**7(a): Strategic Development (c.7, 7th edition, Johnson et al)**

The ability of an organisation to survive and successfully achieve its strategies depends on

 (1) it responds to the competing forces from the business environment (c.2);

 (2) its strategic capability (c.3) and

 (3) the cultural and political context (c.4)

These three pressures somehow create the three types of motives for an organisation to pursue some strategies to attain competitive advantage:

 (a) Environmental motives – fitting new strategies to a changing and challenging

 environment.

(b) Capability motives – stretching and exploiting its resources and competences.

(c) Expectations-based motives – meeting the expectations created by the cultural and

 political context.

These motives indicate:

(1) The development directions for strategy development.

(2) Methods used for strategic development in organisations.

(1) The development directions for strategy development

What are development directions?

They are the strategic options that are available to an organisation. (NB: Ansoff Matrix)

**Strategic Directions**

Igor Ansoff’s product-market framework provides the strategic directions. It is the most commonly used model for analysing the possible strategic directions that an organisation can follow.

 **Products**

 **Existing New**

 **Market penetration**  **Product development**

 **Existing** (increases market share) (new or improved products)

 (Consolidation)

 **Markets**

 **Market development Diversification**

 (new customers, new market (new products into new

 **New** segments or new countries markets)

 for existing products)

 The Ansoff Matrix Model

The matrix shows potential areas where core competences and generic strategies can be deployed. There are four broad alternatives:

1) Market penetration – increasing market share in existing markets by utilizing existing

 products.

* This may involve taking steps to enhance existing core competences or building new ones. Such competence development may be intended to improve service or quality so as to enhance the reputation of the organisation and differentiate it from its competitors.
* Equally competence development may be centred on improving efficiency so as to reduce costs below those of competitors.
* Mature or declining markets are more difficult to penetrate than those that are still in the growth phase. In the case of a declining market, the organisation may also consider the possibility of withdrawal so as to redeploy resources to more lucrative markets (a form of consolidation approach or strategy).
* When a business’s current market shows signs of saturation, it may wish to consider alternative directions for development (for example consolidation).

2) Market development – entering new markets and segments using existing products.

* Entering new markets is likely to be based upon leveraging existing competences but may also require the development of new competences.
* Entering new segments of existing markets may require the development of new competences that serve the particular need of customers in these segments.
* Internationalisation and globalization are commonly used examples of market development. It is likely that an organisation will need to build new competences when entering international markets to deal with linguistic, cultural, logistical and other potential problems.
* The major risk of market development is that it centres on entry to markets of which the business may have only limited experience.

3) Product development – developing new products to serve existing market.

* The intention is to attract new customers, retain existing ones and to increase market share.
* Providing new products will be based upon exploiting existing competences but may also require that new competences are built (such as in product research).
* Product development offers the advantage to a business of dealing with customer needs of which it has some experience because they are within its existing market.
* In a world of shortening product life cycles, product development has become an essential form of strategic development for many organisations.

4) Diversification – developing new products to serve new markets.

* It brings about business growth through new products and new markets.
* It is an appropriate option when current markets are saturated or when products are reaching the end of their life cycle.
* It can produce important synergies and can also help to spread risk by broadening the product and market portfolio.
* Diversification can take two main forms depending upon just how different the products and markets are to existing ones.
* Related diversification is said to have occurred when the products and/or markets share some degree of commonality with existing ones. This ‘closeness’ can reduce the risk of diversification. In practice, related diversification usually means growth into similar industries, or forward or backward in a business’s existing supply chain.
* Unrelated diversification is growth into product and market areas that are completely new and with which the business shares no commonality at all. It is sometimes referred to as conglomerate diversification.

**An adaptation of Ansoff Matrix (J & S, 7th edition, p.341)**

 **Products**

 **Existing New**

 **A B**

 **Protect/ build Product development**

 - Consolidation - With existing capabilities

 **Existing** - Market penetration - With new capabilities

 - Beyond current expectations

 **Markets C D**

 **Market development Diversification**

 **New** - New segments - With existing capabilities

 - New territories - With new capabilities

 - New uses - Beyond current

 - With new capabilities expectations

 - Beyond current expectations

**Ansoff Matrix** shows the different strategies that are available to an organisation in terms of products and market coverage taking into consideration of its strategic capability and the expectations of its stakeholders.

