Business Analysis Project

Session 7- Strategic Choices

Andre Samuel

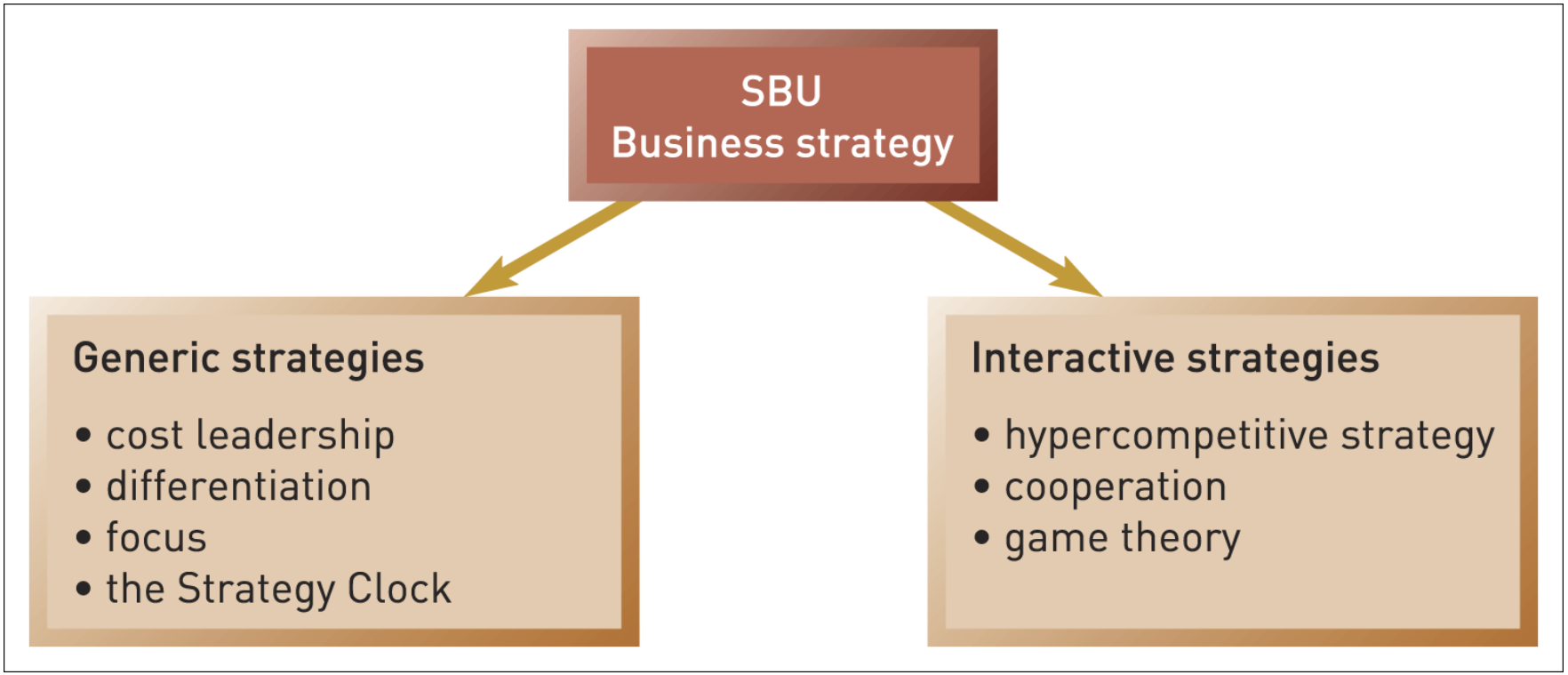
This Session

- Business Strategy
  - Generic strategies
  - Interactive strategies
- Corporate strategy and Diversification
- Mergers, Acquisitions and Alliances

Strategic Choices:

Business Strategy

Business strategy



Strategic business units (SBUs)

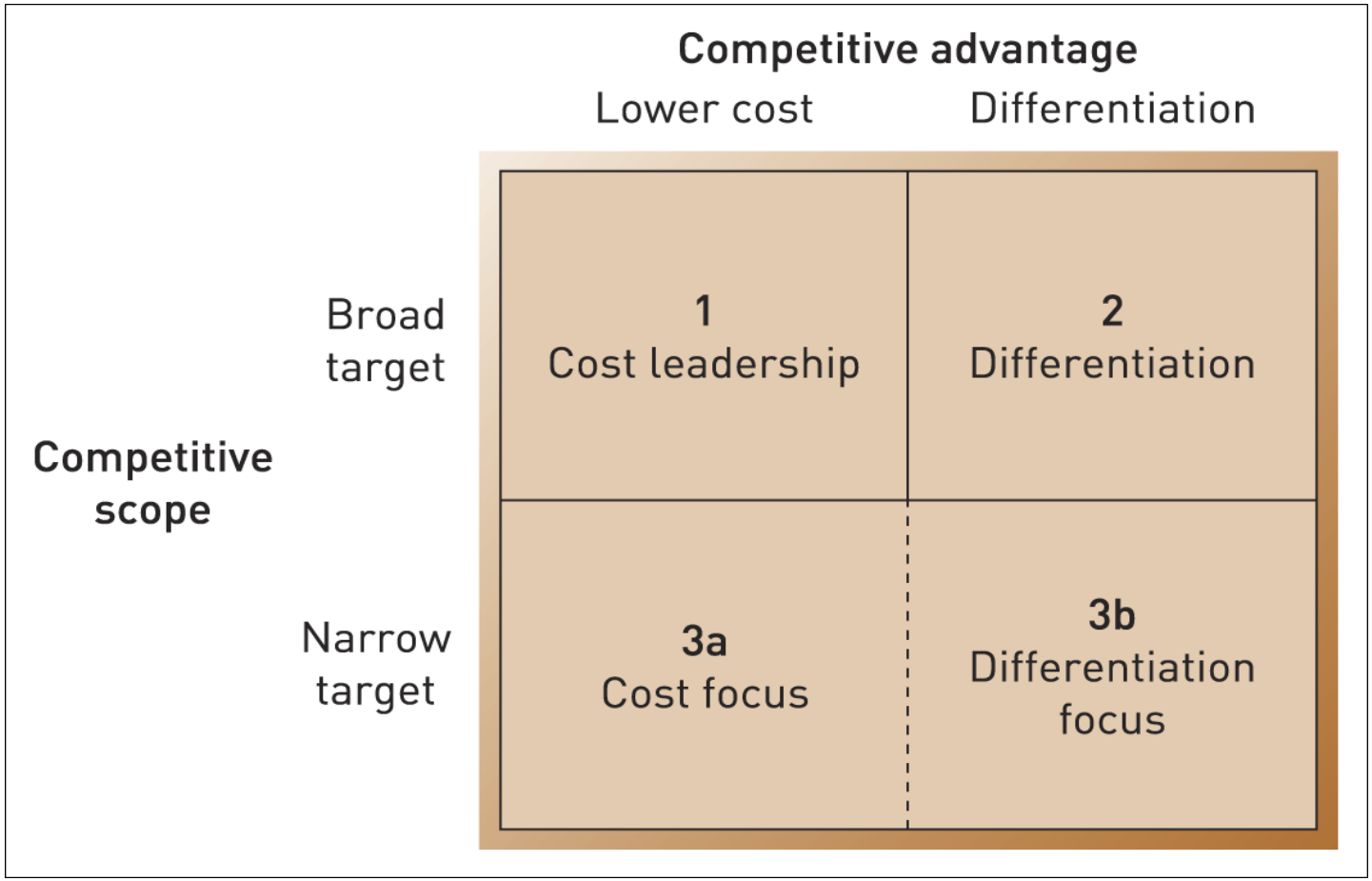
A strategic business unit (SBU) supplies goods or services for a distinct domain of activity.

- A small business has just one SBU.
- A large diversified corporation is made up of multiple businesses (SBUs).
- SBUs can be called ‘divisions’ or ‘profit centres’
- SBUs can be identified by:
  - Market based criteria (similar customers, channels and competitors).
  - Capability based criteria (similar strategic capabilities).

Generic strategies

- **Porter** introduced the term ***'Generic Strategy'*** to mean basic types of competitive strategy that hold across many kinds of business situations.
- ***Competitive strategy*** is concerned with how a strategic business unit achieves competitive advantage in its domain of activity.
- ***Competitive advantage*** is about how an SBU creates value for its users both greater than the costs of supplying them and superior to that of rival SBUs.

Three generic strategies



Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster, Inc., from *Competitive Advantage: Creating and Sustaining Superior Performance*
by Michael E. Porter.

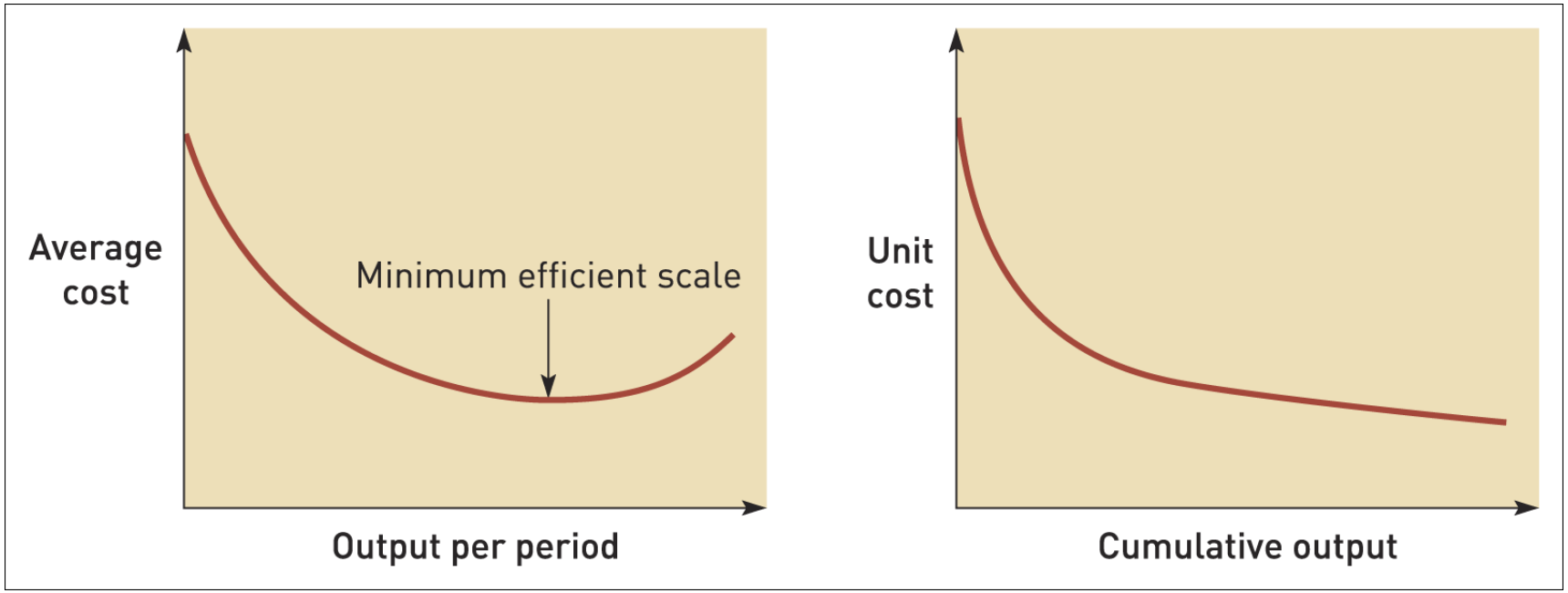
Cost-leadership

Cost-leadership strategy involves becoming the lowest-cost organisation in a domain of activity.

