



Global Corporate Strategy

**Martin Testa
MBA Program
Maastricht School of Management**

MSM

MBA Master of Business Administration Programme
Subject Outline Form
MBA Outreach

Subject : Global Corporate Strategy
Lecturer : Martin Testa

TOPICS	READINGS	CASES, EXERCISES
Topic 1 Strategic Thinking & Purpose	<ul style="list-style-type: none">-Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook- <i>Overview of Strategic Thinking Process</i>, Article- <i>Hierarchical Levels of Strategy</i>, Article- <i>Vision & Mission</i>, Article-<i>Transforming Corner-Office Strategy into Frontline</i>, Action, HBR, Article	<ul style="list-style-type: none">- Team Formation for Assignment- Borg Holdings Case- LIG Case
Topic 2 Internal Strategic Resource Analysis	<ul style="list-style-type: none">--Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook- <i>McKinsey 7S Framework</i>, Article- <i>Competitive Advantage</i>, Article	<ul style="list-style-type: none">- Borg Holdings Case
Topic 3 External Strategic Assessment	<ul style="list-style-type: none">-Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook-<i>PEST Analysis</i>, Article-<i>Porter's 5 Forces with examples</i>, Article-Porter, "<i>How Competitive Forces Shape Strategy</i>", HBR, Article	<ul style="list-style-type: none">- Biotech Industry Case

MSM

MBA Master of Business Administration Programme Subject Outline Form MBA Outreach

Subject : Global Corporate Strategy
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TOPICS	READINGS	CASES, EXERCISES
Topic 4 Customer Alignment and Competitive Positioning	<ul style="list-style-type: none"> -Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook -<i>The Value Chain</i>, Article -Hamel, "<i>The Ideology of Revolution</i>" HBR, Article Extract -Testa, <i>The 7 Mantrich Globuster Levers</i>, Article -The 3 Emerging Giant Strategies Article 	<ul style="list-style-type: none"> - Caterpillar Tractor Case - Sadafco Case
Topic 5 Designing Strategic Options & Corporate Strategy	<ul style="list-style-type: none"> -Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook - <i>SWOT Analysis</i>, Article - <i>Porter's Generic Strategies</i>, Article - <i>Ansoff Matrix</i>, Article - <i>Vertical & Horizontal Integration</i>, Article - <i>Boston Matrix</i>, Article - Campbell, Goold , Alexander "Corporate Strategy: The Quest for Parenting Advantage" HBR, Article 	<ul style="list-style-type: none"> - Borg Holdings Case
Topic 6 Taking Strategic Action & Controlling Strategic Direction	<ul style="list-style-type: none"> -Johnson and Scholes, <i>Exploring Corporate Strategy</i>, Textbook - Testa, <i>Guidelines to Corporate Governance & the Board of Director</i>, Article 	<ul style="list-style-type: none"> -Borg Holdings Case
Presentation	<ul style="list-style-type: none"> - Presentation Part of Assignment 	<ul style="list-style-type: none"> - Case Presentation by Students

Program Lecturer

MBA and Executive Programs

Lecturer and Trainer

MARTIN TESTA

B.A. (Hons) Business Management, MBA(Henley-Brunel),
Dip. M., MCIM, Chartered Marketer



Since 1989 Martin Testa has consulted in market leading companies with such names as: Swatch, Nike, Benetton, Sector, Thalgo, Del Monte, Parmalat, Cirio, Kellogg's, Heinz, Lego, Mattel, Microsoft, IBM Global Network, Novell Networks, Vespa, Piaggio, Moody, Grand Metropolitan, Diageo, Moët Hennessy, Seagrams, Guinness,

Nettingsdorfer –Smurfit and Emirates among others. He is the CEO of Nobel Mantrich Ltd., a strategy and marketing consultancy organisation (www.nobelmantrich.com) and Chairman and Founder of the Global Emerging Giants Network (GEGN), a global community sharing knowledge on Emerging Multinationals. GEGN embraces emerging multinational groups, practitioners, researchers, academics, consultants, executives, and government officers.

He has consulted in a number of industry segments including: Information Technology, Financial and Investment Services, Telecommunications, Government Services, Utilities, Medical Services, Commodities, Retailing, Tourism, Travel, Hotel & Leisure, Marketing Communications, Education, Auto Industry, Beverages and Tobacco, Paper, Packaging & Printing, Clothing & Accessories, Toys, Foods & Catering, Engineering & Electricals, Construction, Pharmaceuticals & Cosmetics, Furniture, Agri-industry, and Airlines.

Martin Testa is primarily a specialist in Emerging Multinationals, the likes of Tata, Embraer, Huawei, Brasil Foods, Koc Holdings, Rusal and Orascom. Between 1979 and 1991 he occupied top operational and managerial positions assisting multinationals including STMicroelectronics, Baxter Healthcare, Methode Electronics, Trelleborg Dowty, Playmobil, Actavis and De La Rue in their foreign direct investment initiatives. In 1991 he commenced his training career and in 1996 started practicing internationally as a consultant, trainer and lecturer on various programmes and projects including those of the Maastricht School of Management (MSM), the Commonwealth Fund for Technical Cooperation, the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), as well as those of Chambers of Commerce internationally. With his expertise in Strategy and Marketing, he has given management training several times to owners, directors and managers as well as at MBA level in universities and training institutes in



Maastricht, Shanghai, Haikou, Cairo, Sharm El Sheik, Malta, Ho Chi Minh, Dhaka, Kuala Lumpur, Jakarta, Lima, Arusha, Malawi, Jeddah and Riyadh amongst others. Many participants on his training programmes are owners of diversified privately controlled businesses or managers in multinational listed blue chip companies such as Rank Xerox, Glaxo Wellcome, Alcatel-Lucent, Ericsson, Citibank, Novartis, Intercontinental, Schlumberger, IBM, Exxon-Mobil, Nestlé, 3M, Shell, etc.

"The course given by Prof. Martin Testa is one of the most interesting and fruitful courses I have attended."

Bo Liu

Senior Manager

Baosteel Resources International Ltd, China.

Martin covers the below-mentioned 6 disciplines thoroughly in international training and consultancy projects:

1. Global Strategy of Emerging Multinationals
2. Professionalisation of Family Business Groups
3. Advanced Strategic Planning & Implementation
4. International Marketing
5. Marketing for Services Business
6. Marketing Management

Martin has been designated the professional status of Chartered Marketer by the Chartered Institute of Marketing. He has been Chairman of the National Vocational Qualifications Development Board for Marketing, Sales and Retail and Lead Assessor of the People Management and Satisfaction National Award of the Employment and Training Corporation which has been modelled on the European Foundation for Quality Management (EFQM).

