coordination |
| Joint ventures | Access to local partner's knowledge<br>Sharing development costs and risks<br>Politically acceptable | Lack of control over technology<br>Inability to engage in global strategic coordination<br>Inability to realize location and experience economies |
| Wholly owned subsidiaries | Protection of technology<br>Ability to engage in global strategic coordination<br>Ability to realize location and experience economies | High costs and risks |

ADVANTAGES AND DISADVANTAGES OF ENTRY MODES, HILL (2013)

A wholly owned subsidiary in a foreign country may be set up from scratch through a greenfield venture or through the acquisition of a local firm (Hill 2013: 503). Each of these methods has both advantages and disadvantages associated with them.

| | **ADVANTAGES** | **DISADVANTAGES** |
|---|---|---|
| GREENFIELD VENTURES | • Provides a firm with the opportunity to establish the type of subsidiary which it wants:<br>o Coherent, single organisational culture is established.<br>o Coherent operating systems established. | • Slow to establish<br>• Risky: degree of uncertainty around future revenue and profitability.<br>• Possibility of being pre-empted by global competitors that enter the market quickly through acquisitions (Hill 2013:503). |
| ACQUISITIONS | • Quick to execute enabling them to rapidly build a presence in the target market. | • Often produce disappointing results.<br>• Acquisitions often fail due to:<br>o Inadequate pre-acquisition screening |

| | | |
|---|---|---|
| | • Provides a means to pre-empt competitors.<br>• Managers may perceive acquisitions to be less risky than a greenfield venture (Hill 2013: 501). | o Acquiring firms overpaying for assets of acquired firm<br>o Clash of cultures between the acquiring firm and acquired firm<br>o Integrating the operations of the two firms often takes much longer than anticipated (Hill 2013: 501). |

The final entry mode that paves the way of global expansion is through a strategic alliance. Under strategic alliances the incoming foreign firms partners and aligns itself with a domestic firm on the basis that it makes strategic sense to do so.

Global strategic alliances refer to cross-border partnerships between two or more firms from different countries with an attempt to pursue mutual interests through sharing their resources and capabilities. Strategic alliances may take the form of formal equity joint ventures to short term contractual agreements. Strategic alliances are a popular mode of entry as it is often felt that the benefits from a strategic alliance outweigh the limitations of it. The following table provides a brief overall of the arguments for and against strategic alliances.

**Global Strategic Alliances**

**Advantages**

- May assist entry into a foreign market.
- Fixed costs and the associated risks are shared with the strategic partner.
- Brings together complementary assets and competencies which neither firm could easily develop on its own.
- Could facilitate the development of technological standards for the industry, which would ultimately benefit the firm (Hill 2013: 504 – 507).

**Disadvantages**

- Provide competitors with a *"low cost route to new technology and markets"* (Hill 2013: 507).
- Alliances may be risky: a firm could potentially receive less than it gives away.
- Alliances may result in benefit to one strategic partner and damage to the other (Hill 2013: 507).
- Loss of autonomy and control may lead to inter-partner conflicts

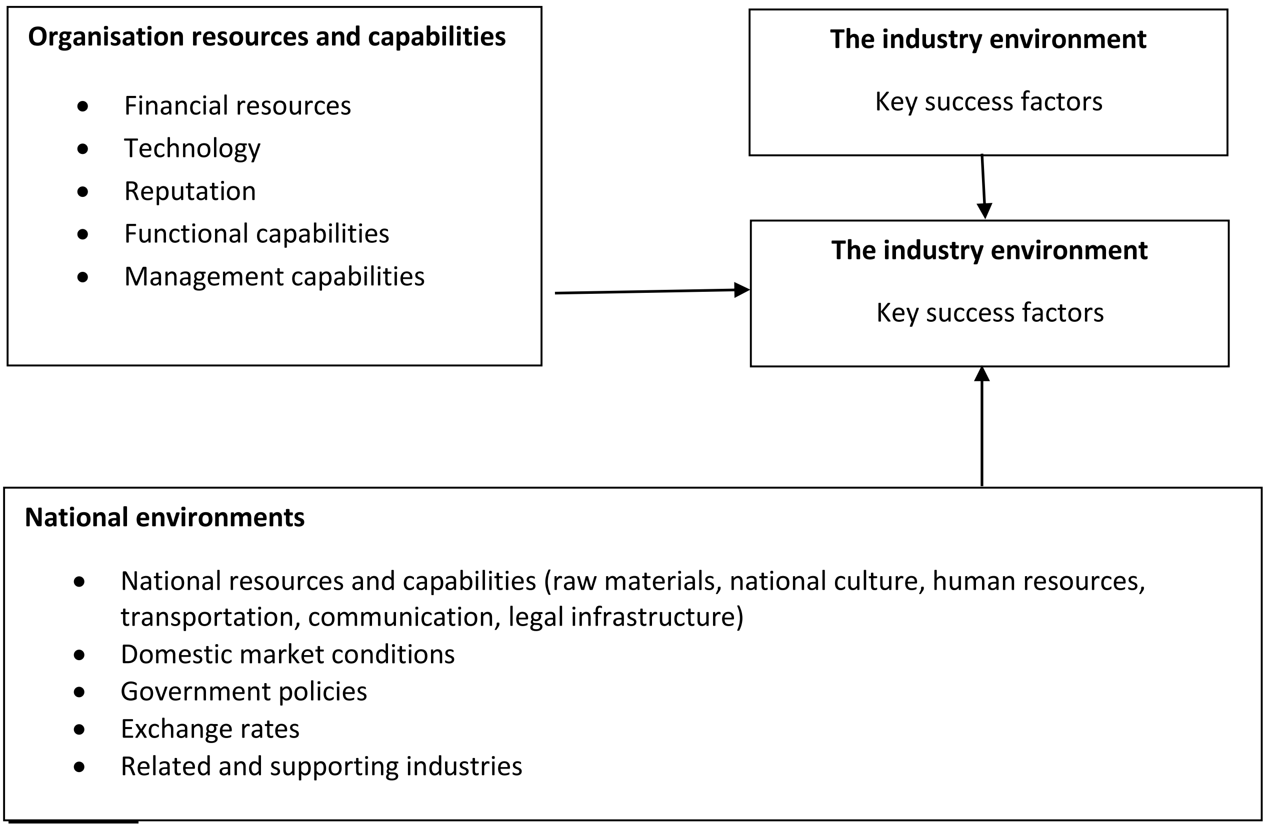
## THINK POINT

Could the competitive advantage of a domestic organisation differ from that of an organisation involved in international business**?**

**Reflection perspective**

The competitive advantage of an organisation whose operations are located in different countries depends on:

- the organisation's internal capabilities and resources in its home country
- the sources of competitive advantage in international industries that differ from the organisation's domestic industry
- conditions in the various country environments in which the organisation operates especially with regard to resource availability and factor cost (Louw and Venter, 2011:406)



Sustaining competitive advantage rather than creating it initially presents the real challenge for organisations. The imperative is therefore constant innovation – changes in products, services and strategies which take account of market demand, market saturation and competitor activity.

Heller (1998) – quoted in Thompson et al (2014:201) proposes that competitive advantage can be sustained over time by addressing seven questions:

- Are we supplying the 'right' things?
- Are we doing it in the most effective way?
- And at the lowest possible cost?
- Are we good as – and better than – our strongest competitor?
- Are we targeting and serving the widest possible market?
- Do we have a unique selling proposition?
- Are we innovating to ensure the answer to all these questions will remain yes?

Hough et al (2011:175) state that deciding which generic strategy to employ is perhaps the most important strategic commitment an organisation makes – it tends to drive the rest of the strategic actions an organisation decides upon and it sets the whole tone for the pursuit of a competitive advantage over rivals.