Four key cost drivers that can help deliver cost leadership:

- *Lower input costs.*
- *Economies of scale.*
- *Experience.*
- *Product process and design.*

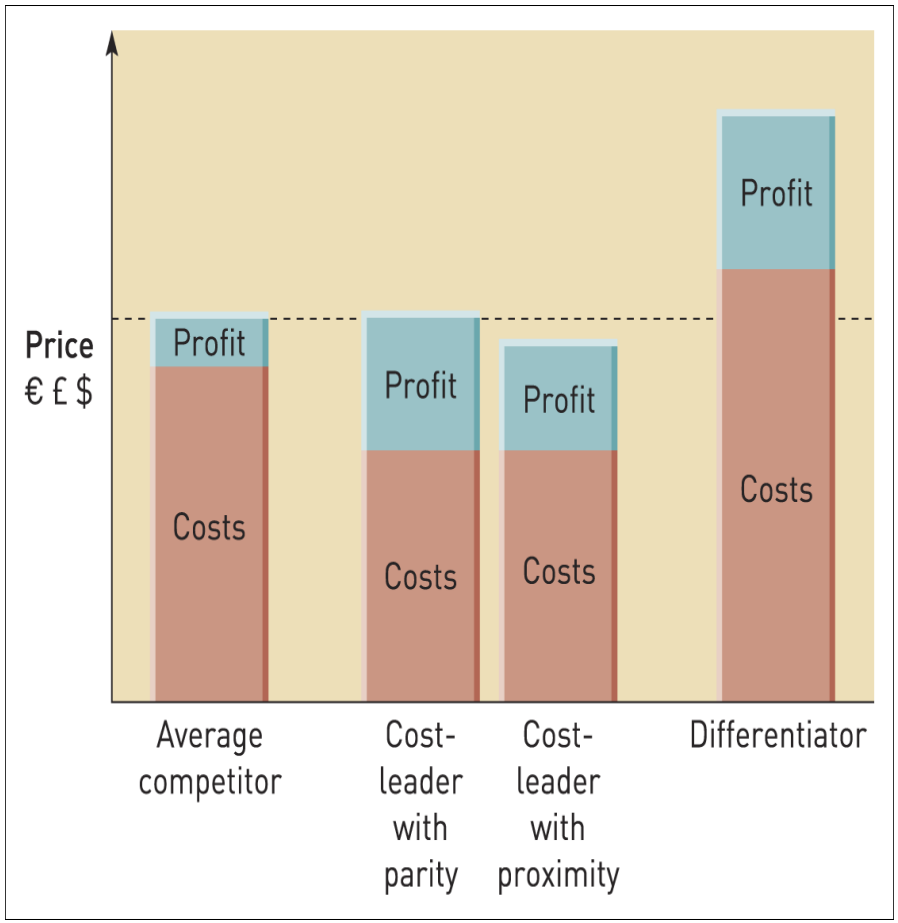
Economies of scale and the experience curve



Costs, prices and profits for generic strategies

Porter's 2 requirements:

1. Business cost structure needs to be *lowest cost*
2. *Low cost* should not be pursued in total disregard for quality
   1. *Parity- charge same price as competitors therefore more profit*
   2. *Proximity- lower price than similar competitor*



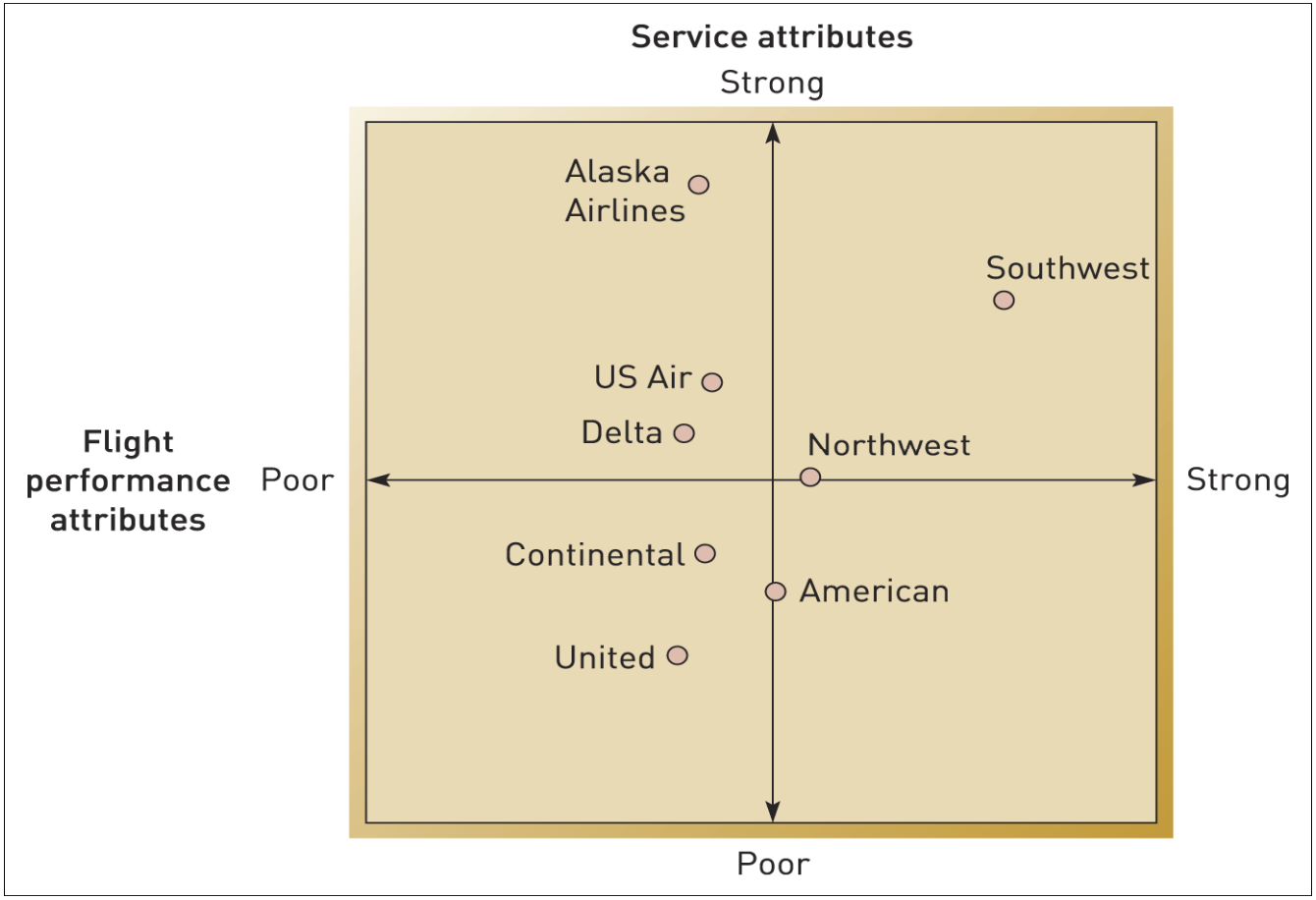
Differentiation strategies

Differentiation involves uniqueness along some dimension that is sufficiently valued by customers to allow a price premium.

Two key issues:

- The *strategic customer* on whose needs the differentiation is based.
- *Key competitors* – who are the rivals and who may *become* a rival.

Differentiation in the US airline industry



Mapping differentiation in the US airline industry

Source: Simplified from Figure 1, in D. Gursoy, M. Chen and H. Kim (2005), 'The US airlines relative positioning', *Tourism Management*, 26, 5, 57–67: p. 62

Focus strategies (1)

A focus strategy targets a narrow segment of domain of an activity and tailors its products or services to the needs of that specific segment to the exclusion of others.

Two types of focus strategy:

- *cost-focus strategy* (e.g. Ryanair).
- *differentiation focus strategy* (e.g. Ecover).

Focus strategies (2)

Successful focus strategies depend on at least one of three key factors:

- *Distinct segment needs.*
- *Distinct segment value chains.*
- *Viable segment economics.*

‘Stuck in the middle’?