The development directions are represented in four different boxes in the matrix. In practice, a combination of development directions is usually pursued if organisations are to develop successfully in the future. E.g. the development into new markets usually requires some product changes too.

**A. Protect and build on current position in its current products and markets.**

The suggested strategic options are:

(a) Consolidation

(b) Market penetration.

(a) **Consolidation**

It is where organisations focus defensively on their current markets with current products.

It takes in two forms:

1. Defending market share – in the face of aggressive competitors who want to take more of the market share, the organisations defend their market shares by working very hard and by being creative to prevent the competitors from doing so. The defending organisations have to keep their market share in order to sustain the business in the long term. They spend more on R & D and use differentiation strategies to build their customer loyalty.

2. Downsizing or divestment – when the size of the market is declining, it is better to reduce the size of the business through closing capacity i.e. the production capacity. This is downsizing. In another way is to divest some activities i.e. selling some activities to other businesses.

The term ‘consolidation’ is so used to mean *the strategies of buying up rivals in a fragmented industry*. E.g. SABMiller acquiring the smaller beer producing companies in China, South Africa and in South America. By acquiring weaker competitors and closing capacity, the consolidating company can *gain market power and increase overall efficiency*. This form of consolidation is actually *increasing the market share*, and it is in fact a kind of *market penetration*. However, the motive here is essentially defensive.

However, both consolidation and market penetration strategies such as mergers and acquisitions are by no means the only strategies to be used, their limitations may force managers to consider other strategic directions such as joint-ventures, strategic alliances and internal development.

(Source: Johnson, Scholes & Whittington, 2008, p. 260)

Across several industries, the extent and international scope of consolidation points to the ***primary benefit being less competition***. The returns to less competition are not only monopoly profit. As British economist J. R. Hicks observed: “The best of all monopoly profits is a quiet life.” In recent time concentration has increased sharply in several mature sectors. In particular:

* The world cement industry has been transformed by mergers and acquisitions from a fragmented industry populated by local producers to one dominated by 4 global groups:

 Lafarge (France), Holcim (Switzerland), Cemex (Mexico) and Heidelberg (Germany).

* In oil and gas, a wave of mergers, triggered by BP’s merger with Amoco in 1997, has resulted in a small group of “supermajors” Exxon Mobil, Royal Dutch/Shell, BP-Amoco –Arco, Total-Fina-Elf, ChevronTexaco, and Conoco-Philips.
* In investment banking has become dominated by a small group of “bulge bracket” players led by Citigroup, Goldman Sachs, Morgan Stanley Dean Witter, Merrill Lynch and UBS.
* In aluminium the leading groups – Alcan (US), RusAl (Russia), Alcan (Canada), Norsk Hydro (Norway), and Pechiney (France) – seem posed for yet more consolidation.
* Consolidation in alcoholic drinks has resulted in distilled spirits consolidating around three leading players – Diageo, Pernod-Ricard and Allied Domecq – and the beer sector featuring 4 massive global players – Anheuser Busch, Interbrew, SAB Miller and Heineken.

(Source: Robert M. Grant, 2005, Contemporary Strategy Analysis, 5th edn., Blackwater Publishing , UK, pp. 512-513.) (Identify 6 benefits of consolidation from above passages.)

**What is consolidation and its importance or implications to organisations?**

Consolidation is an approach taken to protect and strengthen the position in the current markets with existing (current) products.

As the markets become more competitive with new entrants and improved performance of the competitors, the organisation in order to remain competitive has to consider and do much reshaping and innovation to its existing products and services. This means that the organisation has to depend on its resources and competences (capabilities, expertise, experiences, know-how and skills) to achieve successful new innovations in order to stay ahead of the competitors. This means the organisation has to consolidate its position. It may require the organisation to downsizing or withdrawal from some activities such as:

* There are products at the declining stage of their life cycles and can no longer compete profitably in the market.
* The value of the of the company’s products or assets are changing overtime and it may be better to sell them while they still have some value in a speculative market.