CHAPTER FOUR CASE STUDIES CASE STUDY 1

Read the following and answer the questions that follow:

**Cobra Beer**

Cobra Beer is one of the fastest growing bottled beer companies in the United Kingdom (UK). It was founded in 1989 by Karan Bilimoria, a 45-year-old Indian-born British entrepreneur who, along with a partner, had spotted a gap in the market for a lager that could be drunk easily with meals in Indian restaurants. The idea was simple: they would produce a high-quality lager-type beer that was less gassy than those normally sold by restaurateurs and would therefore not bloat diners.

Bilimoria was born in Hyderabad and came to the UK in 1981 to further his education, obtaining a law degree and accountancy qualifications from Cambridge University. After a short while working as an accountant, he long with his partner Arjun Reddy, started up a business importing from India such varied things as polo sticks, leather goods, jackets, towels, and pearls. These were sold with varying degrees of success, but, as Bilimoria says, his 'big idea' was always beer. And so in 1898 the partners founded

Cobra Beer Ltd. Their mission from the beginning was to brew the finest Indian beer and make it into a global brand.

Bilimoria claims that they owed some of their subsequent success to luck. For example, a chance contact with staff from Mysore Brewery, which supplies beer to the Indian army, in which his father had been a general, Bilimoria discussed his idea for the new beer with the brewery's master brewer. "To him, it was a challenge but I was very clear about the product, its taste and texture, and we worked with him to create it from scratch, adding maize and rice to the usual lager mix" Bilimoria says.

Bilimoria was planning to enter one of the most competitive beer markets in the world. The main brand, Carlsberg, was firmly entrenched, a new competitor, Kingfisher, had already entered eight years earlier, and numerous other beer brands were also trying to break into the market. The partners also knew nothing about the industry and they had no money. Bilimoria, however, was determined to succeed and had a passionate belief in the product.

Initially Cobra Beer was run out of Bilimoria's flat – up three flights of stairs – and deliveries were made from his old Citroen car which held exactly fifteen cases. The car was so tatty that the partners would park it out of sight of the restaurants to which they were delivering. Although Cobra beer was £1 more expensive (typically 10 to 15 percent more than competitors beer) and deliberately positioned up-market, Bilimoria and his partner went for the best restaurant first on the basis that others would follow their lead. They created a sales pitch that pointed out that if restaurants could supply diners with a beer that did not make them so full – because it was less gassy and of better quality (i.e. Cobra) - the restaurant could sell more food.

Within two years, Bilimoria and Reddy were delivering over a thousand cases of Cobra a month to over a hundred restaurants with a large number of repeat orders. For ten years, Cobra beer sales in Europe averaged annual growth of over 40 percent. By 2005, was one of the fastest growing beer brands in Britain; it was being served in 90 percent of the 6000 licensed Indian restaurants in Britain and was available in supermarkets, mainstream bars, pubs and clubs.

Cobra beer has regularly won Grand Gold Medals at the prestigious Monde Selection Awards in Brussels (the brewing industry's 'Oscars'), and created history in 2004 by winning the medal for the fourth time in a row with its UK brewery partner Charles Wells. Its Polish brewery Browar Belgia went further, wining four gold medals in 2004, the first year it had brewed Cobra. In 2006, for the second year running, Cobra was awarded more gold medals than any other company in the world: it won twelve.

Although principally focused on Cobra beer, the company has engaged in some product diversification. In 1999, in honour of his father, Bilimoria set up the General Bilimoria wine brand. Like the beer, it was designed to accompany Indian food to replace house wines served in Indian restaurants. The wine is produced in France and Spain and sells about 350 00 bottles a year.

In 2005 – 2006, Cobra launched an alcohol-free beer and a low calorie beer aimed at women between 25 and 35, promoted as an alternative to both full-calorie lagers and bland low-calorie brands. It also launched King Cobra, a bottle-conditioned strong (8 percent) lager, which is sold in 750 ml champagne-style bottles.

It has also expanded geographically. Export sales, particularly to Italy (where there are fewer than 100 Indian restaurants) and Ireland began to take off in 1996. However, Britain still accounts for over 90 percent of Cobra sales. Bilimoria realised that the company was too reliant on the UK and needed to spread market risk. As a result, Cobra opened subsidiaries in South Africa, India, and the United States. The company has also expanded into Russia and Eastern Europe. Its taste is a selling point.

Cobra is now available in 11 states in the USA, although they were unable to use the Cobra name there, and so call it 'Krait' (a snake from the same family as the cobra). Krait prestige is the equivalent of the King Cobra brand and Cobra Beer in America has ambitions to achieve a 3 percent share of the US beer market. China is another country where Cobra plans to establish operations.

However, the main push was into India, the world's second most populous country with over 1bn inhabitants, with a market estimated to be about 100m cases of beer a year and growing at around 7 per cent per annum. Cobra licensed Mount Shivalik Group to brew Cobra in their Behror brewery in Rajasthan. Paradoxically, although Cobra is marketed as an Indian beer, for most of its life production has been carried out in Europe. Although the beer was produced in Mysore's brewery in Bangalore for the first seven years of the company's life, quality and supply problems meant that production was transferred to Charles Wells' brewery in the UK. The Belgian brewer, Browar Belgia began producing Cobra beer in 2003.

1. Analyse the source of Cobra's competitiveness and discuss the sustainability of its competitive advantage.
2. Discuss the major strategic issues that face Cobra Beer as it strives to make Cobra a global brand.
3. Identify the strategic options available to Cobra.
4. Recommend a course of action for Cobra, giving reasons for your answer

CASE STUDY 2

Read the following and answer the questions that follow:

Brewing beer and other alcoholic drinks are among the world's oldest and most universal industries. As brewing became more organised and began to exploit scale economies, dedicated regional and national brewers emerged, including Carlsberg of Denmark. Founded in Copenhagen by J C Jacobsen in 1847, Carlsberg is a very late comer, judged against brewers such as Stella Artois (Belgium), Kronenbourg (France) and Oettinger (Germany).

In 1875 the Carlsberg Laboratory began to explore the science of yeast fermentation when brewing pilsner (lager) beer. This successful venture evolved later into the world-renowned Carlsberg Research Centre, a pioneering institution in yeast genetics, biotechnology and biomedical research. In 1876 Jacobsen formed the philanthropic Carlsberg Foundation, to which he bequeathed ownership of his brewery. Meanwhile his son, Carl had founded his own Carlsberg brewery; the two companies were reunited in 1906. Today the Foundation remains the majority owner of Carlsberg A/S, the brewing company, and supports various Carlsberg foundations and research interests.

After 1868 Carlsberg slowly developed an export business. Non-European destinations included South America; after 1903 and collaboration with the East Asiatic Company, China and other east Asian countries became significant markets for Carlsberg bottled beers. By 1939 Britain had become one of Carlsberg's biggest export markets. From the 1950s onwards Carlsberg appointed European licensees such as Charrington and Tetley in Britain to brew and bottle Carlsberg beer. During the 1970s Carlsberg became joint and later sole owner of the Carlsberg breweries in Britain. A joint venture with Scottish & Newcastle (S&N) created Baltic Beverages Holding, which Carlsberg now wholly owns, extending its presence to Russia, Ukraine, Kazakhstan, Uzbekistan and the Baltic states. When Heineken and Carlsberg jointly acquired and dismembered S & N, Carlsberg gained additional operations in France, Vietnam and China.

In 1970 Carlsberg became the senior partner in a merger with Danish rival, Tuborg. In 1972 it opened a brewery in Malaysia. In 1980 it began a joint venture brewery in Hong Kong, which it subsequently acquired and then transferred production to the Huizhou brewery in mainland China, another licensee in which Carlsberg acquired a majority share in 1995. Today, Carlsberg owns 20 breweries in China, fully or partially. It owns three breweries in India. In 2000 it merged with Orkla of Norway, a major brewing and soft drinks enterprise covering the Nordic area and Russia. Initially Carlsberg owned 60% of the merged enterprise, called Carlsberg A/S, becoming 100% owner in 2004.