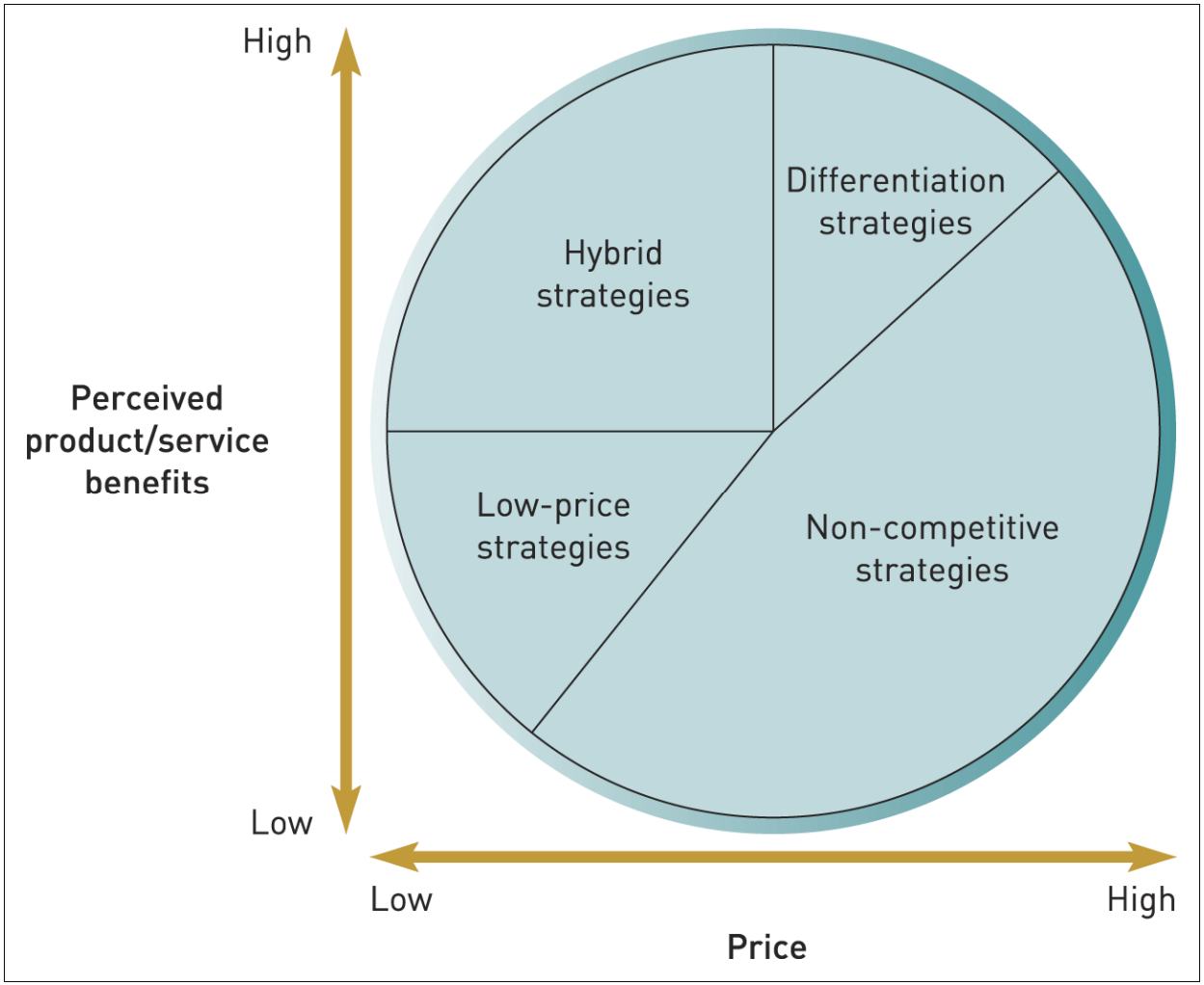
Porter’s argues:

- It is best to choose which generic strategy to adopt and then stick rigorously to it.
- Failure to do this leads to a danger of being *‘stuck in the middle’* i.e. doing no strategy well.
- The argument for pure generic strategies is controversial. Even Porter acknowledges that the strategies can be combined (e.g. if being unique costs nothing).

Combining generic strategies

- A company can create separate strategic business units each pursuing different generic strategies and with different cost structures.
- Technological or managerial innovations where both cost efficiency and quality are improved.
- Competitive failures – if rivals are similarly ‘stuck in the middle’ or if there is no significant competition then ‘middle’ strategies may be OK.

Strategy clock



The Strategy Clock

Source: Adapted from D. Faulkner and C. Bowman, *The Essence of Competitive Strategy*, Prentice Hall, 1995

Strategy clock - differentiation

- Strategies in this zone seeks to provide products that offer benefits that differ from those offered by competitors.
- A range of alternative strategies from:
  - *differentiation without price premium (12 o'clock) – used to increase market share.*
  - *differentiation with price premium (1 o'clock) – used to increase profit margins.*
  - *focused differentiation (2 o'clock) – used for customers that demand top quality and will pay a big premium.*

Strategy clock – low price

Low price combined with:

- *low perceived product benefits* focusing on price sensitive market segments – *a 'no frills' strategy* typified by low cost airlines like Ryanair.
- *lower price than competitors* while offering similar product benefits – aimed at increasing market share typified by Asda /Walmart in grocery retailing.

Strategy clock - hybrid

- Seeks to simultaneously achieve differentiation and low price relative to competitors.
- Hybrid strategies can be used:
  - *to enter markets and build position quickly.*
  - *as an aggressive attempt to win market share.*
  - *to build volume sales and gain from mass production.*

Strategy clock – non-competitive

- Increased prices without increasing service/product benefits.
- In competitive markets such strategies will be doomed to failure.
- Only feasible where there is strategic ‘lock-in’ or a near monopoly position.

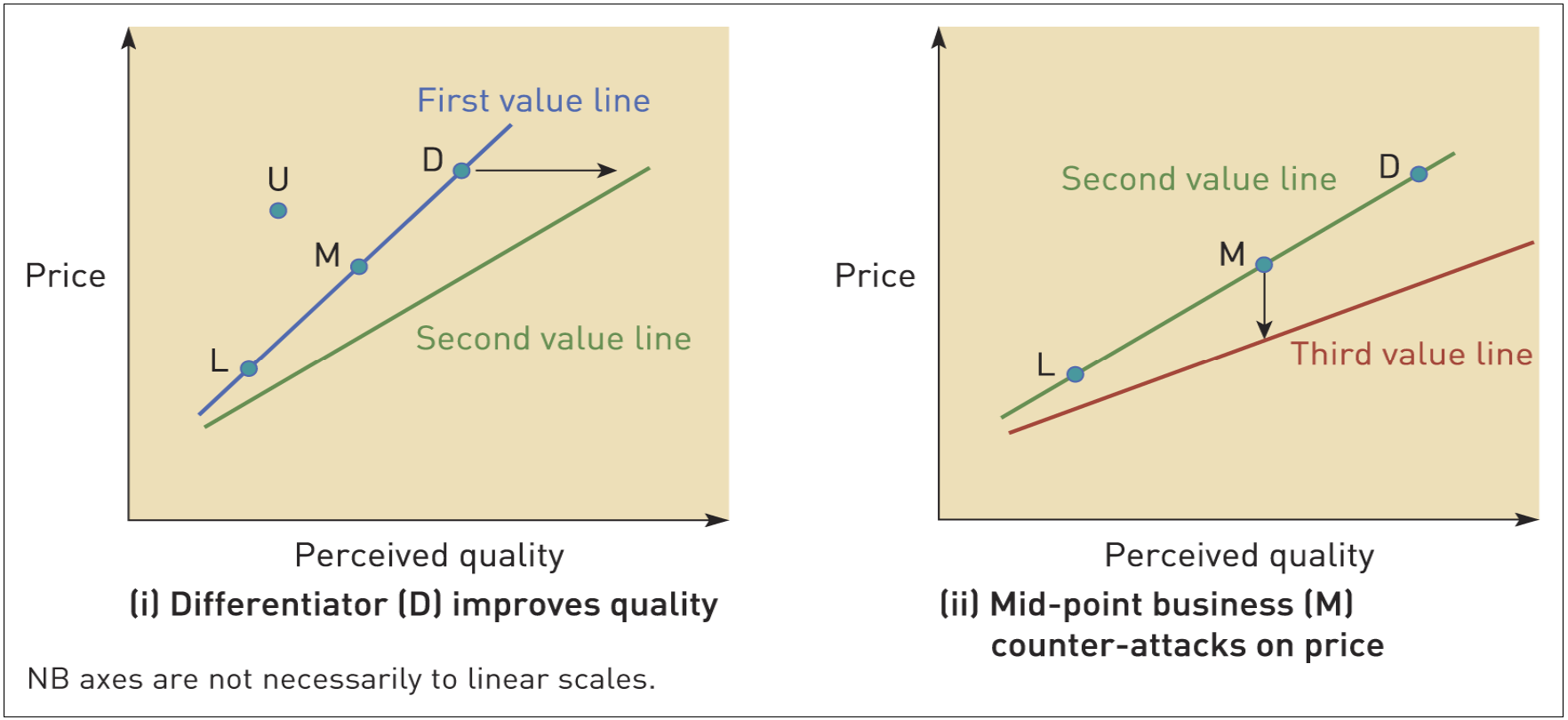
Strategic lock-in

- ***Strategic lock-in*** is where users become dependent on a supplier and are unable to use another supplier without substantial switching costs.
- Lock-in can be achieved in two main ways:
  - *Controlling complementary products or services.* E.g. Cheap razors that only work with one type of blade.
  - *Creating a proprietary industry standard.* E.g. Microsoft with its Windows operating system.

Hypercompetition

- ***Hypercompetition*** describes markets with continuous disequilibrium and change e.g. popular music or consumer electronics.
- Successful hypercompetition demands *speed and initiative* rather than defensiveness.

Interactive price and quality strategies

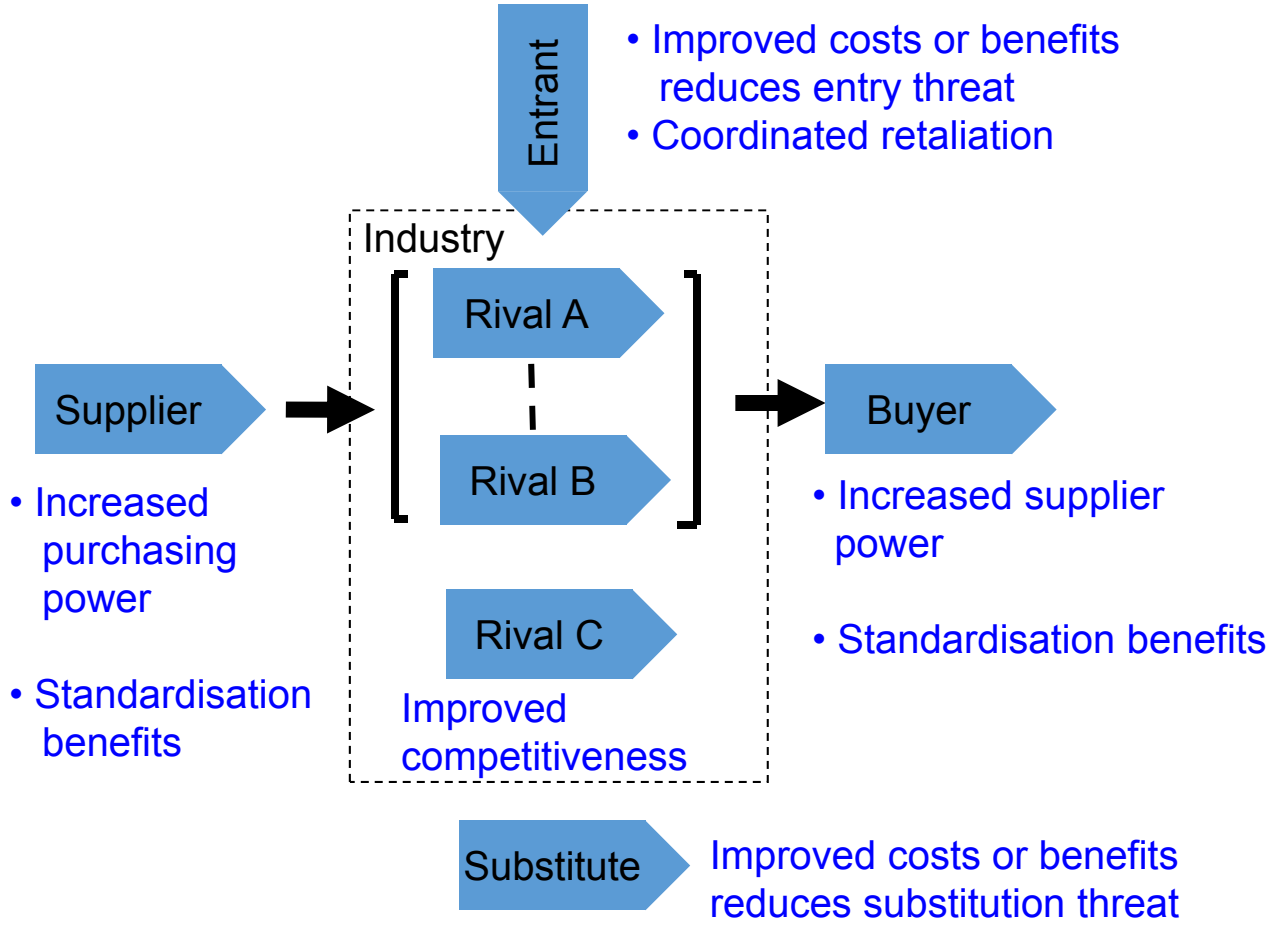


Interactive price and quality strategies

Interactive strategies in hypercompetition

- Four key principles:
  - *Cannibalise bases of success.*
  - *A series of small moves rather than big moves.*
  - *Be unpredictable.*
  - *Mislead the competition.*