The product line is no longer attractive in the market because of newer technological development with more attractive cost of production.

* The company has serious competitive disadvantage e.g. cannot secure the resources or not able to reach the competitive level of the leaders in the market overall or the niches or segments of the market.
* Giving priority to certain activities. By downsizing or withdrawing of some activities enable resources to be made available for other activities to achieve competitive situation.
* The stakeholders may want the downsizing and withdrawing from the markets.

***On the other hand***, consolidation may be used to maintain market share in existing markets.

This is particularly important to companies with high market share. They have cumulative experience and have learnt to do activities more efficiently, develop core competences and gain competitive advantage.

These high share organisations have a number of advantages over their competitors. E.g. they have high asset turnovers, purchase/sales ratios and R & D/Sales ratios and attain economies of scale. With the ample financial resources they are able to sustain spending on R & D, and develop high priced quality products.

However, high market share and size are two different things. There are large firms which do not dominate the markets in which they operate e.g. Sainsbury in UK grocery retailing. There are also small firms that dominate market segments e.g. Dolby in sound systems or Pure digital in digital radios.

It is important to note that gaining and holding market share during the growth stage of the product life cycle is important since it may give advantage during the maturity stage.

(How is consolidation important to a business?)

**(b) Market Penetration** – **it is a strategy that is used to gain market share.**

If an organisation has the competences to improve its product quality or to sustain its innovation or to increase its marketing activities – these are means of achieving market penetration.

However for an organisation to achieve a policy of market penetration will depend on:

1. There is a growing market.

2. There is no issue on having resources needed for penetrating a market.

3. There is complacency of market leaders to allow the taking of market shares. E.g. Virgin’s

 extensions into airlines and financial sectors.

**B. Product Development in Existing Market**

Changes in the existing market demand for new products or services and as a consequence organisations are forced to come out with new products or modified existing products. The changes in the market provide opportunities for organisation to compete in the existing market and to maintain its marketing position, if not to become a market leader in the industry it is in. Sometimes the organisation may be able to do so with its existing capabilities (i.e. the knowledge, expertise and skill and core competences). For example:

1. Able to follow the changing needs of customers.
2. Able to come out with new products or modified existing products for those products with short life cycles.
3. Able to create new *critical success factors* (CSFs) when the existing ones are no longer able to provide the competitive advantage.

The development of new products may appear to be interesting and attractive but it may not meet the expectations and create dilemmas for organisations. For example:

1. The process to create a new product is risky, expensive and potentially unprofitable. There are many creative ideas but not many of them could not be innovated or serve useful purposes in the market. There is a need to have creative people but they are not easy to find even though they can be trained to develop the creative skills.
2. Organisations are forced to develop new products if they want to remain in the market. It becomes unacceptable not to develop new products. This is providing an opportunity for others to acquire the organisation.

**C. Market Development**

Market Development where there is a new market for the existing products – where there is a new market for the existing products. This is particularly fitting for an organisation that has the capability to produce and meet the need of new markets for the existing products. For example:

1. Where similar CSFs exist in the new markets for the existing products to be exploited (i.e. to take advantage of).
2. Where new uses for the existing products can be found.
3. Has the ***capability*** and ***financial*** means to bring about expansions of marketing the existing products to other geographical regions such as to go international as the new markets. A good example is the European brewing industry.

**D. Diversification**

This is a strategy that takes the organisation away from both its current markets and products. It goes for new markets and new products. Diversification can be of related or/and unrelated. It increases the diversity in terms of markets and products for the corporate centre or parent headquarters to hand. The strategy is at the corporate level involving strategies like global, multi-domestic or transnational.

Organisations are forced by circumstances in the home countries to go international for reasons such as looking for new markets to reach economies of scale because of saturation of home markets, looking for cheap and abundant supplies of resources and possibilities of getting better and new technology and expertise or where the governments of foreign countries encourage and provide good incentives and opportunities to invest in those countries.

The TOWS matrix below provides a complementary way of generating options basing on the internal strengths and weaknesses and the external opportunities and threats. Each box in the TOWS matrix identifies options that address a different combination of the internal factors and the external factors.