Through its multiple acquisitions and overseas investments the Carlsberg Group has become a global brewer. In 2012 it had 7.5% global share by volume, making it the fourth largest brewing corporation after AB InBev (Belgium, 21% share by volume), SABMiller (UK, 13%) and Heineken (Netherlands, 9%). Its 2009 sales were 59.4 billion Danish Kroner, on which it achieved a 15.8% operating profit margin. It employed 43000 people and marketed over 500 brands and sub-brands of beer. These include prestige international brands such as Carlsberg Pilsner, Tuborg, Kronenbourg 1664 and Baltika; and country-specific brands such as Tetley's (Britain), Ringnes (Norway), Feldschlösschen (Switzerland), Lav (Serbia) and 'Wind Flower Snow and Moon' (China). Its advertising strap line 'probably the best beer in the world' and its variants are widely recognised in many of the 150 countries where it competes.

Carlsberg's strategy focuses on the geographic regions of Northern and Western Europe; Eastern Europe; and Asia (including China). Its future strategy emphasises innovation in its core brewing activities and premium brand positioning wherever possible. It will continue investing in its own assets where these constitute a core capability. Where it does not own brewing facilities it will export or maintain local licensing agreements.

**Adapted from Pitt, M and Koufopoulos, D (2012) Essentials of Strategic Management Sage Publications**

1. Carlsberg's development features a complex pattern of inward overseas investments, transnational alliances and joint ventures that later it acquires. Evaluate this strategy.
2. Can a global strategy that sustains 500 brands possibly be right? Discuss the proposition that Carlsberg should rationalise its facilities and focus on far fewer brands.
3. Despite its international strategy, Carlsberg is still only the fourth largest brewing group, much smaller than AB InBev, which like others has grown dramatically through acquisitions and mergers. Discuss the extent to which Carlsberg is a future acquisition target and how it should respond to a future bid.

# CHAPTER 5: STRATEGY IMPLEMENTATION AND CONTROL

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

- Distinguish between strategy formulation and strategy implementation
- Explain the significance of strategy implementation
- Describe the barriers to successful strategy implementation
- Discuss the drivers and instruments for strategy implementation

**READING**

Hough et al (2011) Chapters 8 and 9 Readings 07 and 09

Strategy implementation is an action-oriented, operations-driven activity aimed at shaping performance of core business activities in a strategy-supportive manner. It is tougher and more time-consuming than crafting strategy

The key tasks of strategy implementation include

- Improving efficiency of the strategy being executed
- Showing measurable progress in achieving targeted results

Strategy implementation includes:

- Building a capable organization
- Allocating resources to strategy-critical activities

- Establishing strategy-supportive policies
- Instituting best practices and programmes for continuous improvement
- Installing information, communication, and operating systems
- Motivating people to pursue the target objectives
- Tying rewards to achievement of results
- Creating a strategy-supportive corporate culture
- Exerting the leadership necessary to drive the process forward and keep improving

Good strategy execution Involves creating strong "fits" between the strategy and

- Organisational capabilities
- The reward structure of the organisation
- The internal operating systems
- The Organisation's work climate and culture

The stronger these "fits" the better the execution and the higher a company's odds of achieving its performance targets.

Strategy implementation is the process that turns strategic plans into a series of action tasks, and ensures that these tasks are executed in such a way that the objectives of the strategic plan are achieved.

Strategy implementation differs from strategy formulation in several ways. Firstly, strategy formulation is the intellectual or thinking phase, whilst implementation is the phase where these thoughts are operationalised and turned into action. Secondly, is mostly a market-driven activity with an external focus, whereas strategy implementation is an internal, operations-driven activity. Another difference between these two phases is evident in the required skills: strategy formulation requires good intuitive and analytical skills, whilst strategy implementation requires motivation and leadership skills.

| CRAFTING THE STRATEGY | EXECUTING THE STRATEGY |
|---|---|
| Primarily a market-driven activity<br>Successful strategy making<br>depends on<br>– Business vision<br>– Perceptive analysis of market conditions and company capabilities<br>– Attracting and pleasing customers<br>– Outcompeting rivals<br>– Using company capabilities to forge a competitive advantage | Primarily an operations-driven activity<br>Successful strategy execution<br>depends on<br>– Doing a good job of working through others<br>– Good organisation-building<br>– Building competitive capabilities<br>– Creating a strategy supportive culture<br>– Getting things done and delivering good results |

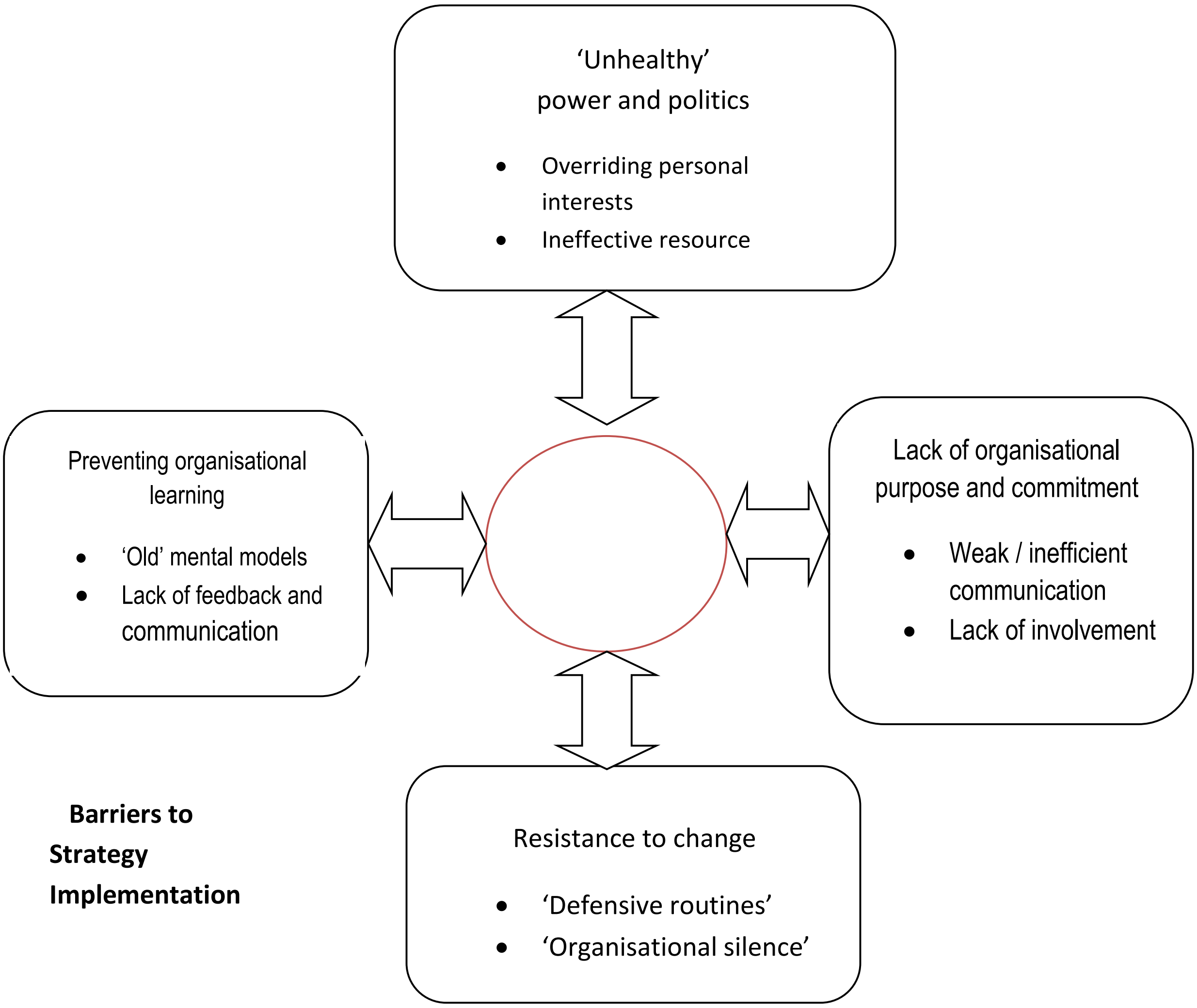
| Strategy Formulation | Strategy Implementation |
|---|---|
| Positioning forces before the action | Managing forces during the action |
| Focuses on effectiveness | Focuses on efficiency |
| Primarily an intellectual process | Primarily an operational process |
| Requires good intuitive and analytical skills | Requires motivation and leadership skills |
| Requires coordination among a few individuals | Requires coordination among many persons |

2

Organisations often experience problems when attempting to implement their chosen strategy or strategies. Such problems include:

- Ineffective coordination of implementation efforts.
- Inadequate leadership and direction provided by managers
- Goals not sufficiently defined; goals not well understood by employees
- Formulators of strategy not involved in the implementation
- Changes in responsibilities of employees not clearly defined.