Cooperating with rivals



Cooperating with rivals

Summary (Business Strategy)

- Business strategy is concerned with seeking *competitive advantage* in markets at the business rather than corporate level.
- Business strategy needs to be considered and defined in terms of *strategic business units (SBUs).*
- Different *generic strategies* can be defined in terms of cost-leadership, differentiation and focus.
- Managers need to consider how business strategies can be *sustained through strategic capabilities* and/or the ability to achieve a 'lock-in' position with buyers.

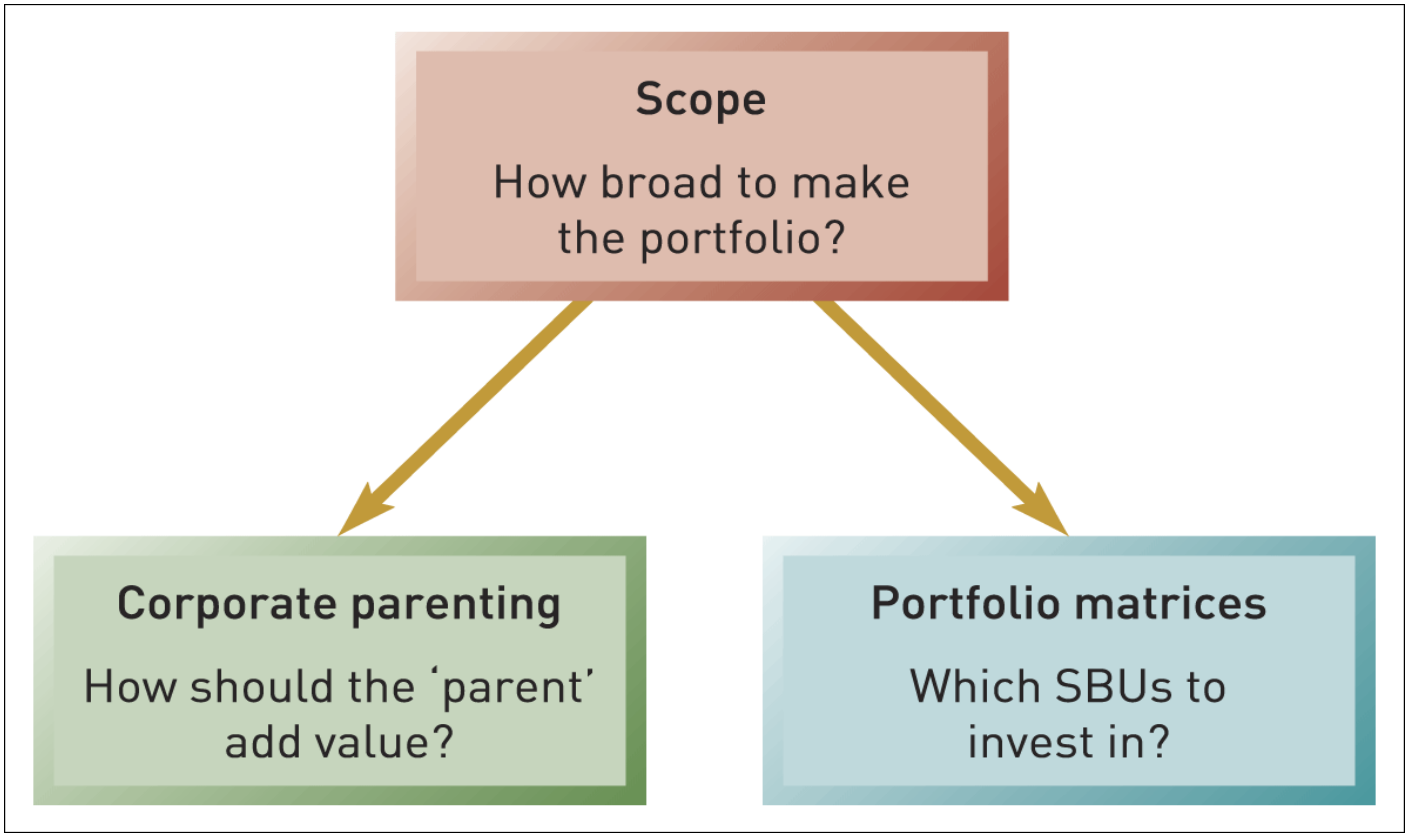
Summary (Business Strategy)

- *In hypercompetitive conditions* sustainable competitive advantage is difficult to achieve. Competitors need to be able to cannibalise, make small moves, be unpredictable and mislead their rivals.
- *Cooperative strategies* may offer alternatives to competitive strategies or may run in parallel.

Strategic Choices:

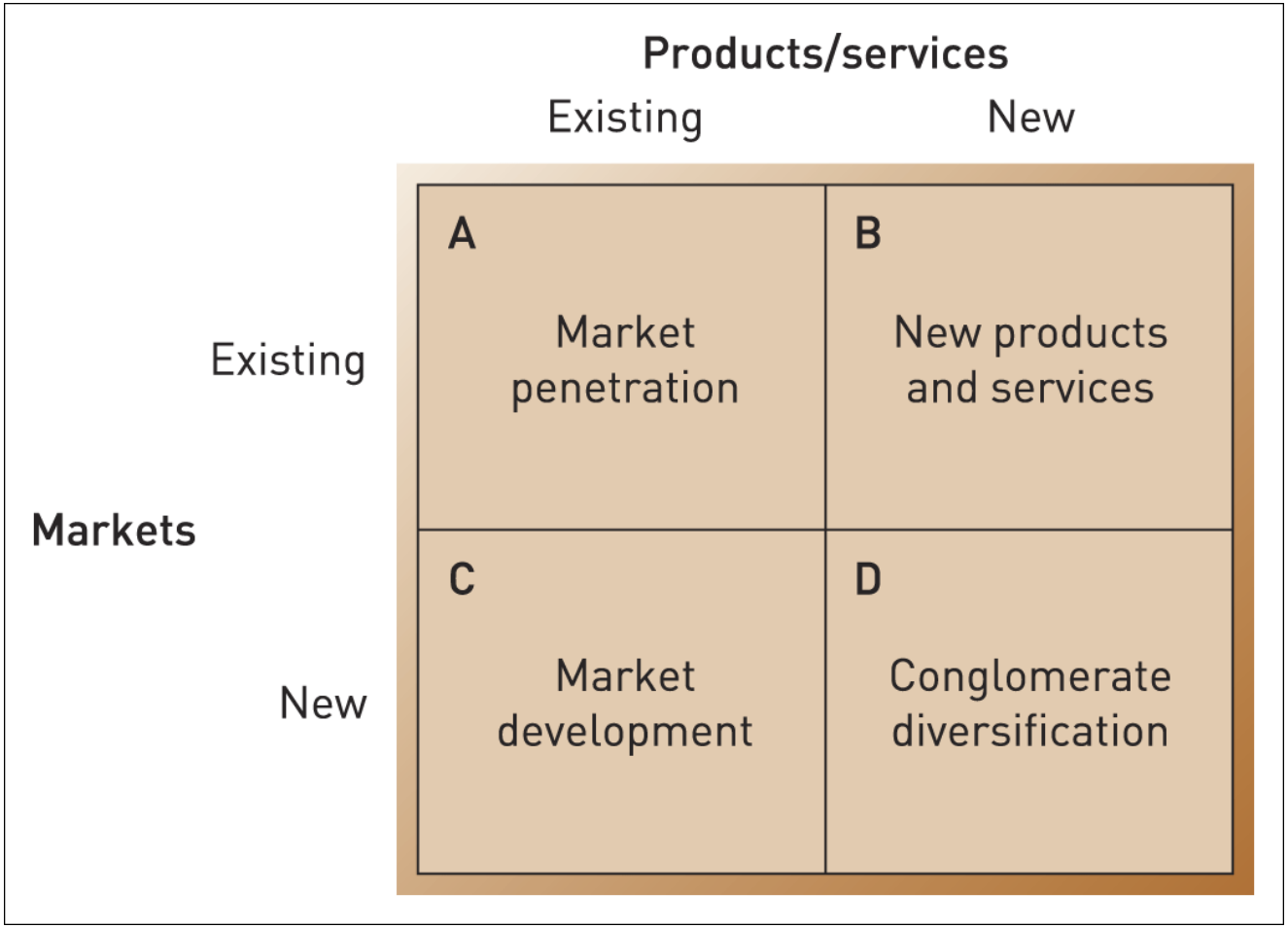
Corporate Strategy and Diversification

Strategic directions and corporate-level strategy



Strategic directions and corporate-level strategy

Corporate strategy directions



Corporate strategy directions

Source: Adapted from H.I. Ansoff, *Corporate Strategy*, Penguin, 1988, Chapter 6. Ansoff originally had a matrix with four separate boxes, but in practice strategic directions involve more continuous axes. The Ansoff matrix itself was later developed