His main research interest is on The Rise of Multinationals from Emerging Countries and Regions. His first degree dissertation centred on Managing Business Diversification in Family Owned Companies. His Masters degree dissertation (MBA) focused on Corporate Strategy in Diversified Family Businesses. He has published in various journals and presented conference papers in his areas of research. In the years he has been lecturing with MSM (since 1996), he has consistently been getting very good feedback from participants of all locations in which he has lectured. In blind participant evaluation, he is currently hitting the top scale ("excellent") 90% of the time. He is also chairing the Dissertation Defense committees regularly for MSM's MBA programme in various outreach locations.
email: mba@nobelmantrich.com

Titled Training Programmes Delivered By Martin Testa

The following titled programmes have actually been delivered successfully by Martin Testa in half-day sessions each and several times internationally

A. Management and Globalisation of Emerging Multinationals, Sessions delivered:

1. The Challenges and Opportunities for Emerging Multinationals in a the Global Economy
2. Strategically Aligning the Private Equity Partners and the Business in an Emerging Multinational
3. Managing Corporate Strategy in a Privately Controlled Emerging Multinational
4. Diversification Patterns in Emerging Multinationals.
5. The Tools of Corporate Strategy for Emerging Multinationals
6. Factors which affect the Success of Diversified Conglomerates in Emerging Markets – becoming an Emerging Giant
7. The Fight of the Giants: How do Emerging Multinationals Defend their Local Market Territory Against Foreign Multinational Competition?
8. Problems of Financing, Control and Corporate Governance in Emerging Multinationals
9. A Succession and Career Development Model for Owners of Emerging Multinationals
10. What Emerging Multinationals and their Western Counterparts Would Like to Know More About But are Afraid to Ask
11. Mantrich Plan G: Succession Tools for Privately Controlled Multinationals

"A very interesting program. I would have wished the program could be further prolonged over another one or two days."

Georges Boghassian
Vice President Logistics
Cemex Group (Construction Materials – Cement)

B. Business And Strategic Planning

Training Sessions delivered:

1. Understanding the importance of the mission, vision, and purpose of the organisation and the power this gives us to achieve a greater focus on what we do best.
2. Identifying the real competitive advantage of the company and learning how to utilise this in our daily work.
3. Learning to become more aware of the business environment around us and building on this knowledge to take advantage of opportunities as they present themselves.
4. Finding where the true value in our operations lie and getting to know how every one bit of value can

build on the next to achieve operational alignment and customer delight.

5. Achieving the leap between minor value improvements and major operational breakthroughs that lead to the creation of new profitable and sustainable competitive space;
6. Knowing how to think six steps ahead of each player in our market, whether our competitor, supplier, retailer or customer and how to eventually get each player in the position we want them to be.
7. Recognise when to add a new product, customer or business category and when not to and how this insight can help us achieve greater profitability and competitive advantage.
8. Being able to choose between various roads to take that will lead to the future destiny of our organisation and how our People and our major Stakeholders groups can prove to be a major insight in this regard.
9. Becoming aware of the real way decisions are taken within our organisation; getting our People culture to work in favour of our company rather than against it; identifying and coping with resistance to change; applying the 15% principle to achieve major strategic breakthroughs.
10. Adopting a radical change breakthrough with business process reengineering and the "clean slate" approach; Empowerment
11. Monitoring strategic performance, realigning the strategy to new realities and keeping the delicate balance between our financial, customer, operational and people management goals.

C. The Marketing of Services and Customer Satisfaction

Sessions Delivered:

1. What is so special about the Marketing of Services?
2. Listening to Services Requirements – Understanding Service Customer Expectations
3. Marketing Research in Services
4. Building Customer Relationships in Services
5. Designing the Right Service Format – Building a Service Blueprint Map and KPIs
6. Delivering to Chosen Service Format – The Moment of Truth – Aligning Staff, Customer and Technology
7. Matching Service Performance to Promises – The 16 Winning Steps to Integrating Services Marketing Communication

Program Lecturer

MBA and Executive Programs

D. Brand Building and Successful Product Marketing

Sessions Delivered:

1. Concepts of Branding
2. Strategic Thinking & The Branding Process
3. Branding Research
4. Business to Consumer (B2C) Branding and Business to Business (B2B) Branding
5. Brand Segmentation, Targeting and Positioning

Product/Service Branding

E. Internationalisation

Sessions Delivered:

1. Getting ready for the international markets - Identifying your best potential
2. International market segmentation and research - Finding the best markets
3. International product adaptation - Adapting yourself to the market
4. International costing and pricing - Making sure you are competitive
5. International modes of entry, distribution and logistics - Finding the best way to deliver
6. International market finance and methods of payment - Reducing your export risks
7. International marketing communications - Passing on the right message
8. Developing the regulatory and strategic role of national Enterprise and Foreign Direct Investment (FDI) agencies
9. The national coordination of FDI strategic initiatives
10. Building International FDI positioning strategies at country level
11. Creating Strategies for Trade Promotion Organisations (TPOs)
12. Strategies for National Positioning of the Export Initiative

F. Marketing Management, Public Relations and Corporate Communications

Sessions Delivered:

1. The Basics of Marketing
2. Understanding Marketing's functional role within the organization
3. The relationship between Marketing and the strategy of the organisation
4. Understanding who the customer is
5. Gathering the necessary data to build a profile of the customer
6. How to segment customers, target them and position the company's products to these selected set of customers
7. Adapting the product to better meet the needs of the selected set of customers.

8. Developing products that could fit the ever-changing needs of the customer.
9. Using Pricing as a way to ensure better perceived value of the product to the customer
10. Understanding the various methods that can be used to price products and services from a marketing perspective.
11. Selecting the most appropriate channels through which the product is delivered to the customer.
12. Building a well integrated plan to communicate interactively with the customer
13. Building a relevant and effective advertising and public relations campaign targeted to the chosen set of customers.
14. Knowing how to communicate directly with customers through various methods eg. Direct Marketing, sales promotion campaigns, the company's sales force, etc. in a way that effectively motivates the customers to seek the services and products of the company.
15. Completing the building of a well-conceived Marketing Plan that takes into consideration not only the customers but also the competitive positioning and quality aspects of the product or service that is being delivered.

"I believe that the program itself is very informative. I found it to be interesting and extremely beneficial. The material is very much diversified with different cases from all over the globe. The way it was set is very much related to the sequence of the program.

As for the instructor, Martin Testa, he is very patient and generous by sharing his knowledge in his areas of expertise. He offered to advise participants on a one-to-one basis even during breaks and lunchtime about how to address and solve current problems. He was also tolerant and accepted all questions and repeated until everyone was comfortable with the ideas. Mr Testa's methodology in instructing is unique. It is very provocative, in the sense that, it urges you to think and analyse from the minute you set foot into the 3-day workshop. I was very impressed by the results each group came out with from the cases presented and how they were all ready to give their input."

Nevine Mohamed El Kilany
Chairman's Office, The Egyptian Stock Exchange

MBA OUTREACH PROGRAM
GLOBAL CORPORATE STRATEGY
Maastricht School of Management

LEARNING ELEMENTS

INTRODUCTION

The course: *Global Corporate Strategy* introduces concepts, frameworks and methodologies useful to managers formulating and implementing both business unit and corporate level strategy. Session discussions focus on case studies, readings, lectures and exercises. Grades are based on the assignment and the final exam. However, session preparation and participation will be given their due importance.

KEY LEARNING ELEMENTS

The *Global Corporate Strategy* course sessions are scheduled to suit the members' organisational requirements. The Subject Outline Form is included for your guidance.

Readings play an important part within this course. Participants must be familiar with some of the theories and factors behind *Global Corporate Strategy* before the sessions so that each session can be devoted to actively analysing the approach of various organisations to strategic management including the member's own organisation and in producing action plans for future implementation. If participants do not familiarise themselves with the readings before the sessions, time will be wasted and the sessions will not be so productive and useful to the participant.

Case study material is an essential part of this course and parts of this course are devoted to questions arising from live case studies which allow concepts, models and techniques learnt in the course to be utilised to assist you during real strategic analysis and implementation in your organisation during and after you achieve your MBA. In addition, this folder contains detailed case studies which require thorough reading for background and self analysis before the sessions.

PREPARATION

The *Global Corporate Strategy* course works on the principle of applying theory to practice. This implies that what is studied must be related and applied to the workplace and to real life situations and the process of study is itself derived from the challenging questions, dilemmas and beliefs that the participants themselves possess about the strategic management discipline.