The barriers to successful strategy implementation can be illustrated as follows:




Strategy implementation is the phase in which management aligns or matches leadership, organisational culture, organisational structures, reward systems, and resource allocation with the chosen strategy. These are often referred to as the drivers of strategy implementation.

## Leadership and strategy implementation

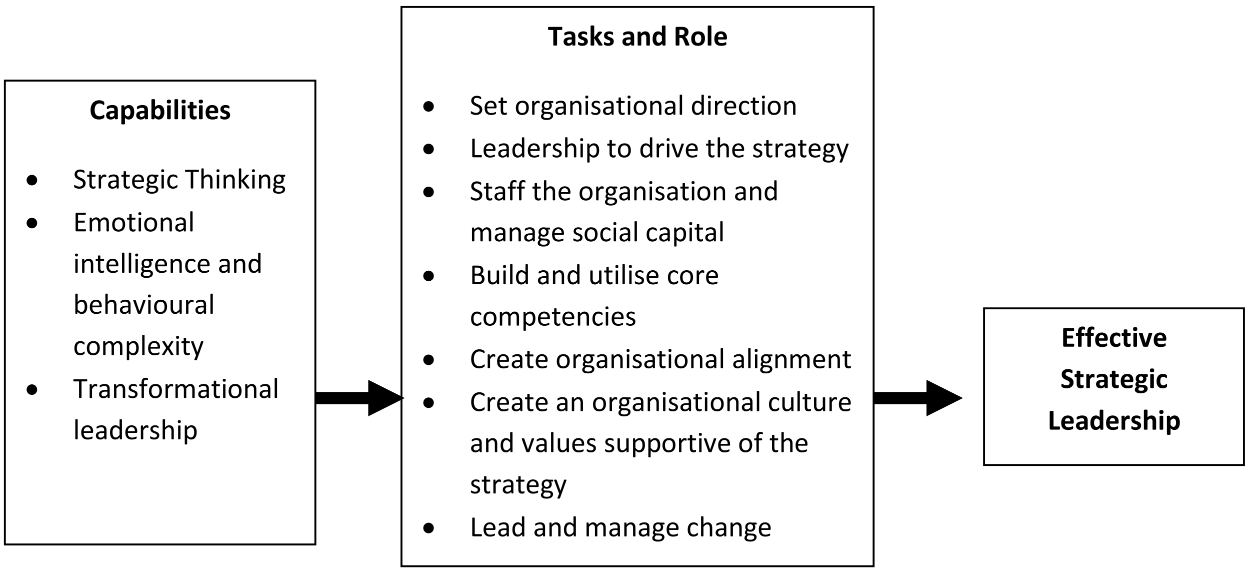
Strategic leadership is defined a the ability to anticipate, envision, maintain flexibility and to empower others to create strategic change as necessary (Hitt, Ireland and Hoskission, cited in Ehlers and Lazenby, 2007:217).

Strategic leadership involves managing through others and influencing human behaviour in order to achieve goals. The key responsibilities of a strategic leader are:

- Developing an appropriate vision or strategic direction for the organisation
- Communicating the vision and strategic direction to all the employees
- Inspiring and motivating the employees to achieve the strategic objectives
- Designing appropriate reward systems and organizational structures
- Developing and maintaining an effective organizational culture.

(Ehlers and Lazenby, 2007:223)

Strategic leadership is about leading entire organisations; it is about understanding entire organisations and the environments within which they operate and using this understanding to create strategic change through other people so as to position organisations in the environment for both short-term stability and long-term viability.




**Key characteristics of good strategic leaders**

1. **Vision, eloquence and consistency**

   Give a clear sense of direction; a clear and compelling vision of where the organisation should go.

   Eloquence to communicate the vision and energise people.

   Consistently articulate their vision until it becomes part of the culture.

2. **Articulation of a business model**

   Ability to identify and articulate the business model the company will use to attain its vision. A business model is the conception of how the various strategies that the company pursues fit together into a congruent whole.

3. **Commitment**

   Strong leaders demonstrate their commitment to their vision and business model by actions and words and often lead by example.

4. **Being well informed**

   Develop a network of formal and informal sources who keep them well informed about what is going on. Using informal and unconventional ways to gather information is wise because formal channels can be captured by special interests or by gatekeepers who may misrepresent the true state of affairs.

5. **Willingness to delegate and empower**

   Unless they delegate, leaders can become overloaded with responsibilities. Empowering subordinates is a good motivation tool. However, astute leaders recognise the need to maintain control over certain key decisions.

6. **The astute use of power**

   Power comes from control over important resources: budgets, capital, positions, information and knowledge. Astute leaders use these resources to acquire another critical resource – critically placed allies who can help attain strategic objectives.

   Strategic leaders must play the power game with skill and attempt to build consensus for their ideas rather than use their authority to force ideas through; they must act as members of a coalition or its democratic leaders rather than as dictators.

7. **Emotional intelligence**

   A bundle of psychological attributes – self-awareness, self regulation, motivation, empathy and social skills.

Leadership drives strategic change and strong leadership is an important 'tool' to give direction and purpose to integrated strategy formulation, implementation and control.

Strategic leadership is the ability to anticipate, envision, maintain flexibility and to empower others to create strategic change as necessary and to articulate a strategic vision for the organisation and to motivate others to buy into it. It involves managing through others and influencing human behaviour in order to achieve goals.

Management is about coping with complexity; leadership is about coping with change (Kotter, 2001)

| **Management** | **Leadership** |
|---|---|
| • Directing others in the pursuit of goals<br>• Tend to be more analytical, structured and controlled; work is a quantitative science.<br>• Focus on the details, instruct and apply authority | • Guiding, encouraging and facilitating others<br>• More experimental, visionary, flexible, creative and value intuitive side of work<br>• Focus on the bigger picture, inspire and apply influence. |

Leadership is not better than management or a replacement for it; leadership and management complement each other. Experience in both is necessary for successful strategy implementation.

**Strategy and Organisational Culture**

Every organisation has its own unique culture. The character of a company's culture or work climate is made up of its core values and business principles that executives adopt the standards of what is ethical or not, the operating business practices and the behaviours that define "How we do things around here."

The company's approach to people management, the 'chemistry' and 'personality' that exist in the work environment and the stories that get told repeatedly to illustrate and reinforce the company's values, business practices, policies and traditions all influence the company culture. It also includes individual attitudes and behaviours, the peer pressures that exist within the business and the company politics.

Over time all these factors take root and become embedded in the way in which the company conducts its business, they come to be accepted and shared by both managers and employees and are encouraged to be adopted and followed by new and prospective employees.