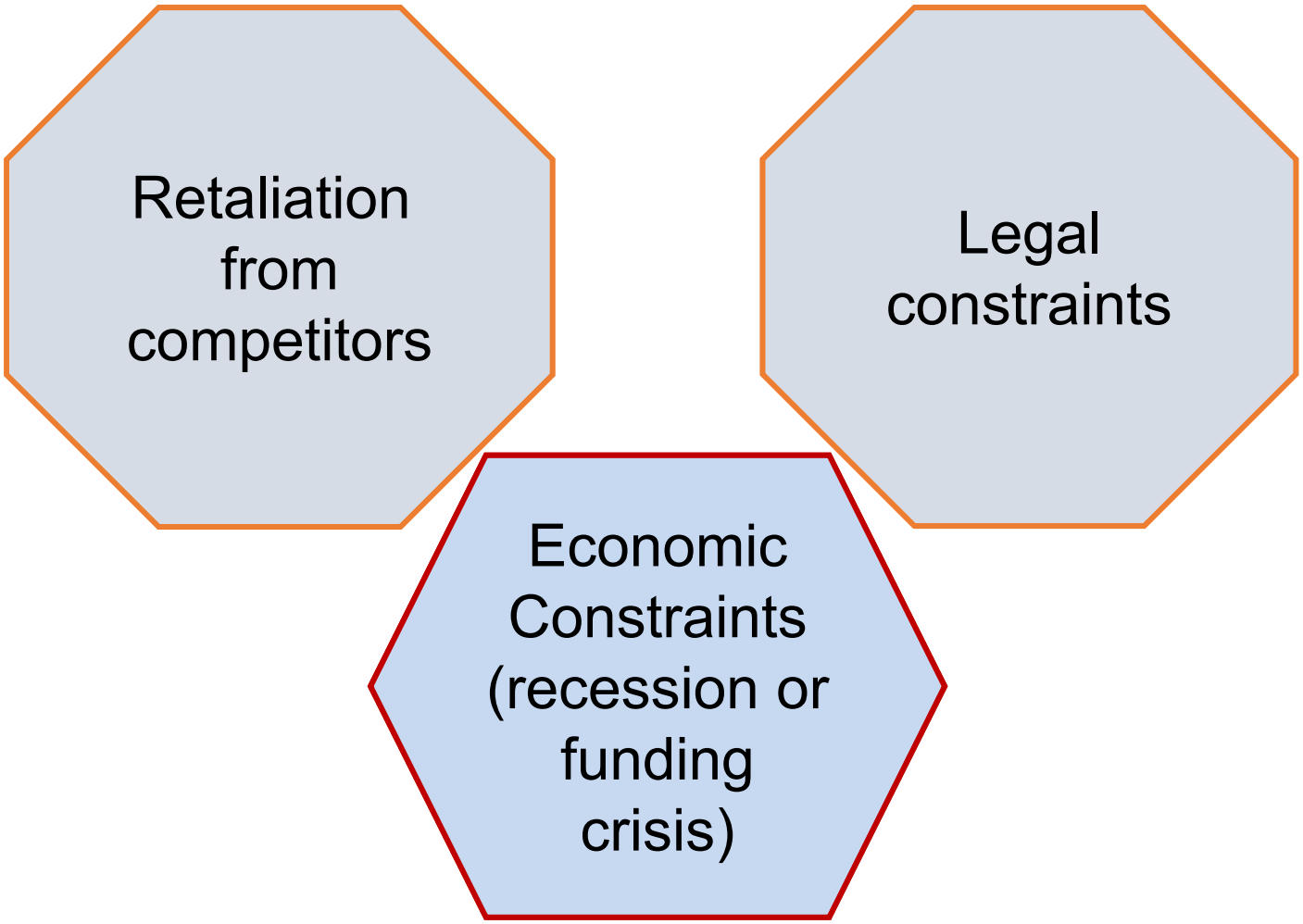
Market penetration

Market penetration refers to a strategy of increasing share of current markets with the current product range.

This strategy:

- *strategic capabilities; builds on established*
- *scope is unchanged; means the organisation's*
- *increased power; leads to greater market share and with buyers and suppliers;*
- *economies of scale; and provides greater and experience curve benefits.*

Constraints of market penetration



Consolidation & retrenchment

- ***Consolidation*** refers to a strategy by which an organisation focuses defensively on their current markets with current products.

- ***Retrenchment*** refers to a strategy of withdrawal from marginal activities in order to concentrate on the most valuable segments and products within their existing business.

Product development

Product development refers to a strategy by which an organisation delivers modified or new products to existing markets.

- This strategy :
  - *involves varying degrees of related diversification (in terms of products);*
  - *can be an expensive and high risk*
  - *may require new strategic capabilities*
  - *typically involves project management risks.*

Market development (1)

Market development refers to a strategy by which an organisation offers existing products to new markets

Market development (2)

This strategy involves varying degrees of related diversification (in terms of markets) it;

- *may also entail some product development (e.g. new styling or packaging);*
- *can take the form of attracting new users (e.g. extending the use of aluminium to the automobile industry);*
- *can take the form of new geographies (e.g. extending the market covered to new areas – international markets being the most important);*
- *must meet the critical success factors of the new market if it is to succeed;*
- *may require new strategic capabilities especially in marketing.*

Diversification

- ***Diversification*** involves increasing the range of products or markets served by an organisation.
- ***Related diversification*** involves diversifying into products or services with relationships to the existing business.
- ***Conglomerate (unrelated) diversification*** involves diversifying into products or services with no relationships to the existing businesses.

Conglomerate diversification

Conglomerate (or unrelated) diversification takes the organisation beyond both its existing markets and its existing products and radically increases the organisation's scope.

Drivers for diversification

- Exploiting *economies of scope* – efficiency gains through applying the organisation's existing resources or competences to new markets or services.
- Stretching *corporate management competences.*
- Exploiting *superior internal processes*.
- Increasing *market power*.

Value-destroying diversification drivers

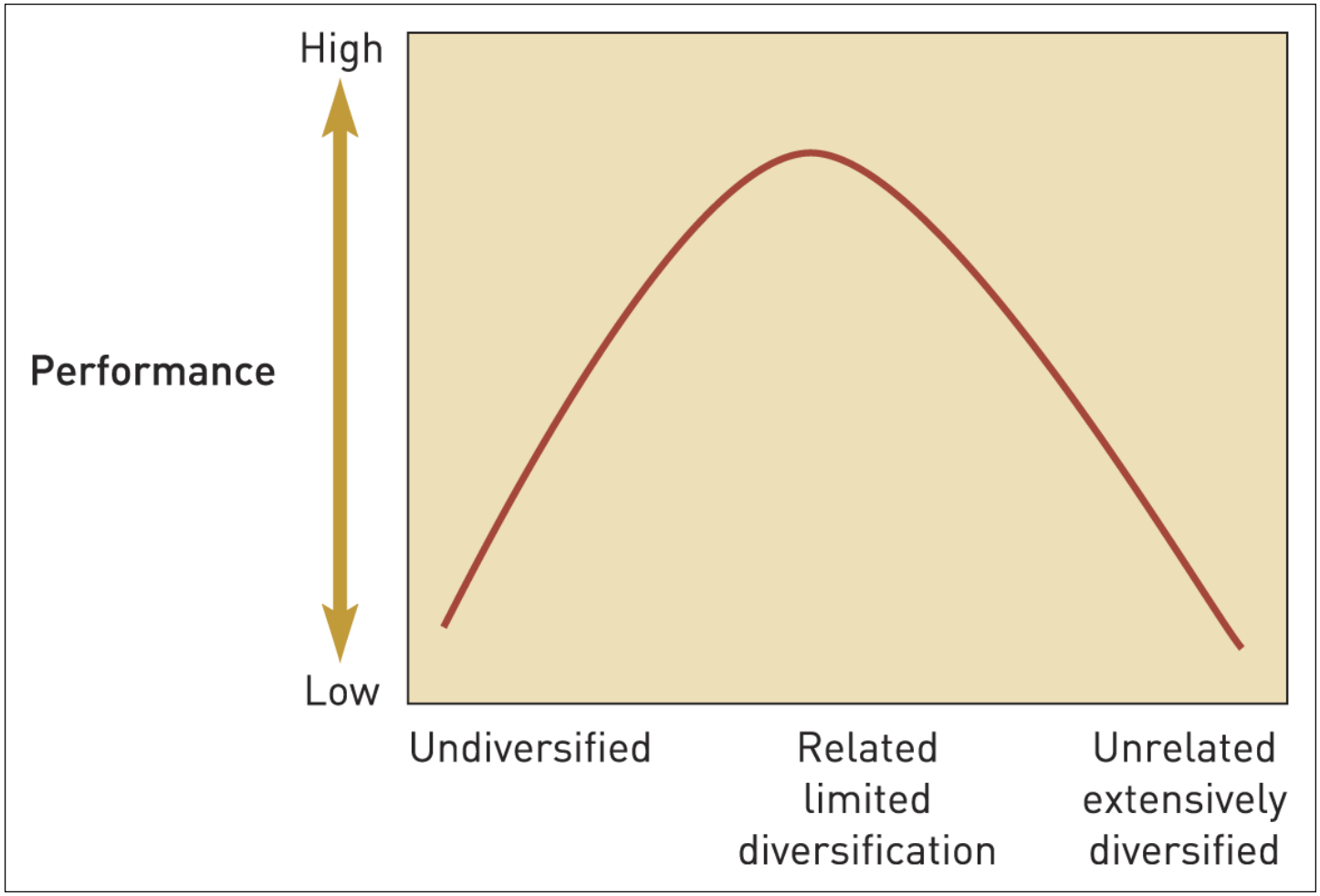
Some drivers for diversification which may involve value destruction (negative synergies):

- *Responding to market decline,*
- *Spreading risk and*

N.B. Despite these being common justifications for diversifying, finance theory suggests these are misguided.