It is therefore essential for participants to spend an adequate amount of time "preparing" thoroughly for this course by completing any set readings, cases or exercises as well as familiarising themselves with the textbook and other recommended readings and completing any other preparation specified in individual sessions. It would also be fair to say that, together with class sessions, the cases and readings would be an invaluable source of study in preparation for the final exam.

STRUCTURE OF THE STRATEGIC MANAGEMENT COURSE

It is important to ensure that participants complete: (a) their written comments on readings and (b) their written comments on the analysis of the case studies and exercises in preparation for class discussion. Make sure that the cases and readings you prepare are relevant to the session you are about to attend. The Subject Outline Form attached will guide you for this purpose.

Readings

Some sessions revolve around readings. There are many ways of making these a significant learning exercise. They include:

- Group discussions over the meaning and implications of the reading;

- Considering segments and extracts one at a time and using application questions at the end of the extract;
- Forming small groups to consider a reading and reporting back on the implications of it.

Application questions/Action points

Where appropriate, questions will be asked during the session about the application of a principle, theory, technique, insight etc. to real life situations as well as to the participants organisations in order to help consolidate learning. Application questions allow participants to relate what they have learnt to the activities of their organisation. Action points reinforce what a participant needs to know, plan and do.

Exercises

Any exercise within the course are for learning from the practical application of activities. An Exercise can be completed individually depending on the nature of the exercise and time constraints. When an exercise has been completed, key points or statements can be collated.

Group Work

I also strongly encourage you to meet with your usual study group to discuss each case before the start of the session. I know that you are under a lot of time restraints, but if you can possibly find the time it will be to your favour. Working in groups will give you a chance to learn from your colleagues. It also provides an opportunity to discuss your ideas in a setting approximating the management teams typically charged with these tasks. Group work allows you to learn how to deal with teams and get the best out of them. It is a key skill to progress in your career.

CASE STUDIES

The Purpose And Nature Of Case Studies

The case study provides a vehicle for identifying problems, analysing them, deriving solutions and considering the difficulties in implementing these solutions. These last two aspects of the case study method are important. It is easy to devote most of the available time to analysis, leaving very little time for developing situations and none at all for considering the problem of implementing the solution. This "disease" has been termed "analysis paralysis". Beware of it.

In a live case study contained in this folder, you link the advanced concepts you study with the reality of policies, practices and issues within a live organisation (probably, but not necessarily, your

own) by carrying out a direct investigation and recording observations yourself. You can also collect further data about the company being represented in the case if you feel that this can help you.

Cases can range from one page and contain very little detail or a seemingly baffling amount. Cases may be addressed to a very specific problem or may cover a great range of problems. The issue for discussion is sometimes obvious, sometimes not.

Cases rarely contain all the information that a reader would like, but this is realistic as it is often difficult and perhaps expensive (in money or time) to get additional information. Paradoxically, you may sometimes think you have too much information or that much of the information is in an unusable form. Again, this is not realistic. It is rare for organisations to have comprehensive and relevant information available; the records many organisations keep are usually for purposes other than those for which the manager solving a particular problem would use them.

Cases, usually, do not have right or wrong answers. Answers may be good or bad but this largely depends on supporting arguments and the use that is made of the available information. If the lack of right or wrong answers sometimes leads to frustration, you should bear in mind that there are very rarely clear-cut right or wrong answers to problems in the real world.

You may experience difficulty in adjusting to the case study method of learning. You may feel frustrated and think that you are not really learning when you participate in a case study. It is undoubtedly easier to acquire factual knowledge through textbooks and lectures, but the aim of management education is not simply to impart factual knowledge, principles and theories; rather it is to develop in participants the ability to reason effectively when dealing with specific problems and to convince others. It is in this context that case studies are of use.

Case studies are usually excellent for discussion in small groups and for reporting back. They may also be used in the same way as readings.

ANALYSING A CASE STUDY

You will naturally develop your own approach to analysing a case study. Whatever the approach

adopted, it is essential to master the facts given in the narrative.

Many people find it helpful to prepare a case study by first reading it through quickly to gain an understanding of the overall situation and to identify the major problem areas. This can then be followed by a detailed examination of the case during which notes should be made. These notes should detail the problem, use the available information to develop a solution, and consider how to implement the solution. Relevant numerical information, where provided, should be used. Where information seems to be lacking, intelligent assumptions may be necessary to arrive at solutions. Care should be taken to develop arguments with the available facts and to ensure that any assumptions made can be reasonably justified.

The study of cases should follow essentially the same steps a manager would use in solving an actual problem. The following summary of the technique of case study and analysis may be helpful; you must, however, develop your own analytical methods.

Clarify the problem

The objective should be clearly identified and then the situation should be reviewed to determine the difficulties involved in reaching it. You should ask yourself, "Just what is wanted and what am I up against?"

It is necessary to determine the exact issue. Sometimes the issue may be very clear but at other times it may be obscure. This is because the first form in which a business problem presents itself to a manager is often only remotely similar to what she or he finally determines the real issue to be.

When the issue has been clearly identified, the next step is usually to break the problem down into sub-issues. In other words, to solve the main problem it will be necessary to answer a number of subordinate questions. The resolution of a significant sub-issue may lead to a costly error in decision.

Master and analyse the facts

It is always essential to develop a complete mastery of the facts in the case, sorting out those that are pertinent and discarding any which are found to be irrelevant. Here, the word "facts" includes opinions, inferences and forecasts as well as historical records and statistics. Care must be taken to appraise the reliability of such information; it is rarely possible for a manager to base his or her decisions solely on the basis of objective data.

It may sometimes be necessary to use numerical data in the case to make various calculations and comparisons that will throw light on the problem.

It is necessary to develop a clear mental picture of the situation being studied. This calls for realistic imagination because it is never possible to give all the facts. If you lack the background to fill in these details you should seek descriptions of similar industrial or departmental operations which will help in this sensing of the "real situation". It is well worth cultivating a realistic imagination because this is useful to the manager in thinking through the effects of a contemplated course of action.

Determine the alternatives and key factors

This is usually an essential element of the analysis. There are usually several possible solutions to a problem and the wise choice must rest on identifying the crucial differences between each possibility. This analysis of the problem enables one to concentrate upon the important issues and avoid wasting time on irrelevant matters. Data must be sifted, combined, and related to the alternatives and factors developed.

Decide on the course of action

Judgement is usually still necessary in deciding which plan to follow. Factors must be balanced against each other, adjustments made for uncertainty and full consideration given to timing and to the difficulties in implementing the chosen plan.

Check the decision from several angles

Executive action almost always deals with complex situations and it is wise to examine a decision and plan from several different points of view. For example, an organisation plan can be checked by tracing a typical transaction from start to finish to make sure it is clear "who does what"; similarly, a personnel decision may be checked by putting oneself into the position of several different individuals and thinking how each will react.

Prepare a short brief with your comments on the case.

This need not necessarily cover all the steps outlined above, but is important to help clarify and articulate your thoughts.

A GUIDE TO STUDYING GLOBAL CORPORATE STRATEGY

The various challenging management disciplines that you have mastered in the previous modules must now become more focused. This implies that

the process of study now also derives from the challenging questions faced in your own organisation or that of others. In view of this, it will greatly help you if you are able to share views with other participants, colleagues, sponsors, superiors and especially managers from other organisations. Certainly this will not always be an immediate, practical possibility but over time, such opportunities should be taken.