“The meshing together of stated beliefs, business principles, styles of operating, ingrained behaviours and attitudes, and work climate define a company’s corporate culture.” (Hough et al, 2011)

Once established, company cultures are spread throughout the organisation in a six important ways:

1. By screening and selecting new employees who will fit in well with the culture
2. By systematic training of new members in the culture’s fundamentals
3. By efforts of the senior group members to reiterate core values in daily conversations and announcements.
4. By telling and retelling of company stories and legends
5. By regular ceremonies that honour members who display desired cultural behaviours
6. By visibly rewarding those who display cultural norms and by penalizing those who don’t

However, it is important to realise that cultures are not static, just like an organisations strategy or structures; cultures evolve and change to satisfy new environments and conditions. New challenges in the marketplace, revolutionary technologies and shifting internal conditions all change the ways in which things are done and thus the general culture of the organisation. Likewise, diversification into new businesses, expansions into foreign countries, rapid growth, an influx of new employees and a merger or acquisition of another company can all result in cultural changes of some kind.

A company’s present culture and work climate may not be compatible with what is needed for effective implementation and execution of the chosen strategy.

When a company’s work climate promotes values, attitudes, practices and behaviours, which are in line with effective strategy execution; then its culture functions as a valuable resource in the process. However, the opposite is also true. When the company culture is in conflict with some aspect of the company’s direction, performance targets, or strategy, the culture becomes a negative aspect in strategy execution.

A culture that is well aligned with strategy enhances a company’s strategy execution in two ways:

1. A culture that encourages actions supportive of good strategy execution not only provides company personnel with clear guidance regarding what behaviours and results form good job performance, but also produces significant peer pressure from co-workers to conform to culturally acceptable norms.
2. A culture that is surrounded with value and behaviours that assist strategy execution promotes strong employee identification and commitment to the company’s vision, performance targets and strategy.

**Unhealthy Cultures**

The distinctive characteristic of an unhealthy organisational culture is the presence of counterproductive cultural traits that adversely impact on the work climate and the company's performance. The following three are particularly unhealthy.

1. A highly political internal environment

This is a situation in which many decisions are made and issues are resolved solely on the basis of who has the most political clout and power and not on what is necessarily the best decision for the organisation as a whole. Often a lot of time, energy and money are wasted on something that is not close to optimal for the company.

2. Hostility to change

This includes people who are resistant to change and have a general wariness and negativity towards people that respond well to change and encourage new ways of thinking and doing things. These people avoid taking risks, do not pursue emerging opportunities, lack innovation in their product and service offerings and tend to follow rather than lead the market.

3. A 'must be invented here' mind-set

This occurs when the company personnel are against looking outside of the company for best practices and benchmarking, new approaches and innovative ideas. They are arrogant and generally underestimate competitors by thinking they can do everything themselves better than what may exist externally to the organisation.

"It is the strategy maker's responsibility to select a strategy compatible with the sacred or unchangeable parts of the organisations prevailing corporate culture. It is the strategy implementer's task, once the strategy is chosen, to change whatever facets of the corporate culture hinder effective execution" (Hough et al 2011.)

Changing a company's culture in order to align it with the strategy is one of the most complicated and challenging tasks because of the deeply entrenched values and habits that have been instilled into the organisation. People are also generally resistant to change and tend to cling emotionally to the old and familiar ways of doing things. It takes intensive management effort over a long period of time to replace and unhealthy culture with a better one and to hinder unwanted behaviours and introduce ones that are strategy supportive. Thus the single, most important factor that distinguishes successful cultural changes from failed attempts is competent leadership at the top of the organisation.

The initial step in fixing a problem culture is to identify the areas of the present culture that are dysfunctional and explain why they pose obstacles to executing strategies and achieving goals. Next the managers must decide upon and clearly define the desired new behaviours and specify the key characteristics of the culture that they want. Thirdly, managers need to talk openly to all those concerned about the problematic aspects of the culture and explain how the new behaviours will improve the company's performance.

The final and most important, the talking has to be followed by visible, aggressive actions to promote these desired new behaviours.

The methods management can use to change a problem culture include:

1. Make a compelling case for why the new direction and culture is in the company's best interests and why individuals and groups should commit themselves to making it happen.
2. Repeating the message of why this culture change is good for all the company's stakeholders at every opportunity that arises.
3. Visibly praising and rewarding those employees who adopt and display the newly advocated cultural norms and participate in implementing the desired kinds of operating practices.
4. Altering incentive compensation to reward the desired cultural behaviour and deny rewards to those who resist the change.
5. Recruit and hire new managers and employees who already posses the desired cultural values and can serve as role models for the desired cultural behaviour.
6. Replace key executives who are strongly associated with the old culture.
7. Revise policies and procedures in ways that will help to drive cultural changes.

**Reward Systems and strategy implementation**

Organisations can improve employee commitment and encourage behavior consistent with the strategy is to improve their understanding of the strategy and the required implementation process. Another way of ensuring that specific strategy-supportive tasks are performed are met is through the establishment of reward systems. Reward systems can be defined as the umbrella term for the different components considered in performance evaluation and the assignment of monetary and non-monetary rewards to them. (Ehlers and Lazenby, 2007:223)

**Organisational structure and strategy implementation**

Organisational structure can be a source of competitive advantage if designed in such a way that it is aligned with the chosen strategy, is functional and makes it easy for customers to do business with the organisation. An effective organisational structure forms the stable base on which the organisation can build its strategy implementation efforts.

The concept *structure follows strategy* emphasises that a change in strategy necessitates a change in structure. In the absence of a tight fit between strategy and structure, an organisation's performance will decline, it will experience administrative problems, resource allocation problems and conflicting priorities regarding strategy implementation tasks.

However, strategy and structure have a reciprocal relationship, i.e. in as much as strategy influences structure, structure can also influence the choice of strategy to some extent.

Implementing and executing strategy is an operation-driven activity revolving around the management of people and business processes. The manager's emphasis is on converting strategic plans into actions and good results. Management's handling of the process of implementing and executing the chosen strategy can be considered successful if and when the company achieves the targeted strategic and financial performance and show good progress in making its strategic vision a reality. Shortfalls in performance signal weak strategy, weak execution or both.

Eight managerial tasks recur in the efforts to execute strategy:

- Building an organisation with the competences, capabilities and resource strengths to execute strategy successfully.
- Marshalling sufficient money and people behind the drive for strategy execution.
- Instituting policies and procedures that facilitate strategy execution.

- Adopting best practices and pushing for continuous improvement in how value-chain activities are performed.
- Installing information and operating systems that enable employees to carry out their strategic roles proficiently.
- Tying rewards directly to the achievement of strategic and financial targets and to good strategy execution.
- Shaping the work environment and corporate culture to fit the strategy.
- Exercising strong leadership to drive execution forward, improving on the details of execution, and achieve operating excellence as rapidly as possible.

Building an organisation capable of good strategy execution entails three types of organisation building actions:

- Staffing the organisation – assembling a talented management team and recruiting and retaining employees with the needed technical skills, experience and intellectual capital.
- Building core competences and competitive capabilities that will enable good strategy execution
- Structuring the organisation and work effort.

In evaluating how well a company's present strategy is working, a manager first needs to decide upon what exactly the strategy is. It needs to look at the type of strategy used, the firms competitive scope in the industry, what is geographic market coverage is, the size of the customer base, individual functional strategies and many other differentiating factors. Although it is wise to evaluate the strategy from a qualitative standpoint, in terms of its completeness, rationale and suitability; the best quantitative evidence of how well a company is doing comes from studying the company's recent strategic and financial performance. The two best indicators are:

1. Whether the company is achieving its stated financial and strategic objectives
2. Whether it is performing above the industry average or not

Persistent shortfalls in meeting company performance targets and weak performance relative to competitors are warning signs that the company is suffering from poor strategy. Performance of a company's strategy can be gauged by looking at a number of different measures

- Whether the organisation's sales are growing above or below the market pace as a whole, resulting in rising or falling market share
- Whether the company is acquiring new customers as well as retaining existing ones

- Whether the organisation's profit margins are increasing or decreasing and how well they are doing in comparison to rival firms
- Trends in the organisation's net profits, return on investment, economic value added and how these compare to other firms in the industry
- Whether the organisation's overall financial strength and credit rating are improving or worsening
- Whether the organisation can demonstrate continuous improvements in internal performance measures such as unit costs, defect rates, employee morale and turnover, customer complaints etc.
- How shareholders view the organisation based on share price and shareholder value
- The organisation's image and reputation
- Whether the organisation is regarded as a leader in technology, innovation, quality, prices and other relevant factors which affect buyer's choices.