- *Managerial ambition.*

Diversification and performance

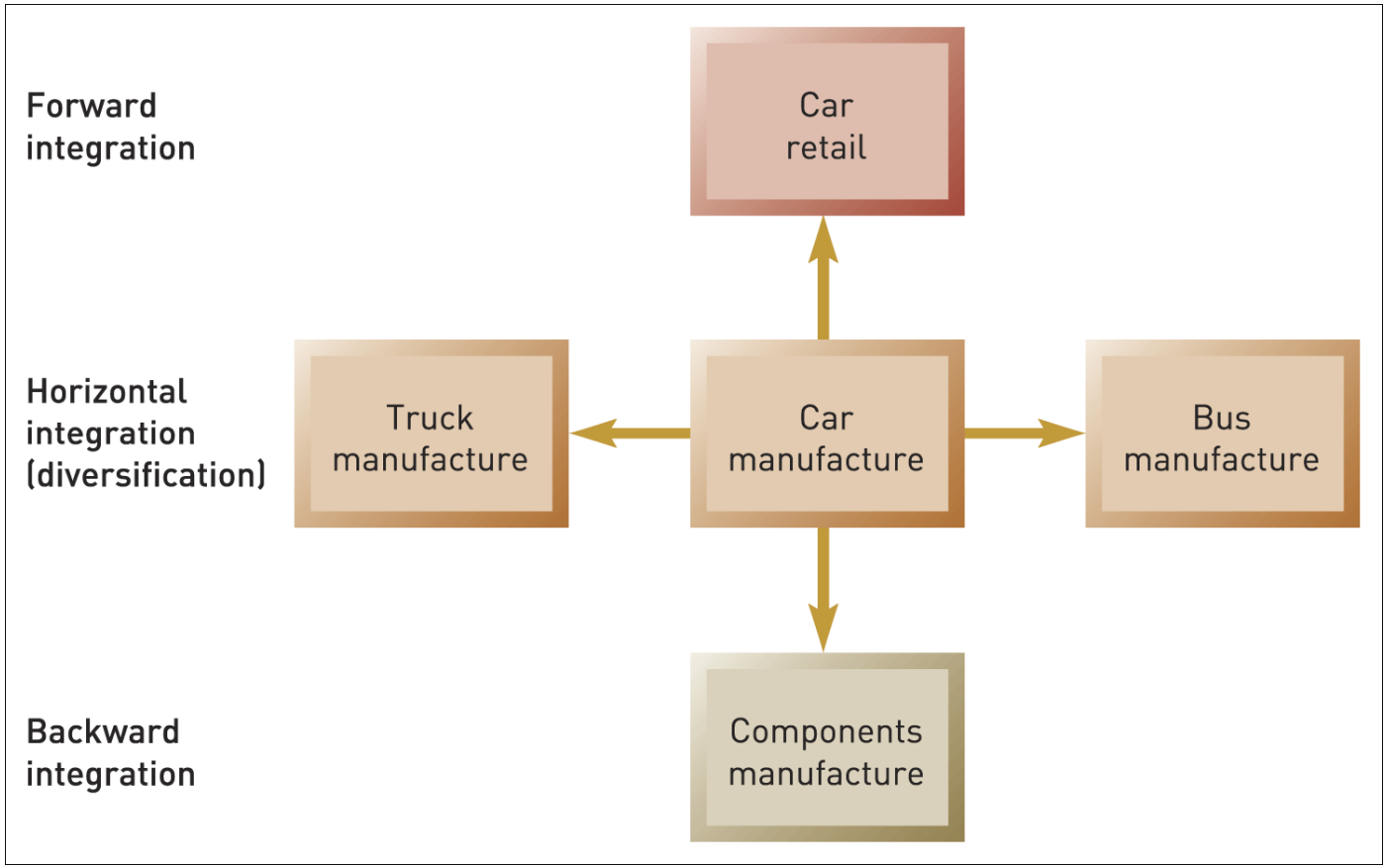


Diversity and performance

Vertical integration

- ***Vertical integration*** describes entering activities where the organisation is its **own supplier or customer.**
  - ***Backward integration*** refers to development into activities concerned with the inputs into the company's current business.
  - ***Forward integration*** refers to development into activities concerned with the outputs of a company's current business.

Diversification and integration options



Diversification and integration options: car manufacturer example

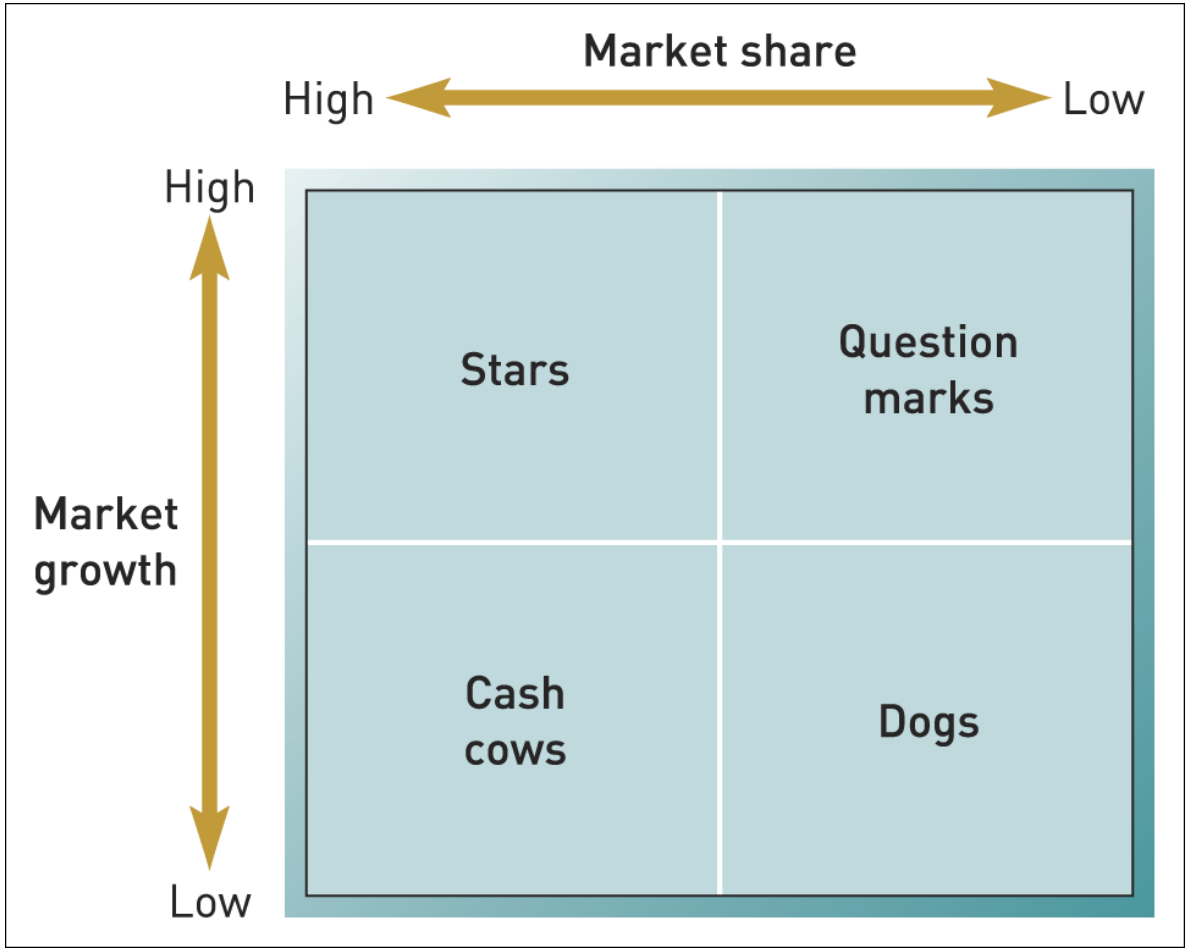
Portfolio matrices

Growth/Share (BCG) Matrix

Directional Policy (GE-McKinsey) Matrix

Parenting Matrix

The growth share (or BCG) matrix (1)



The growth share (or BCG) matrix

The growth share (or BCG) matrix (2)

- ***A star*** is a business unit which has a high market share in a growing market.
- ***A question mark (or problem child)*** is a business unit in a growing market, but it does not have a high market share.
- ***A cash cow*** is a business unit that has a high market share in a mature market.
- ***A dog*** is a business unit that has a low market share in a static or declining market.

The directional policy (GE–McKinsey) Matrix (1)

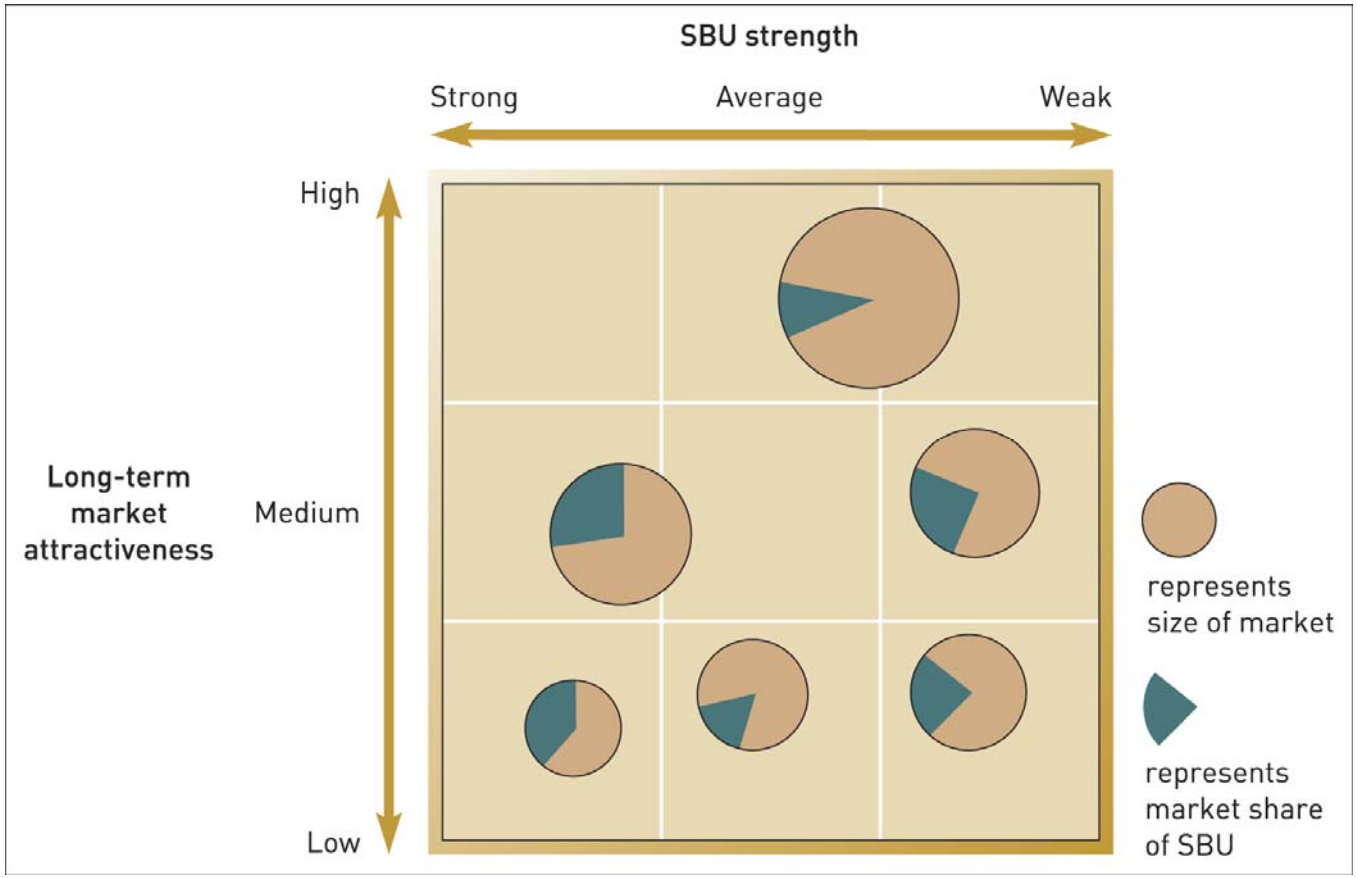


Figure 7.7 Directional policy (GE–McKinsey) matrix

The directional policy (GE–McKinsey) matrix (2)