Questions can be found in the cases contained in this folder. These highlight key issues and should guide you in studying the case and readings as well as preparing for the session discussion. Questions and Debate Points in the cases reinforce what you need to know, remember, plan and do. Not all the cases contain a full list of questions and debate points, since, the important discipline of study is to create your own application questions and list a series of actions, debate points and comments to consolidate your own learning at the end of each session.

In this folder you will also find readily-debated case studies. This will help you to conceptualise the case situation as you go through it. It is important however to critically analyse the concepts presented about the case and form your own conclusions and comments about it.

Session Participation

Conduct of Course: Class sessions will emphasise discussion, consequently attendance and active **participation** is essential. It is a bad thing to come in late for class or to walk out of the classroom during class. Mobiles should be switched off throughout the session. Everyone will be expected to **participate** at least three times every class period. All participation should be directed to the class, not to your neighbour.

I may open the session by asking someone to summarise one of the readings or cases briefly, or answer a short question. In the case of a reading, you may be asked to briefly outline the problem that the article addresses, describe the core points of the readings, and, most importantly, *offer your analysis of the strengths and weaknesses of the reading's central argument*. With a case, you may be asked to identify the key issues, problems and opportunities facing the central protagonists, to articulate and evaluate alternative approaches to the problems, and to describe the course of action that you recommend and the reasons for your recommendations.

It is important to appreciate that every participant is a co-producer of the discussion, and thus it is important that every participant listens carefully to one another and attempts to build on or constructively criticise prior

comments. It would be vital for one to resist the temptation to jump to topics that are not specifically open for discussion. Some of the specific things that I would be noting during session participation are:

- *Is the participant a good listener?*
- *Are the points made relevant to the discussion? Are they linked to the comments of others and to the themes that the participants are exploring together?*
- *Do the comments add to our understanding of the situation? Are they incisive? Do they cut to the core of the problem?*
- *Is there a willingness to challenge the ideas that are being expressed?*
- *Is there a willingness to test new ideas, or are all comments "safe?" (such as repetition of case facts without analysis or conclusions, or of a comment already made by someone)*
- *Does the participant integrate material from past sessions or the readings where appropriate? Do the comments reflect cumulative learning over the course, or does the participant merely consider each case in isolation?*

I do hope that the above serves as a good guideline for you but above all, I do hope that you will enjoy the various sessions we will be having together. I look forward to seeing you.

Best Regards,
Martin Testa

MBA PROGRAM
TEAM WORK ASSIGNMENT PARTS
GENERAL INSTRUCTIONS
Global Corporate Strategy
Maastricht School of Management

As 40% of the formal assessment for the Maastricht School of Management MBA course you are required to take part in a series of strategy projects as a team. The other 60% will be assessment by individual examination.

General Instructions

The names of **UP TO FIVE** students for each Team (self-selected, with their **FULL** names and their exact **MSM registration numbers**) must be submitted to the lecturer on the first lecture day. Teams who are found to have more than FIVE students will have marks deducted.

For assignment assessment purposes, each Team will be assessed in two ways:

- 1) **Daily Assessment:** Each group will be assessed for daily presentations and class participation for cases and other exercises during each session of the course. This will contribute to 10% of the assignment marks.
- 2) **Strategy Assignment Report (90% of Assignment Marks for both parts):**

This consists of Part 1 and Part 2

Instructions for these Parts are found in the next few pages within this Course Manual.

Peer Evaluation:

Your team mates will also have the opportunity to assess your performance as a team-player in the assignment through the Peer Evaluation Form. This Form will be found in the next few pages of this Course Manual.

You will be assessed as a team i.e. all those within your team would obtain identical marks according to the level of report presentation and the supporting documentation. However, if the team feels that one or more members have not been cooperative during the assignment, the Peer Evaluation Form which is submitted confidentially to the Lecturer will show this. The team member in question will be removed from the team list during grade allocation. If, on the other hand, one team member is judged by the

rest of the team to have contributed significantly during the assignment, he will be given a bonus grade as a result of the Peer Evaluation Form.

Report Instructions:

A professional and factual report style format is expected. Reply to all the assignment questions clearly in a question and answer format.

STRATEGY ASSIGNMENT REPORT

Strategic Analysis of One Large Emerging Multinational in the Middle East

PART 1: You are required to choose one large Middle East Emerging Multinational Company and answer thoroughly the questions provided.

In the questions below, when we mention the words: "large Middle East Emerging Multinational Company", or "Emerging Giant", what we mean is a large company (in terms of turnover) which is majority owned or controlled by private individuals in the Middle East or a company fully or partly listed on a Middle East Stock Market and NOT having majority controlling interest by foreign investors or foreign corporations.

To learn more about Emerging Multinational Strategy consult your instructor's material and go to:

<http://www.linkedin.com/groups/Link-EMERGING-GIANTS-STRATEGY-innovative-4086800>

You can only choose one of the companies listed in the back of this brief. As a Team of 4 or 5 individuals you can choose from the list on a "first-come-first-served" basis. If you choose early enough, the lecturer will secure that company to your team and no other team would be allowed to choose that emerging multinational. Give also to the Lecturer the choice of questions you will be answering. Both of these need to be approved by the lecturer. No other team can choose the same questions without approval by the lecturer.

The Assignment will be split in two parts: PART 1) 40% of the marks would be given for the presentation of the chosen Case Questions in the last lecture session and PART 2) 60% of the marks will be given in the form of a report you hand in to RITI at a specified date after the course.

PART 1) For the first part of the strategy assignment report, you are required to make a 15 minute presentation of only Part 1B and submit a maximum of 15 pages for Parts 1A and 1B in both hard copy report format and softcopy (in "word" .doc format) to mba@nobelmantrich.com at the start of the last lecture session. Of these pages, a maximum of 5 pages should be allotted for Part 1A and a maximum of 10 pages should be allotted for 1B.

PART 2) You will prepare the second part of the strategy assignment report, after the last lecture session. To this effect you are required to answer questions 2A and 2B as outlined further on in this document.

Further instructions about this assignment and the way it should be presented are attached.

PART 1

Questions for PART 1A +1B of Assignment = 40% of Assignment Marks (10% for Part1A and 30% for Part1B)