Three questions can be used to test the qualities of one strategy from another and distinguish a winning strategy from a poor or mediocre strategy.

1. How well does the strategy fit the company's situation?

   To be a winning strategy, it has to be well matched to the industry and competitive conditions, the market opportunities and threats and many other aspects that influence the external environment. Whilst at the same time being tailored to the company's own resource strengths and weaknesses, competencies and capabilities. Unless a company's strategy fits tightly with both the internal and external aspects of an organisation, it is not likely to produce the optimal outcomes

2. Is the strategy helping the company to achieve a sustainable competitive advantage? Winning strategies allow the company to achieve a competitive advantage that is durable and cannot be easily imitated by rival firms. The bigger and more sustainable the advantage is, the more appealing the strategy is.
3. Is the strategy resulting in better company performance?

   A winning strategy enhances company performance. These include gains in profitability and financial performance, as well as, gains in the company's competitive strength and market standing.

Strategies that possess the highest scores on all three of the above mentioned questions can clearly be regarded as the most appealing or attractive strategic alternatives. Other criteria that can be used for judging the worthiness of specific strategies include; internal consistency and unity among all the pieces of the strategy and the degree to which the chosen strategy is flexible and adaptable to changing circumstances.

| THINK POINT |
| --- |
| Organisational architecture in strategic alignment and implementation |

**Reflection perspective**

The ability of an organisation to facilitate the effective and efficient implementation of strategy is almost entirely dependent on its internal functioning. It is the internal organisation that comprises those elements pivotal in translating the strategy into tangible outcomes and actions. The internal organisation describes and delineates how things are done and who does what.

Strategies are put into action and results delivered by means of alignment between organisational culture, policies and procedures, an effective knowledge and skills base, a suitable organisational structure, and different processes and systems.

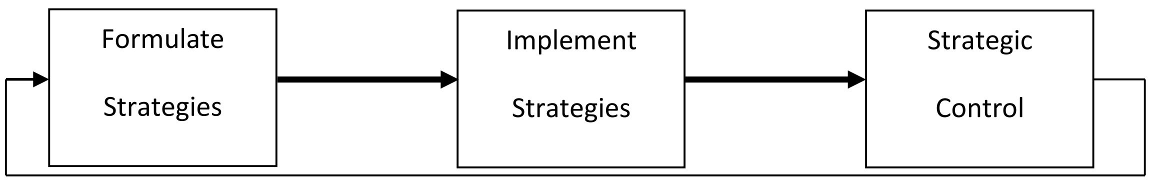
Organisational architecture is the underlying model of the organisation's way of doing business; it is all the various systems, structures, management processes, technologies and strategies that make up the modus operandi of the organisation (Louw and Venter, 2011:479)

<u>Strategic Control</u>

For organisations to be effective, they must practice effective strategic control and corporate governance. Without such controls, the organisation will not be able to achieve competitive advantages and outperform rivals in the marketplace.

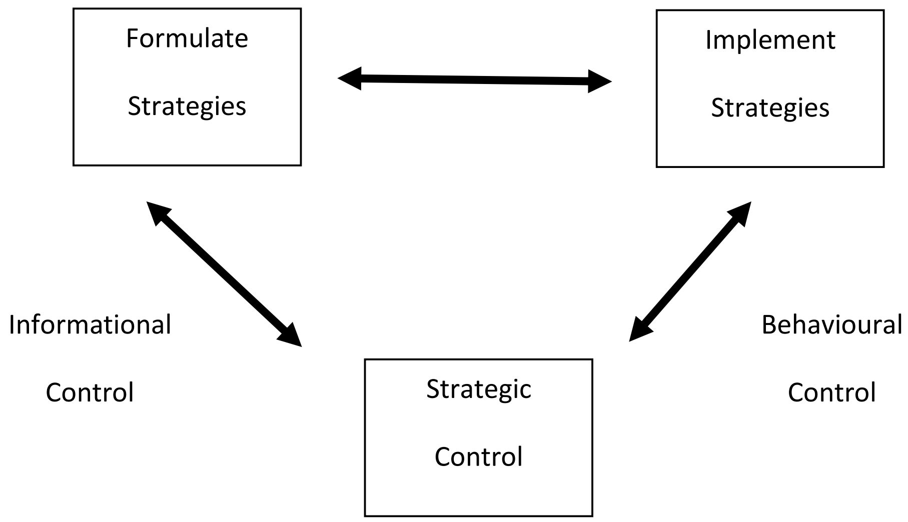
The traditional approach to strategic control is sequential:

(1) Strategies are formulated and goals are set.
(2) Strategies are implemented, and
(3) Performance is measured against the predetermined goal set.



Control is based on a feedback loop from performance measurement to strategy formulation. This process may involve lengthy time lags, often linked to the planning cycle of the organisation. This approach ("single loop') is appropriate when the environment is stable and objectives can be measured with a high level of certainty.

A more contemporary approach to strategic control integrates adapting to and anticipating both internal and external environment change. The relationships between strategy formulation, implementation and strategic control are highly interactive.




Informational control is primarily concerned with whether or not the organisation is "doing the right things". Informational control is a method of organisational control in which the organisation gathers and analyses information from the internal and external environment in order to obtain the best fit between the organisation's goals and the strategic environment.

Informational control is part of an ongoing process of organisational learning that continuously updates and challenges the assumptions that underlie the strategy of an organisation. In such 'double loop" learning, the organisation's assumptions, premises, goals and strategies are continuously monitored, tested and reviewed. The benefits are that time lags are shortened,, changes in the competitive environment are detected earlier and the ability of the organisation to respond with speed and flexibility is enhanced.

Behavioural control asks if the organisation is 'doing things right' in the implementation of its strategy. Behavioural control is a method of organisational control in which the organisation influences the actions of employees through culture and rewards. Where there are strong and positive cultures and rewards, employees tend to internalize the strategies and objectives of the organisation. (Dess, Lumpkin, Eisner and McNamara, 2014:278-305)

<u>CHAPTER FIVE CASE STUDY</u>

Read the following and answer the questions that follow:

When Maria Ramos joined Transnet in 2004, it was floundering. The organisation was in deep trouble financially, strategically and operationally. A loss of R6 billion was reported in 2003/2004.

The then president of South Africa, in the state of the nation address, had committed the government to ensuring that the public sector discharged its responsibilities to the people of South Africa in the process of growth, reconstruction and development of the country. To achieve this, the government needed a well-functioning, efficient and low cost transport system. Thus the political importance of Transnet's role in the economy increased substantially.

Over the previous ten years the organisation had been through a number of unsuccessful change efforts. There had been three different CEO's.

When Ramos took the reins as CEO of Transnet in 2004, it was clear in her mind that the structure of Transnet simply did not provide the platform necessary to maximise the growth and competitiveness needed for the South African economy. The GDP target envisaged was 6 per cent, and the inefficiencies at Transnet were hampering the achievement of that target. Many problems faced Transnet and inhibited its ability to respond to the demands of its business environment. Ramos needed to find a way to formulate an appropriate strategy that would bring about the desired change.

Amongst a myriad of problems, Ramos found that there was mediocre financial performance and weak controls. Almost every week there was one corruption charge or another at Transnet. Risk management and governance were also poor, and there was lack of capital investment – in a sector where having up-to-date infrastructure was key.

In addition, Ramos found that morale was poor and there was a lack of a clear sense of purpose. She said: "People were disgruntled. There was a culture of hiding things. People were tired of multiple strategies and change. The organisation felt like a complex foggy ecosystem, where there were not one but many cultures."