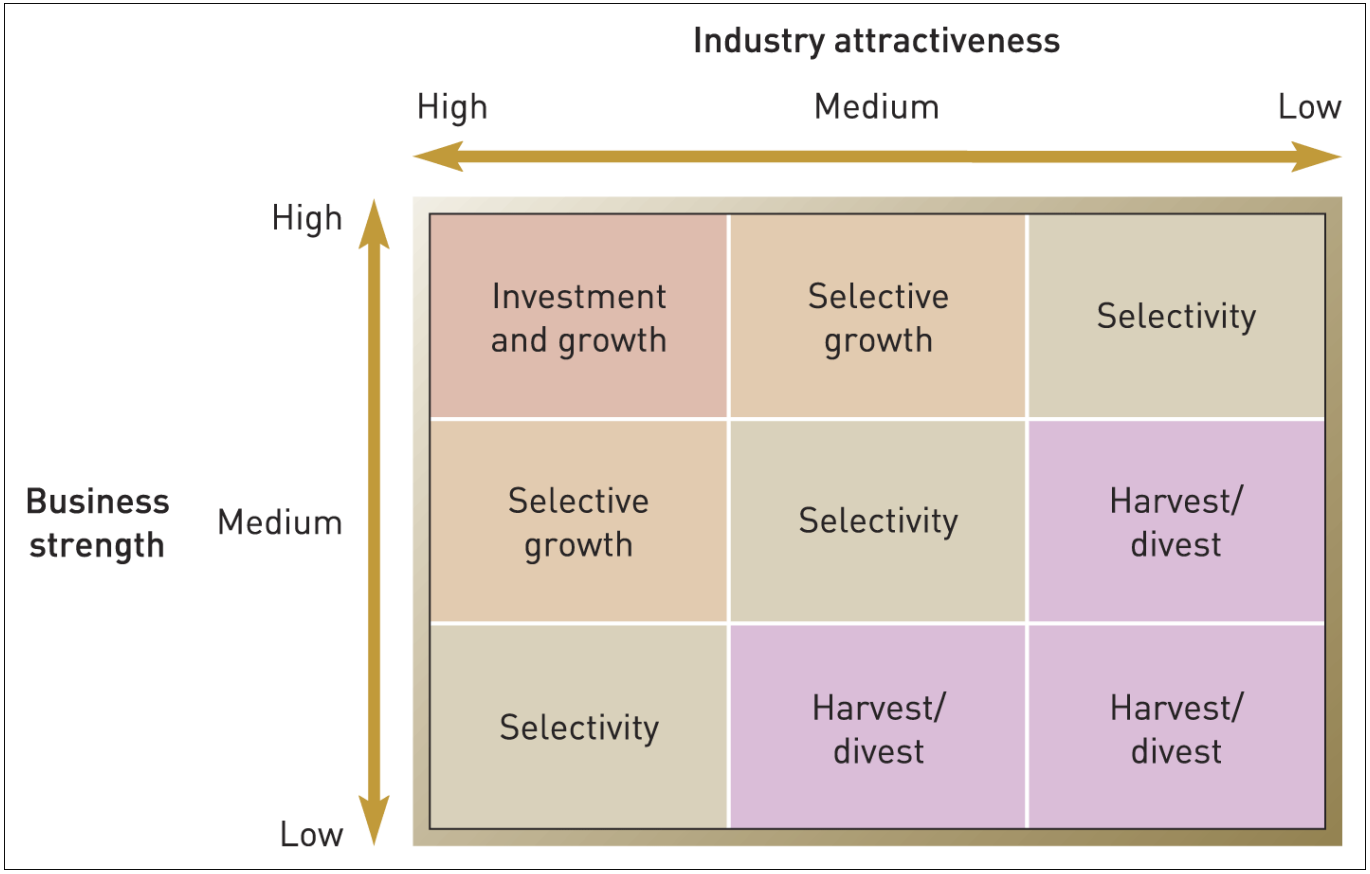


Figure 7.8 Strategy guidelines based on the directional policy matrix

Summary (Corporate Stratgey)

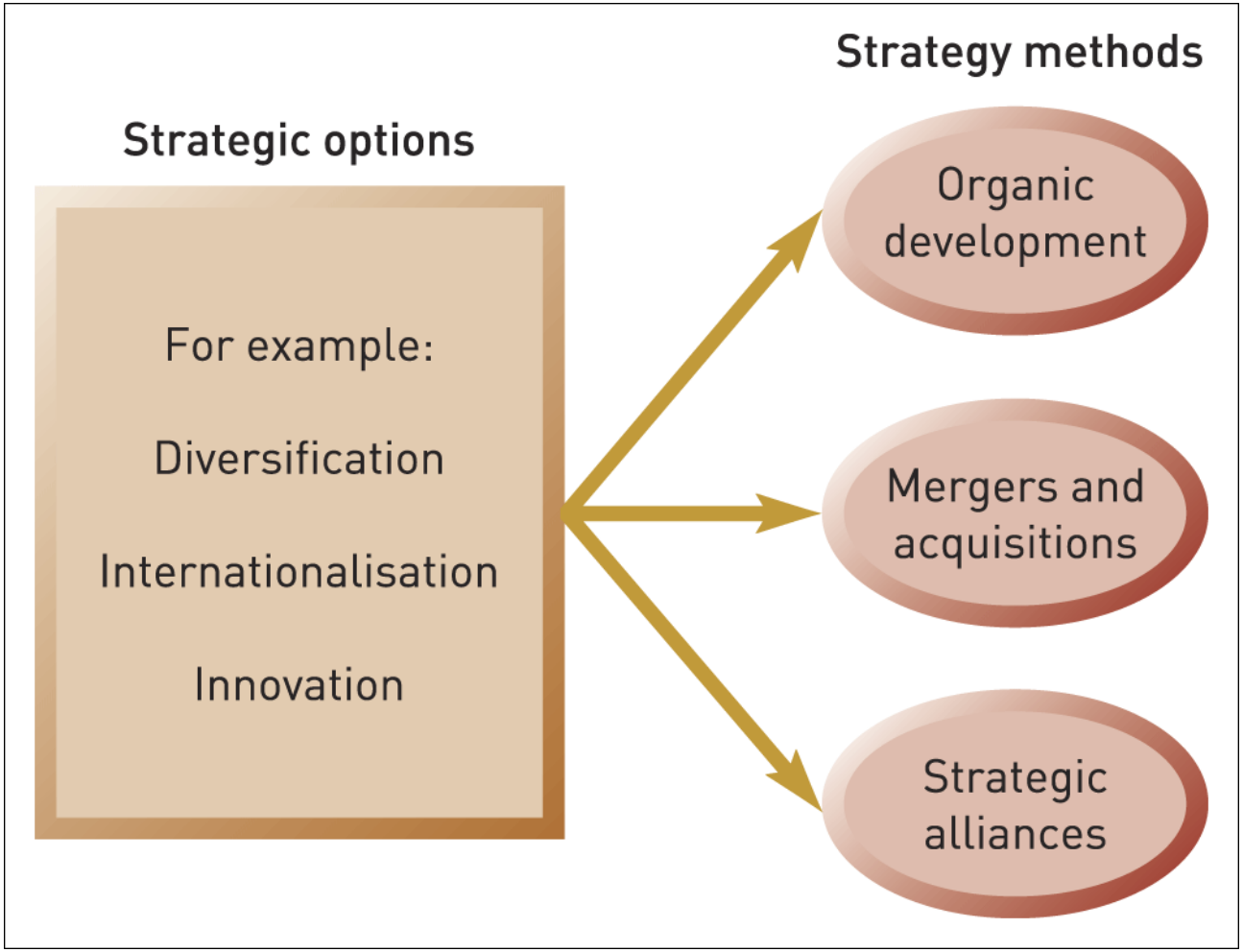
- Many corporations comprise several, sometimes many *business units*. Decisions and activities above the level of business units are the concern of what in this chapter is called the *corporate parent.*
- Organisational scope is considered in terms of *related and unrelated diversification*.
- Corporate parents may seek to add value by adopting different parenting roles: *the portfolio manager, the synergy manager*

Summary (Corporate Strategy)

- There are several *portfolio models* to help corporate parents manage their businesses, of which the most common are: *the BCG matrix, the directional policy matrix*
- *Divestment and outsourcing* should be considered as well as diversification, particularly in the light of relative strategic capabilities and the transaction costs of opportunism.

Strategic Choices
Mergers, Acquisitions and Alliances

Strategy methods



Three strategy methods

Organic development

Organic development is where a strategy is pursued by building on and developing an organisation's own capabilities. This is essentially the 'do it yourself' method.

Advantages of organic development

- *Knowledge and learning* can be enhanced.
- *Spreading investment over time* – easier to finance.
- *No availability constraints* – no need to search for suitable partners or acquisition targets.
- *Strategic independence* – less need to make compromises or accept strategic constraints.

Corporate entrepreneurship

Corporate entrepreneurship refers to radical change in the organisation's business, driven principally by the organisation's own capabilities.

For example, *Amazon's* development of *Kindle* using its own in house development .

Mergers and acquisitions

- ***A merger*** is the combination of two previously separate organisations, typically as more or less equal partners.

- ***An acquisition*** involves one firm taking over the ownership (‘equity’) of another, hence the alternative term ‘takeover’.

Strategic motives for M&A

Strategic motives can be categorised in three ways:

- *Extension – of scope in terms of geography, products or markets.*
- *Consolidation – increasing scale, efficiency and market power.*
- *Capabilities – enhancing technological know-how (or other competences).*

Financial motives for M&A

There are three main financial motives:

- *Financial efficiency* – a company with a strong balance sheet (cash rich) may acquire/merge with a company with a weak balance sheet (high debt).
- *Tax efficiency* – reducing the combined tax burden.
- *Asset stripping or unbundling – selling off bits of the acquired company to maximise asset values.*

Managerial motives for M&A

M&A may serve managerial self-interest for two reasons:

- *Personal ambition* – financial incentives tied to short-term growth or share-price targets; boosting personal reputations; giving friends and colleagues greater responsibility or better jobs.
- *Bandwagon effects* – managers may be branded as conservative if they don't follow a M&A trend; shareholder pressure to merge or acquire; the company may itself become a takeover target.

Target choice in M&A

Two main criteria apply:

- *Strategic fit – does* the target firm strengthen or complement the acquiring firm's strategy? (N.B. It is easy to over-estimate this potential synergy).
- *Organisational fit –* is there a match between the management practices, cultural practices and staff characteristics of the target and the acquiring firm?