The important thing is to answer well each question and parts thereof. THE ASSIGNMENT IS NOT ABOUT APPLYING THE TOOLS MENTIONED AND SHOWING ME THE MODELS THAT YOU HAVE APPLIED. THAT IS NOT WHAT I WANT. MY EXPECTATION IS THAT YOU CONSIDER THE TOOLS TO HELP YOU GET TO THE ANSWER OF THE QUESTION. SO YOU CAN PUT ANY APPLICATION OF THE TOOLS IN AN APPENDIX, AS I DO NOT WANT THEM AS PART OF THE ANSWER. WHAT I WANT IS THAT YOU STUDY THE CASE COMPANY YOU HAVE CHOSEN VERY WELL AND MAKE RESEARCH ON IT BY ALL THE MEANS THAT ARE AVAILABLE TO YOU. GET TO KNOW THE COMPANY VERY WELL. UNDERSTAND ITS COMPETITIVE ADVANTAGE. LEARN WHAT IS "BEHIND THE SCENES" IN THIS COMPANY. FOR EXAMPLE, PERSONAL THINGS ABOUT THE FOUNDER OR THE CEO MAY BE IMPORTANT AS THEY WOULD REFLECT A LOT ABOUT THE CULTURE OF THE COMPANY. INFORMAL INTERNET BLOGS MAY HELP YOU A LOT TO IDENTIFY WHAT EMPLOYEES OR EX-EMPLOYEES HAVE WRITTEN ABOUT THE COMPANY. IF YOU FIND ANY ACADEMIC ARTICLES ABOUT THE COMPANY ON THE INTERNET, USE THEM ONLY TO LEARN MORE ABOUT THE COMPANY. YOU NEED TO GO BEYOND WHAT THOSE ACADEMIC ARTICLES SAY ABOUT THE COMPANY IN ORDER TO MAKE A GOOD ASSIGNMENT. FACTS, DETAILS, NAMES, STORIES, **CLEAR DETAILED EXAMPLES** ARE THE KEY TO A GOOD ASSIGNMENT ANSWER. YOU WOULD BE EXPECTED TO MAKE ONE OR MORE INTERVIEWS WITH PEOPLE WHO HAVE BEEN CLOSE IN SOME WAY TO THE COMPANY. YOU COULD DO THIS BY INFORMALLY ASKING AROUND ABOUT THE COMPANY TO EMPLOYEES YOU HAVE KNOWLEDGE OF OR TO EX-EMPLOYEES, OR TO COMPETITORS, OR TO ITS CUSTOMERS OR ITS SUPPLIERS. YOU ARE EXPECTED TO RESEARCH INFORMAL BLOGS AND SOCIAL MEDIA SAYING BOTH NEGATIVE AND POSITIVE THINGS ABOUT THE COMPANY. IT NEEDS TO BE A BALANCED ASSESSMENT.

Part 1A:

Describe how the emerging multinational that you have chosen undertakes 5 of the following strategic activities: (an example of a choice of Five is: 1.1.1.3 to 1.1.1.5 and 2.2.1.2 to 2.2.1.3). You may suggest to the lecturer other strategic activities not listed here. You can do so but you need to seek approval from the lecturer:

1 Strategic Analysis**1.1 Environmental Scanning and Country Analysis**

1. Use of National Drivers and Barriers and Country Sourcing as Sources of Global Competitive Advantage
2. Dealing with Government Bureaucracy in Emerging Markets
3. Dealing with Economic and Political Instability in Emerging Markets
4. Dealing with Authoritarian Governments
5. Taking Advantage of Low Income Per Capita in Emerging Markets
6. Leveraging High Population Densities
7. Overcoming Weak Legislative Enforcement
8. The Meaning of Market Proximity for Emerging Multinationals
9. The Global Financial Crisis and its Impact on Emerging Multinationals

1.2 Business Analysis

1. How Emerging Multinationals Deal with Limited Data Availability
2. How Emerging Multinationals Take Advantage of Weak Western Counterparts

2 Strategic Design**2.1 Business and Corporate Strategy**

1. Innovation and Research and Development and Technology Transfer Strategies
2. The Use of Diversification, Conglomerate Structures and Synergies by Emerging Multinationals
3. The Use of Government and Political Support In Global Expansion
4. Supply Chain Strategies

2.2 Functional Strategy

1. Marketing Strategies
2. Customer Relationship Management and Total Solutions Provision
3. Global Branding: Local brand vs Global brand positioning
4. Customisation Strategies
5. Aggressive Financing Strategies of Emerging Multinationals
6. Taxation Strategies

3 Strategy in Action**3.1 Strategic Methods**

1. The use of Mergers and Acquisitions Strategies by Emerging Multinationals
2. Acquisition versus organic growth
3. Private-Public Partnerships
4. Dealing with Emerging Multinational Partners in Global Business

3.2 Strategic Implementation

1. Organisation Culture in Emerging Multinationals
2. Merging Regional Best Practices to achieve Global Advantage

3.3 Strategic Control

1. Private Control and Family Governance Structures as Elements of Competitive Advantage
2. Corporate Governance in Emerging Multinationals
3. Corporate Responsibility
4. Risk Management during Global Expansion

Part 1B:

Large emerging multinational companies (Emerging Giants) are strategically positioning themselves to exceed traditional western developed country multinationals in global markets. Emerging Giants can have certain competitive and comparative advantages over a western multinational competing in the same sector and geographic area. We are already seeing numerous examples of large companies from emerging countries like India, China, Brazil and South Africa, etc., speed up their strategic competitive advantages and build global markets at the expense of traditional western developed country multinationals. They are grabbing raw materials, capital, people, suppliers, knowledge, leaders, capabilities, partners, customers, workers, patents, in order to become competitive in global markets to outwit rival companies.

Choose at least one or more of the following questions most relevant to your emerging multinational and answer it. The topics suggested are by no means exhaustive, there could be other strategic topics which your case would cover within that question. Whether you choose one or more of the below questions depends on the question's relevance to your case. The important thing is to answer well each part of the question/s you choose thoroughly. Use your course material, strategic tools and frameworks to give you insights into the answer (Put any application of such tools in an Appendix and not as part of the answer).

- 1. National Barriers:** As much as emerging countries have both their positive and negative elements in their international competitiveness, mention one case where a large emerging multinational managed to bypass some of the national disadvantages of its country to expand

internationally and where even that company has managed to turn a negative national competitive disadvantage into an advantage for itself. Examples of national competitive disadvantages could be: weak legislative enforcement, underdeveloped capital markets, scarce talent, high political uncertainty, lack of democracy, lack of product standards, lack of copyright enforcement, low consumer protection, etc. In the case of your emerging giant, how has its familiarity with specific national barriers in its country of domicile helped it to penetrate other foreign markets with similar barriers? Answer all these questions by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

2. National Drivers: As much as emerging countries have both their positive and negative elements in their international competitiveness, mention one case where a large emerging multinational managed to take advantage of national drivers within its country to expand internationally and where even that company has managed to turn a national competitive advantage into an advantage for itself. Examples of national drivers could be: local Government support of certain products/ services eg. incentives, education, liberalisation, standards; favourable legislation, etc. In the case of your emerging giant, how has its familiarity with specific national drivers in its country of domicile helped it to penetrate other foreign markets with similar drivers? Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

3. Other Globuster Levers: Mention one case where an emerging multinational took advantage of the "Abundants", "Sophistics" or "Weak Giants" in its home emerging market to expand internationally. **Abundants:** Uses your Country's abundant resources; raw materials; supplies, labour & skilled labour; heritage, image or apparent "waste"; nuts in Tanzania, diamonds in South Africa; herbs in North Africa; oil in Middle East ; **Sophistics:** Uses products / services in which customers/workers in your home country are sophisticated in consuming/using/producing both in terms of high quantity and/or high quality; using unique knowledge, unique tastes or unique needs e.g. flowers in Holland; pasta in Italy; wine in France; etc. **Weak Giants:** Uses local assets/resources in market segments where multinationals are weak e.g. fulfilling local tastes, local flavours, or local requirements similar to those in certain other similar socio-psychographic countries. Jollibee Foods (McDonalds of Asia) Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

4. Global Credit Crunch: How are the global credit crunch and the current economic downturn transforming large emerging multinational firms? Answer this question by explaining and giving details and facts of one thorough example where a large emerging multinational firm has

taken advantage of the credit crisis to strategically reposition itself into the international markets to gain market share at the expense of western developed country multinationals.