Ramos also found a company that was completely fragmented. Over time, Transnet had come to comprise more than 20 businesses, as shown in Exhibit 1 below. Moreover, one of the main constraints to developing a coherent strategy was that Transnet was run by a group of managers, operating in different silos. The fragmentation was evident not only in the way different systems operated, but in a particular mentality that was deeply ingrained in the thinking of the managers and the staff.

There were four operations involved in the supply chain that transported goods from the factory onto a ship to the customer somewhere else in the world: the rail which carried the goods; port operations, which handled the freight; the National Port Authority, which brought the ship in and arranged when to take the ship out; and rail engineering, which helped with the maintenance of the rail fleet. All of these had to work together, but were not.

All the fragmentation and lack of coordination between different elements within Transnet made the South African supply chain very uncompetitive: a far cry from the government mandate Ramos had been asked to deliver.

EXHIBIT 1

**NPA (National Ports Authority)**: provides port infrastructure and marine-related services; manages port activities in a landlord capacity for eight ports.

**SAPO (South African Port Operations)**: Port and cargo operator in all major ports of South Africa, managing port, terminal and cargo operations.

**Spoornet**: Freight and rail operator, which focuses on the transport of freight, containers and mainline passengers by rail.

**South African Airways (SAA)**: Major commercial airline with extensive national and global operations.

**Metrorail**: Operates commuter rail transport in most of the major cities in South Africa.

**Petronet**: owns and operates an extensive high-pressure fuel pipeline network through which petroleum products and gas are transported

**Freight Dynamics**: Freight road transport

**Propnet**: Property management

**Transtel**: Operator of Transnet's private telecommunications network.

**Transwerk**: Supplier and refurbisher of railway wagon and rolling stock

**Autopax**: Passenger and road transport

**Protekon**: Construction and project management

**South African Express Airways**: Regional passenger airline.

**Viamax**: Logistics and fleet management

**Marine Data Systems**: Transport logistics

**Owner Driver Management**: Transport logistics

Ramos decided first to deal with the senior management team. A number of people were moved out, a new position of chief operations officer (COO) was created and filled, a new chief financial officer (CFO) was hired and a head of strategy was appointed.

There were a number of challenges that Ramos had to deal with in crafting the change strategy for Transnet. The organisation needed alignment and integration with a new thrust in government policy, which stressed the need for efficient and effective delivery of transport.

Ramos realised that:

- There was a need for Transnet to develop key port, rail and pipeline infrastructure while maintaining financial strength and operating efficiency.
- It was imperative for Transnet to provide appropriate capacity ahead of demand and for the organisation to inspire confidence in the country's economy.
- There was a need to integrate delivery structures within Transnet
- Transnet needed to respond to the country's freight logistics systems and improve its efficiency significantly.

In 2005 a small internal team worked to develop the strategy. They did not go through the normal process of crafting mission and vision statements. They developed a four-point turnaround plan with seven or eight projects under each point, where progress could be tracked against each element of the strategic plan (Exhibit 2).

EXHIBIT 2

Transnet's Four-point Turnaround Strategy

1. **Redirect and Re-engineer the Business**. This pillar is aimed at improving efficiencies and effectiveness of the core business units through re-engineering processes and realising synergies between the various operating divisions.
2. **Restructuring the Balance Sheet**. This pillar seeks to rationalise the business portfolio and achieve a better focus on the core business units. Non-core businesses will be transferred to government and others will be sold. The proceeds will be used to fund infrastructure investment and reduce borrowings
3. **Ensure Corporate Governance and Risk Management**. This pillar is designed to ensure the highest standards of corporate governance are adhered to and the company's risk management is improved.
4. **Develop human capital**. This is focused on revitalising the human resources by transforming the culture and behaviour of employees. The aim of this pillar is to increase talent management and leadership development, transformation management as well as performance and reward management.

Before announcing the strategy, Ramos tested it with government, a critical stakeholder, and gained support. The plan was presented to the Transnet Board and then to the Minister of Public Enterprises.

One of the key strategies for restructuring the balance sheet was to dispose of non-core assets. Early in 2004, even before the strategic plan was devised – Transnet disposed of a number of non-core assets including Fleet Call, Marine Data Systems, Virtual Care, Transtel Autopax and Transnet Housing. The plan was now proposed privatising Freight Dynamics, the Transnet pension Fund administration, and the Blue Train, as well as transferring SAA, Metrorail and Shosholoza Meyl out of Transnet, and moving other business units within Transnet.

In January 2006, the Transnet leadership made the decision to engage more fully with labour In February the Unions embarked on a rolling strike throughout the country, protesting against 'unilateral decision-making and unilateral implementation." The unions declared their 'ideological' opposition to the privatisation of strategic public assets.

Faced with this strike, Ramos wondered whether they had gone about developing and implementing their strategy in the right way.

The strike ended in May 2006 when Transnet concluded an agreement with the unions regarding the principles that would guide the disposal of the non-core assets. By September 2006 Transnet had disposed of most of its non-core businesses.

By 2007 Transnet had done away with the old semi-autonomous and fragmented structure and replaced it with a single, integrated one, so that the organisation comprised:

- Transnet Freight Rail (formerly Spoornet)
- Transnet Rail Engineering (formerly Transwerk)
- Transnet National Ports Authority (formerly the NPA)
- Transnet Port Terminals (formerly SAPO)
- Transnet Pipelines (formerly Petronet).

This re-engineering effort managed to improve the efficiencies and effectiveness of the core operating divisions, particularly the port system and the freight rail business. In implementing the strategic plan, the issues of operational efficiency and productivity were steadfastly pursued.

In 2006, Transnet Projects was set up to implement major capital investment projects (investments worth more than R300 million).

There were significant improvements in financial performance. For example, the net value of assets increased by 246 per cent in Transnet national Ports Authority from 2004 to 2007. Operating profit at Transnet increased from R4.74 billion in 2004 to R8.47 billion in 2007 and rose a further 15 per cent to R10.7 billion in 2008. Gearing levels were reduced to 39 per cent (an improvement of 15 per cent), which meant that Transnet had developed significant borrowing capacity. The net worth of the business had in three years grown fourfold to more than R37 billion.

Once the disposal of non-core assets was completed, Transnet had 48 578 permanent employees and 8543 employees on fixed-term contracts. By 2007, Transnet was able to begin a human capital development strategy. The main elements of this strategy included:

- Skills demand planning
- Recruitment and retention
- Capacity-building and skills retention
- Performance management
- Talent management
- Culture

A 2008 article in the *Financial Mail* remarked: “With steely nerves and unwavering focus, Ramos moved swiftly to introduce sweeping changes to transform and restructure Transnet from a lumbering and heavily-indebted loss making company into a profitable entity. She dared to tackle management productivity and corporate governance issues despite fierce opposition from within and outside the group. She reversed its losses and the once-daily complaints about poor service and backlogs subsided.”

In her statement on her planned departure from Transnet, Maria Rmos had this to say: “I joined the company during one of the most difficult periods in its history. Among the many challenges we faced then was a R6.3 billion loss, a weakened balance sheet, low employee morale, unsustainably high gearing ratios and a steep decline in shareholder’s wealth. We were losing customers and volumes were dwindling as a result of lack of confidence in the company’s services. In essence we were a value-destroying organ of state. Through hard work, focus, discipline and team effort, I am happy to say that this is all behind us now. Transnet is a manifestly new, different and an infinitely better company today. The company has reconnected with its most important stakeholders – the customers – and is much more responsive to their needs.”

**Source: Smit, Cronje, Brevis and Vrba (2011) Management Principles A Contemporary Edition for Africa 5th edition Juta**

1. Ramos and her team would have conducted an environmental analysis prior to developing their turnaround plan. With reference to this, discuss the environmental context (PEST/PESTEL) that Ramos found Transnet in when she assumed leadership of the organisation.

2. Evaluate the turnaround plan that was proposed by Ramos and her team in the light of the context described in 1.1 and the information supplied in the extract.

3. "They did not go through the normal process of crafting mission and vision statements".