Valuation in M&A

Getting the offer price correct is essential:

- Offer the target too little, and the bid will be unsuccessful.
- Pay too much and the acquisition is unlikely to make a profit net of the original acquisition price. (‘*the winner’s curse’).*
- Acquirers do not simply pay the current market value of the target, but also pay a ‘*premium for control’.*

Strategic alliances

- ***A strategic alliance*** is where two or more organisations share resources and activities to pursue a strategy.
- ***Collective strategy*** is about how the whole network of alliances of which an organisation is a member competes against rival networks of alliances.
- ***Collaborative advantage*** is about managing alliances better than competitors.

Types of strategic alliance

There are two main kinds of ownership in strategic alliances:

- ***Equity alliances*** involve the creation of a new entity that is owned separately by the partners involved.
- ***Non-equity alliances*** are typically looser, without the commitment implied by ownership.

Equity alliances

- The most common form of equity alliance is the ***joint venture***, where two organisations remain independent but set up a new organisation jointly owned by the parents.
- **A *consortium alliance*** involves several partners setting up a venture together.

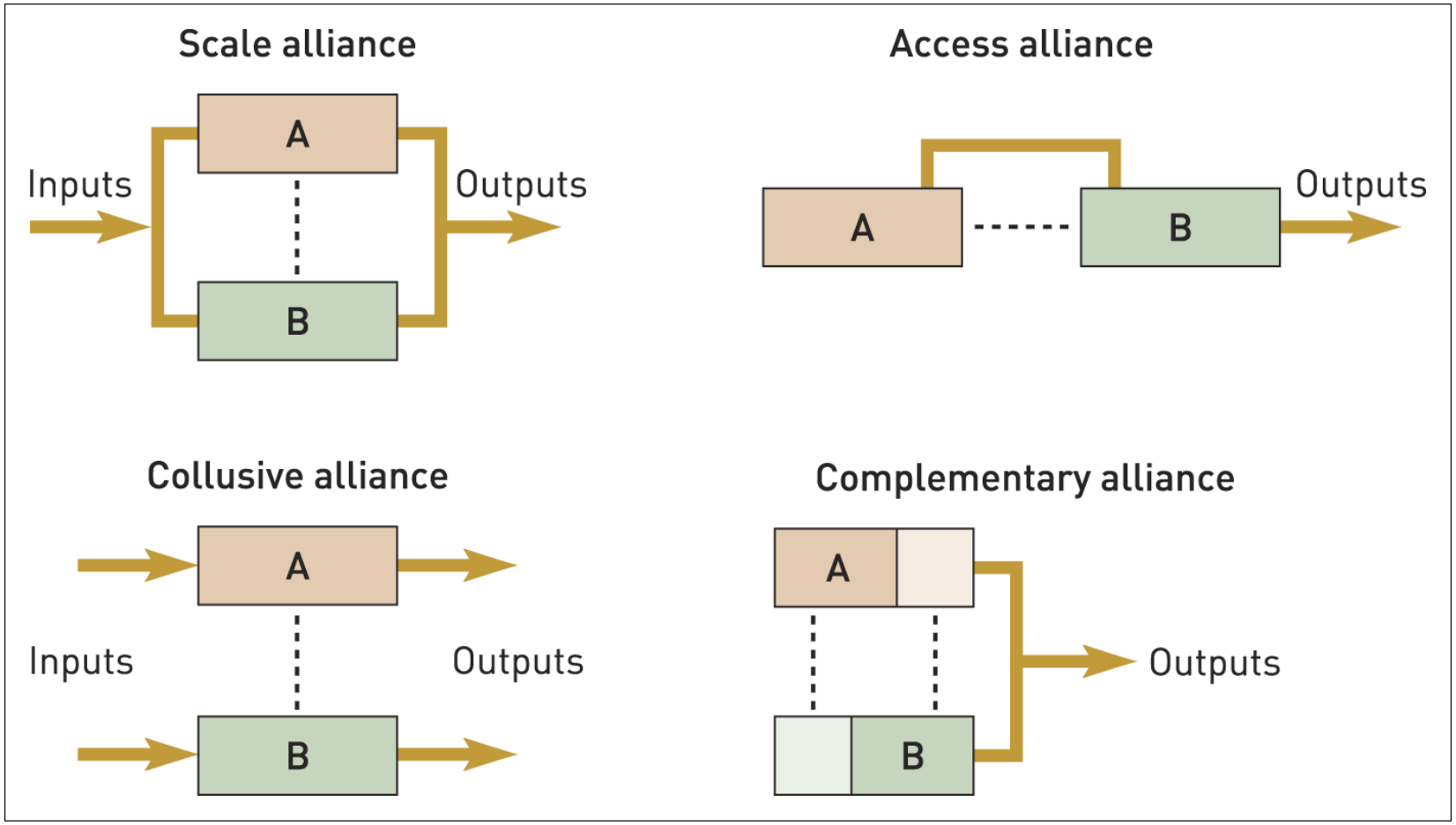
Non-equity alliances

- Non-equity alliances are often based on contracts.
- Three common forms of non-equity alliance:
  - *Franchising.*
  - *Licensing.*
  - *Long-term subcontracting.*

Motives for alliances

- ***Scale alliances*** – lower costs, more bargaining power and sharing risks.
- ***Access alliances*** – partners provide needed capabilities (e.g. distribution outlets or licenses to brands)
- ***Complementary alliances –*** bringing together complementary strengths to offset the other partner's weaknesses.
- ***Collusive alliances –*** to increase market power. Usually kept secret to evade competition regulations.

Strategic alliance motives



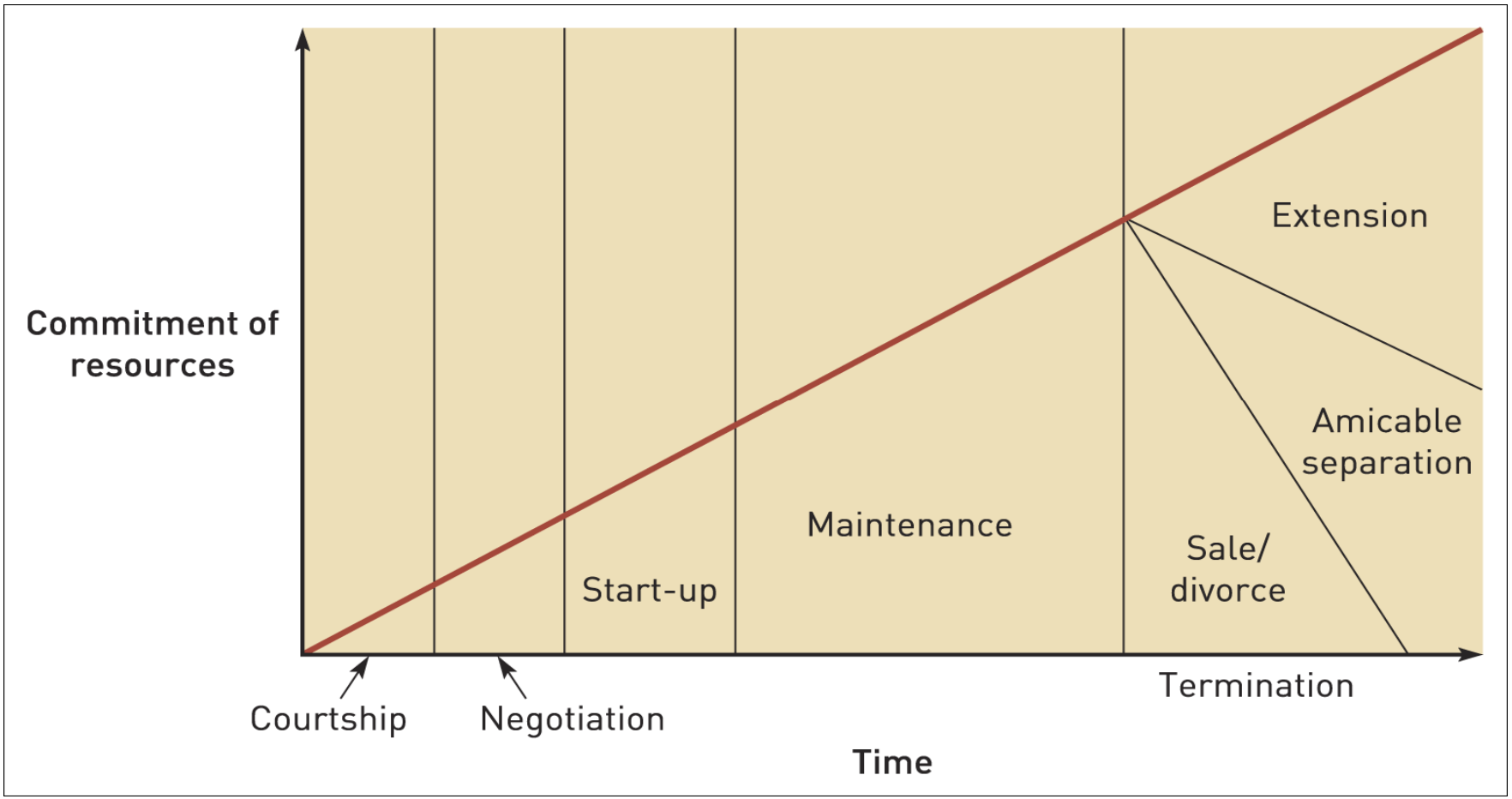
Strategic alliance motives

Strategic alliance processes

Two themes are vital to success in alliances:

- ***Co-evolution*** – the need for flexibility and change as the environment, competition and strategies of the partners evolve.
- ***Trust*** – partners need to behave in a trustworthy fashion throughout the alliance.

Alliance evolution



Alliance evolution

Source: Adapted from E. Murray and J. Mahon (1993), 'Strategic alliances: gateway to the new Europe', *Long Range Planning*, vol. 26, p. 109. www.sciencedirect.com/science/journal

Key success factors

	M&A	Alliances
Similar	Strategic fit Organisational fit Valuation	Strategic fit Organisational fit Valuation
Different	Hostile option Integration Divesture	Courtship Co-evolution Termination

Key success factors in mergers, acquisitions and alliances

Summary (Strategy Methods)

- There are three broad *methods for pursuing strategy*: mergers and acquisitions, strategic alliances and organic development.
- *Organic development* can be either continuous or radical. Radical organic development is termed corporate entrepreneurship.
- *Acquisitions* can be hostile or friendly. Motives for mergers and acquisitions can be strategic, financial or managerial.

Summary (Strategy Methods)

- *The acquisition process* includes target choice, valuation and integration.
- *Strategic alliances* can be equity or non-equity. Key motives for strategic alliances include scale, access, complementarity and collusion.
- *The strategic alliance process* relies on co-evolution and trust.
- The *choice* between acquisition, alliance and organic methods is influenced by four key factors: urgency, uncertainty, type of capabilities and modularity of capabilities.