5. Organisational Structure: How does the multinational organisational structure of a large emerging multinational company differ from that of a western multinational? Explain one thorough emerging giant case where this difference is pronounced and mention both the positives and the negatives that this difference brings along in its international competitiveness. Emerging giants are bringing along structural attributes that are giving them an advantage in international competitiveness. Before it used to be the diversified multinational that thrived – the conglomerate; then came the focused multinational with its huge economies of scale; then came the emerging giants with their substantial cost advantage. How did the emerging giant you chose challenge and force a change on the traditional multinational organisation structure? How does it manage to keep a lean head office structure while retaining control of its business units, especially if its businesses are in diverse sectors? Do you see any merits in its organisational structure that could be the beginning of an effective new multinational structure for the future? What are these merits? What lessons about organisational structure do we learn from your chosen emerging multinational which can revitalise companies in meaningful ways to take on global competitive challenges? Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

6. Strategic Collaboration / M&As: The impact of emerging giants on business collaboration and supply chains. In what ways can a large emerging multinational be positively and creatively different from a western multinational in the way it deals with overseas partners, etc. to achieve a competitive advantage? i.e. rather than using the plain and straightforward Mergers and Acquisitions process, the Joint Ventures process or the Strategic Alliance process, how can an emerging multinational use a configuration of these or other forms of strategic collaboration to penetrate successfully global markets? Mention one successful emerging multinational case example where an interesting and innovative mix of strategic collaboration processes was used to expand successfully into the international markets. How has the emerging giant innovatively transformed the collaboration process in global business dealings? Additionally you can also propose another case where such innovative collaboration processes has the potential to be used successfully by a particular emerging multinational company to expand into global markets. Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

7. Value Chain and Supply Chain: Mention an instance where a large emerging multinational company made significant change in its supply chain (e.g. in its suppliers, its distributors or its retailers), in order to leverage its competitiveness into the international markets. This could have been done by forward or backward integration or by eliminating redundant elements in its supply chain (disintermediation) or by some other revolutionary means. How was this done? Answer this question by explaining and giving details and facts of one thorough emerging multinational example where this is the case.

8. Leadership within the Organisation: Mention a very good successful case where an influential emerging multinational businessman leader was significantly more successful in managing a certain type of organisation than a western business leader coming from a western multinational environment could have been? What type of leadership characteristics does this emerging multinational leader have that western leaders do not have? What type of organisational structure is his/her type of leadership style best adapted to run? Mention certain positive leadership characteristics that this businessman has which other foreign business leaders need if they are to be successful in the running of their business particularly at a global or regional level? What can we learn from the leadership qualities of this influential businessman? Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

9. Leadership Outside the Organisation: Certain emerging multinational businessmen are very smart in the way they deal with foreign companies in their international expansion strategies i.e. in the way they handle their cross-cultural negotiations across borders and in the way they pick up dispersed pieces of strategic data and link them. This seems especially true in their dealings in other emerging countries. Mention a very good case of an influential emerging multinational businessman where this has successfully occurred several times. I would like you to only mention a case where you feel that this businessman has greater strategic negotiation superiority than any other foreign businessmen of some western multinational particularly in his dealings with other emerging countries. Explain and give details and facts of one thorough example where this is the case.

10. Human Resources Strategy: Mention a very good successful case where an influential emerging multinational was significantly more successful in its human resources (HR) strategy than a western multinationals operating in the same industry environment. What type of HR strategies does this emerging multinational practice that western

multinationals do not? How did these strategies help the emerging multinational to compete globally against other multinationals? Mention certain characteristics that these people management strategies contain that other businesses need if they are to be successful in the running of their business globally. Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

11. Technology and R&D Management: There are cases where large emerging multinational companies have successfully adapted a technology from foreign sources and then built on that technology to cater for the needs of both customers from their country of origin as well as other customers from other emerging countries. The way they have done so was very smart and cost effective. Mention a very good case where this has happened. How did they successfully copy, "borrow", acquire, adapt or build a technology which later gave them a competitive or comparative advantage in a foreign market? How is your emerging giant case transforming the way we develop, acquire, adapt and sell technology? There are huge strides in technologies that are empowering businesses and consumers: the fusion of social media, cloud computing, mobile and other collaborative/communicative technologies. How has this "empowerment" helped your emerging multinational case make inroads into global markets? How is your emerging giant case leapfrogging traditional technologies and embracing boundary-less markets in an increasingly easier, cheaper, faster and better way? How is it supplying markets and new market spaces with services and products that have previously been inaccessible to it? Answer all these questions by explaining and giving details and facts of one thorough emerging multinational example where these technological issues are mostly relevant.

12. Strategy as Revolution: Mention an emerging multinational case where a company broke the unwritten rules of competition in its industry to gain more competitive or comparative advantage. This is what the Body Shop had done by breaking the rules of how to compete in the cosmetics industry i.e. by recreating a totally different business model and way of packaging, selling, advertising and distributing cosmetics. In your emerging multinational company case, how did the "breaking of the rules" help the company to grow and prosper? How can the company replicate its success in the global market by breaking the same rule/s but in foreign markets outside its country of origin? Or has it already done so? How? Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

13. Corporate Governance: There are a number of emerging giants who although originating from emerging markets have build up high standards of corporate governance of comparable levels to those of the best western multinationals. Such emerging giants have therefore won the confidence of stock market investors and financiers, reduced their cost of capital and adopted better risk management techniques. Explain and give details and facts of one thorough company example where this is the case.

14. Corporate Responsibility: There are a number of emerging giants who although originating from emerging markets have build up high standards of corporate responsibility and Corporate Social Responsibility (CSR), at comparable levels to those of the best western multinationals. Such emerging giants have therefore won the confidence of many different types of stakeholders, including governments, social communities, environmentalists and ethics monitoring institutes. Explain and give details and facts of one thorough company example where this is the case.

15. Family Governance: There are a number of emerging giants which are owned by large families in business who have now reached their fourth or fifth family owning generation or more. Although originating from emerging markets such giants have build up high standards of family governance that enable them to sustain family business continuity and business sustainability. This includes high standards in succession planning of family

members into the business and a good system for managing the owning family's relationship with the business. Ultimately, these family controlled giants have outwitted stock market companies in their profitability and ROI. Explain and give details and facts of one thorough company example where this is the case.

16. Changing Perceptions and Strategic Marketing: We are seeing more and more emerging multinational businesses building successful international strategies and taking away market share that used to be in possession of western multinationals. If this shift of emerging companies towards global markets continues, in what way can it affect the social fabric of the countries where these products or services are ending up? Mention a case where the successful penetration by a large emerging multinational in markets abroad has changed the perceptions of foreigners about the country from where that emerging multinational originated or about the products and services coming from that country or has changed in some way the lives of those who enjoy such products and services in their foreign country. How is your chosen emerging giant changing the way we brand and market products and services. Also what marketing and branding strategies is this emerging giant utilising to expand its global markets? What lessons do we learn from this? How do you think will your emerging giant case contribute to rewriting the rules of Branding in the years to come? Answer all these questions and address all these issues by explaining and giving details and facts of one thorough emerging multinational example where these issues are mostly relevant.

IMPORTANT NOTE:

Precise and thorough referencing of content will be given priority in assessment scoring. Such quotes can come from books, articles, websites and blogs, interviews, emails, etc. Usage of your **own** words and your **own** interpretation of material you find will be noted in the assessment. Do NOT cut and paste from internet or book sources. MSM supplies lecturers with software that scans assignments against information available in public domains, databases and publications. The Lecturer makes use of [iThenticate software](#) or [ePhorus software](#) to check the originality of submissions received. Such blatant copying and paraphrasing will lead to failure in the assignment. It is not a problem to refer or to quote material from the internet as long as you give a number to that quote and make proper reference to it at the bottom of your assignment.