The TOWS Matrix

 **Internal factors**

 **Strengths (S) Weaknesses (W)**

 **SO strategic options WO Strategic options**

 Generate options here that use Generate options here that take

 **Opportunities (O)** strengths to take advantage of advantage of opportunities by

 opportunities overcoming weaknesses.

  **External**

 **factors** **ST Strategic options WT Strategic options**

 **Threats (T)** Generate options here that use Generate options here that

 strengths to avoid threats. minimise weaknesses and

 avoid threats

**Methods used for strategic development**

What is a strategic method?

A strategic method –it is the ***means*** by which any strategic direction will be pursued.

Available strategic methods:

1. Internal development – where strategies are developed by building on and developing an organisation’s own capabilities.
2. Mergers and Acquisitions
3. Strategic alliances – JV, Consortia, licensing, franchising, subcontracting, networks, opportunistic alliances.

 Types of Strategic Alliance

 **FORM OF RELATIONSHIP**

 ***Examples*  Loose (Market) Contractual Ownership**

- Networks - Licensing - Consortia

 **INFLUENCING FACTORS** - opportunistic - Franchising - Joint ventures

 alliances - Subcontracting

 **The Market**

* Speed of market change Fast change Slow change

 **Resources**

* Asset management Managerial separately Managed together

 by each partner

* Partner’s Asset Draw on ‘parent’s assets Dedicated assets for

 alliance

* Risk of losing assets High risk Low risk

to partner

 **Expectations**

* Spreading financial risk Maintains risk Dilute risk
* Political climate Unfavourable climate Favourable climate

***STRATEGIC EVALUATION (NB: L.13)***

How to judge whether a strategic option will be successful?

The following criteria are applied:

1. Suitability
2. Acceptability
3. Feasibility

 4. Validity – assumptions must be consistent with strategic options.

 5. Consistency – options achieve the objectives e.g. ROI achieved objective.

**1. Suitability**

It is concerned with whether a strategy addresses the ***circumstances*** in which an organisation is operating – strategic position. It involves the broad assessment of the extent new strategies would fit:

* the future trends (key drivers) and changes in the environment;
* exploit the strategic capability of an organisation; and
* meet the expectation of the stakeholders.
* cultural influences

Strategic directions and strategy methods are not concerned with the understanding of the directions and methods available but they provide reasons why each might be considered. See exhibit 1 and 2.

Exhibit 1: Suitability of strategic options in relation to strategic position

|  |  |  |  |
| --- | --- | --- | --- |
| Concept | Exhibit illustrations | Helps with understanding | Suitable strategies must address (examples) |
| PESTEL | lll.2.1 | Key environmental driversChanges in industry structures | Industry cyclesIndustry convergenceMajor environmental changes. |
| Scenarios | lll.2.2 | Extent of uncertainty/riskExtent to which strategicoptions are mutually exclusive | Need for contingency plans or ‘low-cost probes’ |
| Five-forces | Ex.2.2lll.2.3 | Industry attractivenessCompetitive forces | Reducing competitive intensityDevelopment of barriers tonew entrants. |
| Strategic groups | lll.2.5 | Attractiveness of groupsMobility barriersStrategic spaces | Need to reposition to a more attractive group or to an available strategic space |
| Core competencies | Exs. 3.1, 3.6, 3.8 | Industry threshold standards Bases of competitive advantage | Eliminating weaknessesExploiting strengths |
| Value chain | Exs 3.6, 3.7 | Opportunities for vertical integration or outsourcing | Extent of vertical integration or possible outsourcing |
| Stakeholder mapping | Ex. 4.5, lll.4.4a,b | Power and interest of stakeholders | Which strategic options are likely to address the interest of which stakeholders |
| Cultural web | Ex.5.7lll. 5.4 | The links between organisational culture and the current strategy | The strategic options most aligned with the prevailing culture |