   3.1 Explain what mission and vision statements are and outline their importance to the strategy development process.

   3.2 Explain why this 'normal' process was omitted.

4. Discuss the characteristics of strategic leadership that Ramos displayed as she sought to turnaround Transnet.

# CHAPTER SIX: EVALUATING STRATEGIES

**LEARNING OUTCOMES**

After completing this chapter, the student will be able to:

- Employ three success criteria for evaluating strategic options'
- Distinguish between efficiency and effectiveness
- Explain how organisational success might be assessed in financial terms
- Describe a frame work for evaluating strategies

**READING**

Hough et al (2011) Chapter 7

Reading 08

The strategic management process results in decisions that can have significant, long-lasting consequences. Erroneous strategic decisions can inflict penalties and can be difficult to reverse.

Strategy evaluation is vital to the well-being of an organisation because timely evaluations can alert management to problems or potential problems before a situation becomes critical.

Strategy evaluation includes three basic activities:

(1) Examining the underlying bases of the strategy of the organisation
(2) Comparing expected results with actual results
(3) Taking corrective actions to ensure that performance conforms to plans.

Johnson, Whittington and Scholes (2011: 363) outline three evaluation criteria:

- Suitability – which is concerned with assessing whether the strategy addresses the key issues relating to the opportunities and constraints faced by an organisation?

- Acceptability – is concerned with whether the expected performance outcomes of a proposed strategy meets the expectations of stakeholders.
- Feasibility – is concerned with whether a strategy could work in practice.

Rumelt (1980), cited in David and David (2015:374) offered four criteria that could be used to evaluate a strategy:

- Consistency – a strategy should not present inconsistent goals and policies
- Consonance – refers to the need to examine trends in evaluating strategies
- Feasibility – a strategy must neither overtax available resources nor create unsolvable subproblems.
- Advantage – a strategy must provide for the creation or maintenance of a competitive advantage in a selected area of activity

Consonance and advantage are mostly based on an organisation's external assessment, whereas consistency and feasibility are largely based on an internal assessment

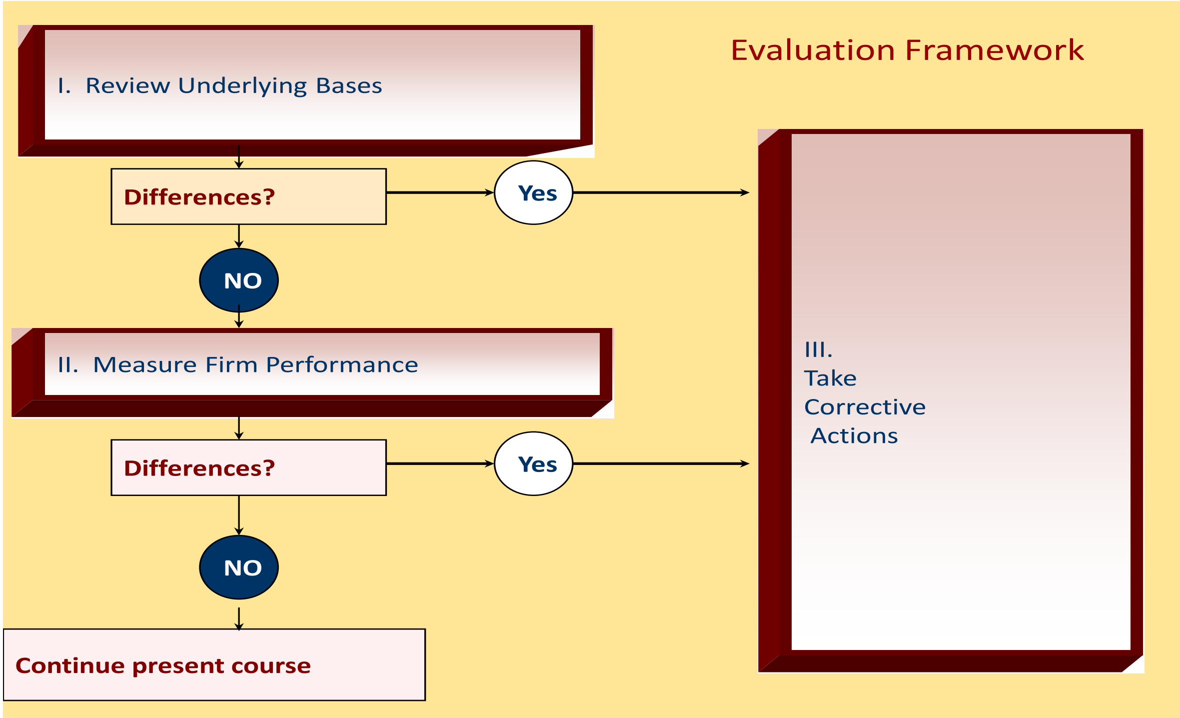
Thompson, Scott and Martin (2014:383) state that there are three important measures of performance:

- Economy – which means doing things cost effectively. Resources must be managed at the lowest possible cost consistent with achieving quantity and quality targets
- Efficiency – which implies 'doing things right'. Resources must be utilised to maximise the returns from them.

Economy and efficiency measures are essentially quantitative and objective.

- Effectiveness – or 'doing the right things'. This means that resources should be allocated to those activities which satisfy the needs, expectations and priorities of the various stakeholders in the organisation.

The following diagram illustrates a strategy evaluation framework:




The three stages are:

Activity One – Reviewing the underlying bases of strategy

Activity Two – Measuring organisational performance

Activity Three – Taking corrective actions. (David and David, 2015: 377)

Strategy evaluation must meet several basic requirements to be effective:

- Strategy evaluation activities must be economical
- Strategy evaluation activities should be meaningful – they should specifically relate to the objectives of the organisation.
- Strategy evaluation activities should provide timely information.
- Strategy evaluation should be designed to provide a true picture of what is happening.
- Information derived from the strategy-evaluation process should facilitate action.
- Strategy evaluation activities should not dominate decisions; it should foster understanding and trust.
- Strategy evaluations should be simple, not too cumbersome and not too restrictive. (David and David, 2015: 383),

Regardless of how strategies are formulated, implemented and evaluated, unforeseen events (strikes, boycotts, natural disasters) can make a strategy obsolete. To minimise the impact of potential threats, organisations should develop contingency plans as part of their strategy-evaluation process.

Contingency plans are alternative plans that can be put into effect if certain events do not occur as expected.

| **THINK POINT** |
| --- |
| The value of the balanced scorecard approach in terms of strategic alignment. |

Reflection perspective

The balanced scorecard is a means to measure the effectiveness of an organisation's strategic management efforts. It allows an organisation to understand how well it has aligned and integrated itself and how successfully it has implemented and executed its strategy. The balanced scorecard approach measures strategic success using four dimensions:

- *Financial perspective* – is the organisation's performance resulting in increased shareholder value? Some indicators are increased revenue growth, better cost management and more effective asset utilisation.
- *Customer perspective* – is the organisation's performance resulting in an increasing share of customer spending?. Indicators here are increased customer acquisition, improved customer satisfaction, better retention of customers and increasing customer profitability.
- *Internal perspective* – are the internal processes effectively aligned to drive and deliver improved performance? Indicators here are operations management processes, customer management processes, innovation processes and regulatory and social processes.

*Learning and growth perspective* – does the organisation have the necessary human capital, technology and culture to drive the strategy? Indicators here are employee know-how, skills and commitment, information technology architecture and the climate of the organisation.

## Conclusion

Strategy in practice concerns who decides... what to do... why and how ... and when things need to change. Strategy is about being aware and being in control of this change agenda. Strategy is:

- *Knowing where the organisation is and how well it is performing*
- *Ensuring that employees know and support what the organisation stands for and where it is going*
- *Knowing how the organisation intends to follow this direction*
- *Ensuring that strategies and strategic ideas are implemented, while recognising that there is a constant need for vigilance and flexibility.*

Strategy is about what organisations do. It is about doing the right things in the right way and for the right reasons. (Thompson, Scott and Martin, 2014:598).

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