List of Large Middle East Emerging Multinationals (Choose ONLY from this list – on a FIRST-COME-FIRST-SERVED Basis)

Al Noor Group, Bahrain	Nasr City Housing & Development Co (Egypt)	Safra Republic Holdings, Lebanon
Aboul Fatouh (Egypt)	Olympic Group (Egypt)	Solh Group (Lebanon)
Alkan (Egypt)	Orascom Construction Industries (Egypt)	Attijariwafa Bank, Morocco
Allamsons (Egypt)	Orascom Telecom Media & Technology, (Egypt)	BMCI Banque Marocaine
Amer Group (Mr Mansour Amer) (Egypt)	Oriental Weavers (Egypt)	Maroc Telecom (Morocco)
Arafa Group (Egypt)	Pico (Egypt)	Saud Bahwan Group, Oman
Bagneid BM Group (Egypt)	Sidi (Sidy) Kerir Petrochemicals (Sidpec) (Egypt)	Tawoos Group (Divers – Oman)
Bahgat (Egypt)	Pharco Group (Egypt)	Abdul Latif Jameel Group (Saudi)
CIB Group (Egypt)	Raya Group (Egypt)	Saudi Binladin Group, Saudi Arabia
Cleopatra (Egypt)	Sekem (Foods - Egypt)	Al Batterjee Group, Saudi Arabia
Daltex (Egypt)	Sofico Group (Egypt)	Al Rajhi Bank (Saudi)
Eastern Company (Egypt)	SODIC (Egypt)	Al Watanaya (Foods)
EFG Group (Egypt)	Sonid (Egypt)	Dallah Albaraka (Divers – Saudi)
Egyptian Resorts Company	Talaat Moustafa Group (Egypt)	Saad Group, Saudi Arabia
EIPICO (Egypt)	Telecom Egypt	Riyad Bank (Saudi)
EK Holdings (Egypt)	Other Egyptian Companies need approval.	Olayan Group (Diversified-Saudi)
El Sewedy (Egypt)	Arab Bank, Jordan	Saudi Basic Industries Corp (SABIC - Chemicals)
El Sherif Corp (Egypt)	Zain Telecom ((formerly MTC) Kuwait	Saudi Electricity (Utilities)
Ezz Steel(Egypt)	Mohammad Abdul-Mohsin Al-Kharafi & Sons, Kuwait	Saudi Telecom
GB Auto (Egypt)	Americana Group, Kuwait	Savola Group (Saudi)
IGI (International Group for Investments) (Egypt)	Michel Pharaon, Président, Groupe Pharaon SAL, Lebanon	Al Abbas Group (Divers – UAE)
Juhayna Food Industries (Egypt)	Saudi Oger, Lebanon	Dubai Ports World (UAE)
Kandil Group (Egypt)		Jumbo Group, UAE
Lecico Egypt		Etisalat, UAE
Luxor Group (Al Ahram & Glass) (Egypt)		
Maba (Egypt)		
MM Sons (Egypt)		
Mobica (Egypt)		
Monsour (Egypt)		

Always get the permission of the lecturer about the company case from the above list before you proceed with doing the assignment. Selection of company case name is on a first-come-first-served basis. No other team can chose the same name. Crossed out names signify that the company cannot be used for this assignment at this time.

PART 2

Questions for PART 2 of Assignment (60% for post-course Report – answer all Questions below for the Case you chose in Part 1) For Part 2A and 2B, you need to submit a **softcopy in "word" .doc format (with font size 10) and send ONLY by email to your local MSM MBA office by the stipulated deadline.**

Part 2A)

You are required to note down the lecturer's and participants comments and questions during the class presentation of the last lecture session and after the course, make a deeper data gathering process and analysis of the case to come out with a thorough answer to the Case Question you chose in Part 1B above. So in other words, you are asked to REVISIT the answer you gave in PART 1B and make the necessary corrections and improvements as highlighted by the lecturer and students during your Presentation and RESUBMIT PART 1B of the assignment in a maximum of 15 pages "word" document.

Part 2B)

Furthermore, the project involves finding out more information about the emerging multinational Case Company you chose in Part 1 and answer the following in a document having a maximum of 20 pages:

1. ☐ Outline its organisation structure. What type of management structure does the group possess? How would you describe the management style of the group?
2. ☐ Prepare a strategic audit (CADOT) of the group: Look at competitive advantages and disadvantages, opportunities and threats at Group level, what core competences or strategically valuable assets does the group possess.
3. ☐ What drove the group to expand and possibly diversify? Review its portfolio of investments and its strategic business units. How would you assess the multi-business portfolio of the group in terms of the strategic assessment tools such as the Portfolio Matrix and the Parenting Fit Matrix? Is there synergy in the groups portfolio? Where are the misfits? Why?
4. ☐ What type of corporate strategy is the group following? How would you define the aims and objectives of the group? Does the group have a vision? Do you honestly think the group takes strategic management and planning seriously? To what extent? Why?
5. ☐ What are your recommendations as a result the audits you carried out in Questions 2, 3 & 4.
6. ☐ What type of shareholders does the group have? Who is really in control? To what extent do the shareholders interact with the business? For example, if a private business, how does the family or private shareholders interact with the business? If a listed company, how do the majority shareholders interact with the business? If a government business, how does the government interact with the business? Any problems in this regard? Explain in detail the culture at the top and how it affects the entire business. Give

recommendations of how ownership issues can be improved and better managed.

7. ☐ What is the role of Head Office? How does Head Office manage the complexity that the subsidiaries bring? Any problems here? Recommendations?
8. ☐ How is the Group Board of Directors organised? What is your assessment of the Board's performance? Recommendations?
9. ☐ Assess the Group's performance on various parameters you would find available in terms of financial, market, customer and internal operational and employee measures.
10. ☐ What changes would you make to the organisational structure to improve its performance?
11. ☐ How would you go about improving the strategic management and planning capability of the Group?
12. ☐ What is your assessment of the Group's future? Should the group be looking for growth or consolidation? What opportunities for growth present themselves?
13. ☐ What changes would you make to its portfolio of investments?

The team of participants carrying out this project may use any frameworks from the course that are useful in assessing the organisation of the group, its strategy and to come up with recommendations. To answer appropriately the above questions, you are expected to consult Annual Reports and Performance Reports you may get about the company from the internet and other sources. You would be expected to make one or more interviews with senior managers within the Group. You are expected to research informal blogs saying both negative and positive things about the company. It needs to be a balanced assessment. You need to ask around about the company and ask its customers, suppliers, employees or ex employees as well as competitors. You should answer with a Question & Answer format in the order of the above 13 questions. For this project you should act as Consultants to the Board of Directors of the emerging multinational case you have chosen. You also need to give the following details:

- a) Name of Key Decision Maker/s you met/phoned/emailed/skyped & responded to your queries and his/her position:
- b) Industrial & Service Sectors of the Businesses
- c) Total Number of Employees in all Business Units Owned
- d) Shareholding structure of holding company including names of top 10 principal shareholders.
- e) Total Size of the Business in Terms of Turnover Value in dollar currency terms

PRESENTATION EXERCISE - Version 5

As a Team you are asked to do a 15 minute presentation in which you would address clearly the Case Questions set out to you.

Instructions:

THE FULL NAMES AND MSM IDENTIFICATION NUMBERS OF ALL THE MEMBERS OF EACH GROUP HAVE TO BE SUBMITTED TO THE TUTOR IN THE FIRST SESSION OF THE COURSE.

You can use computer projector with Powerpoint for your presentation. You must have the presentation ready on a disk or other memory media and loaded into the CLASS PC BEFORE class starts. No one will be allowed to use his/her own laptop and connect directly to the PC projector. You are required to submit a hard copy of the Case Question Report at the start of the session and a soft copy of it on CD to the lecturer.