Exhibit 2: Some examples of suitability

|  |  |
| --- | --- |
| Strategic option | Why this option might be suitable in terms of: |
| Environment | Capability | Stakeholder and/or cultural influences |
| Directions |  |  |  |
| Consolidation | Withdraw from declining marketsMaintain market share | Build on strengths through continued investment and innovation | Stick to what the organisation and its stakeholders know best |
| Market penetration | Gain market share for advantage | Exploit superior resources and competences |
| Product development | Exploit knowledge of customer needs | Exploit R & D | Minimise the risk of alienating stakeholders with interests in preserving the status quo or making counter cultural decisions |
| Market development | Gain market share for advantage | Exploit current products and capabilities |
| Diversification | Current markets saturated or declining | Exploit core competences in new arenas | Meet the needs of stakeholders with expectations for more rapid growthBut potential for culture clash  |
| Methods |  |  |  |
| Organic development | Partners or acquisitions not available or not suitable | Building on own capabilities Learning and competence development | Cultural /political ease |
| Merger/acquisition | SpeedSupply/demandP/E ratios | Acquire competencesScale economies | Returns: growth or share valueBut potential for culture clash |
| Joint development | SpeedIndustry normRequired for market entry | Complementary completenessLearning from partners | Dilutes risk Fashionable |

Evaluation tools for assessing suitability

* The TOWS matrix which is the SWOT analysis.
* The relative suitability of options that matters.
* The ranking strategic options
* Decision trees
* Scenarios

**2. Acceptability**

It is about the expected performance outcomes of a strategy and the extent to which these meet the expectations of stakeholders. See Exhibit 3, 8th edition, page371.

Exhibit 3: Some criteria for assessing the acceptability of strategic options

|  |  |  |  |
| --- | --- | --- | --- |
| Criteria | Used to understand | Examples | Limitations |
| **Return**ProfitabilityCost-benefitReal optionsShareholder value analysis (SVA) | Financial return onInvestments in major projectsWider costs/benefits(including intangibles)Sequence of decisionsImpact of new strategies on shareholder value | Return on capitalPayback periodDiscounted cash flow (DCF)Major infrastructure projectsReal options analysisMergers/acquisitionsAssessment of new ventures | Apply to discrete projects.Only tangible costs/benefitsDifficulties of quantificationQuantification Technical detail often difficult |
| **Risk**Financial ratioprojectionsSensitivity analysis | Robustness of strategyTest assumptions/robustness | Break-even analysisImpact on gearing and liquidity‘What if?’ analysis | Test factors separately |
| Stakeholder reactions | Political dimension of strategy | Stakeholder mapping | Largely qualitative |

**Returns**

Types of returns:

 1. Financial analysis

* Return on capital employed (ROCE)
* Estimating the payback period.
* Discounted cash flows (DCFs)

2. Cost-benefits

3. Real options

4. Shareholder value analysis

5. Risk

6. Financial ratios

7. Sensitivity analysis

3. **Feasibility**

It is concerned with whether an organisation has the resources and competencies to deliver a strategy.

Approaches to understand feasibility

* Financial feasibility - cash availability to implement the strategy.
* Resource deployment - resources and core competencies to attain CA.

Evaluation criteria: three qualifications

* Conflicting conclusions and management judgement
* Consistency between the different elements of a strategy
* Implementation and development of strategies (strategy-structure-culture fit)

Note

A strategy comprises of the broad competitive strategy (cost leadership strategy or differentiation strategy), the strategy direction (product development or market development) and the method of pursuing them (internal set-up, merger & acquisition or joint-venture/strategic alliance), these three elements need to be consistent with each other.

**4. Validity** – assumptions must be consistent with strategic options.

**5. Consistency** – options achieve the objectives e.g. ROI achieved objective.

(Refer to Johnson & Scholes 2005, chapter 10.3 for more detail.)

What are the 6 benefits of consolidation?

1. To gain market power.
2. To increase the overall efficiency.
3. To increase market share.
4. To achieve market penetration.
5. To act as a defensive mechanism.
6. To reduce competition.

Why is consolidation important to a business?

It is to protect and strengthen the business in the current market with the existing products.

This happens when the market in which the business operates has become very competitive due to the appearance of new entrants and improved performances of competitors. These developments forced the business to restructure or consolidate its position in the market.