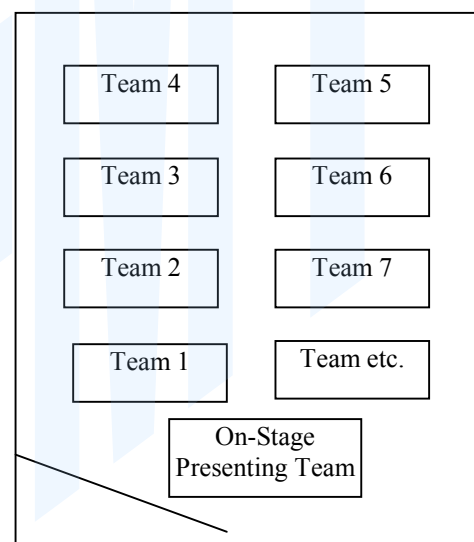
You have exactly 15 minutes to complete your presentation. Make sure you stick to the time limit. One minute spent extra on your presentation would lead to a penalty and reduction of marks.

The audience in front of you will have 5 minutes in which to ask you questions right at the end of your presentation. Those groups who have their members ask good and intelligent questions will be awarded additional marks. The persuasive, intelligent and professional way you answer these questions will also reflect your grade.

All members of your team must equally present part of the presentation. This means that not only do all members of your team need to be standing "on stage" during the presentation but must also give an equal contribution to speak and present a section during those 15 minutes.

The sequence in which each Team will present will be drawn by ballot. A ballot draw will be made after each presentation to identify the next Team who will be presenting.

All PC laptops must be switched off during class presentations. Individuals in teams who distract the Presenting Team by talking during the other team's presentation, or working on laptops or leaving/entering the room during presentations, or taking a break during another team's presentation will have marks deducted from their team. Teams are to be physically positioned in class in the sequence of their Team Number in a U shaped format eg. as follows. This structure should be maintained not only during the last session when presentations are to be held but also on each lecture day:



NOTES:

[illegible]

TEAM NUMBER: _____

NO MORE THAN 5 MEMBERS IN EACH TEAM

1) <u>FULL</u> NAME OF EACH MEMBER OF THE TEAM (incl. middle names) 2) MSM Identification Number 3) Organisation	1) Products/Services of Organisation 2) Your Position within Organisation 3) Email Address 4) Mobile & Tel Numbers	GRADE (FOR OFFICE USE ONLY)	

FOR OFFICE USE ONLY:

PROJECT: _____

CLASS EXERCISE

ASSESS: Q Grd

PRESENTATION PREPARATION & FINAL

NOTES:

[illegible]

Peer Evaluation Form

Your contribution to the Assignment will also be evaluated by your teammates. Please note that the peer evaluations are an important input to the overall evaluation of your performance on the Assignment. When scoring your teammates on their participation in the Assignment, you should consider all the team tasks that you needed to accomplish throughout your course, including team presentation tasks, team research tasks, team discussion tasks, team report tasks, etc, including those team tasks held during the daily class sessions.

A student who averages 5 points or below will obtain 0% in his total Assignment Score and will need to resit the assignment by doing a full written assignment report all on his/her own with the assignment question to be submitted by the Lecturer.

You should submit your individual peer evaluation forms personally and confidentially to the Lecturer on the last lecture day. The Lecturer will not show your scores to anyone else and will keep them strictly confidential. Nevertheless, if you are honest and open with each other throughout the project, no one's final peer evaluation should come as a surprise.

Each student must submit the peer evaluation. The **due** date for submitted the completed evaluation form to the lecturer is at the end of the last session. **If the lecturer does not receive your form filled in by then, he will assign a score of zero to your assignment and he will assume that this lack of action adequately reflects your participation.** The peer evaluations are to be submitted using the form below:

Your Name:	Your Team Number:	Your Intake, Course & Date:
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In the space provided below, please list the names of your group members -- including yourself -- and enter the number **from the scale below** that *best* describes each group member's contribution to the Assignment. Your peer evaluation score will be the average rating you receive from your peers translated to percentage points.

10 - Full Participant. This individual was a true team player, committed to the totality of the project and who made significant content and process contributions. He or she may have contributed in one primary area, but he or she was clearly committed to making the whole project a success.

8 - Strong Selective Participation. This individual made a significant contribution to the project, but within a clearly defined scope; he or she limited participation to a particular content or process role -- and showed initiative in that area -- but did not view the overall project as his or her responsibility.

6 - Weak Participation. This individual did not cause any problems, but made little substantive contribution to content or process. He or she showed little initiative and contributed only what was specifically requested.

3 - Virtually Absent. This individual was frequently out of the loop on this project; he or she often missed meetings or other important communications, was consistently unprepared, and/or contributed substandard work that required correction by fellow team members; this individual exhibited little effort and made minimal contribution to the project.

0 - Totally Absent. This individual was totally absent from this project, and the end product in no way reflects a contribution on his or her part.

Please leave blank the score where your name is placed. The lecturer reserves the right to adjust your teammate's overall proposed peer evaluation score if he deems it necessary.

If your team's average vote score on you Your Teammate is:	Then your teammate will get a Final Individual Assignment Score of:
10	Team Score + 2 Percentage Points
9	Team Score + 1 Percentage Points
8	Team Score Only
7	Team Score -5 Percentage Points
6	Team Score -10 Percentage Points
5	No Assignment Score
4	No Assignment Score
3	No Assignment Score
2	No Assignment Score
1	No Assignment Score
0	No Assignment Score

YOUR TEAMMATE'S NAME (Do not put your name here)	SCORE	COMMENT
1.		
2.		
3.		
4.		

NOTES:

This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. In the background, there is a faint, light blue geometric pattern consisting of various shapes like triangles and polygons, some of which appear to be overlapping or layered. The overall aesthetic is clean and modern, typical of contemporary stationery design.

COURSE FEEDBACK FORM

DEAR Program Participant:

Please give me your comments to understand better where the course is doing fine and where it needs improvement to meet the needs of future participants. Thanks in advance for your participation.

Martin Testa, mba@nobelmantrich.com

Title (Mr, Ms, Dr):

Full Name:

E-Mail Address:

Phone Number/s :

Company Name:

Company Position:

We would like to invite you to be a testimonial by giving your opinion about your experience of my course, by saying something about it here. This comment and your company business name (if you wish) would be published on our various communication materials to other prospective businesses who may wish to benefit from our programs:

Other helpful private & confidential comments you may have about my course:

NOTES:

This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. In the background, there is a faint, light blue geometric pattern consisting of various shapes like triangles and polygons, some of which appear to be overlapping or layered. The overall aesthetic is clean and modern, typical of contemporary stationery design.

Case Study: Borg Holdings

1.1 - Organisational Structure of the Holdings

The structure of the Group is highly informal. The non-executive Chairman/founder of the Group today is very senior in age and plays a minor role in the running of the Group of Companies. He is a very cost conscious person and he still runs one of the more cost sensitive and stable business units of the Group in construction material manufacturing. The two eldest sons of the founder, Peter and Tom Borg are the Directors on the Board who are active and who have the major say in the running of the Group.

Today, Tom is the most active family member in the business and although not yet officially recognised as such, he is regarded as the CEO of the Borg Group of Companies.

1.2 - Investments

The family business was founded 65 years ago with household goods retailing. Seven years later the company had moved into the furniture manufacturing business which eventually became the company's core business: a business which the company has been highly renowned for. 30 years ago the company had diversified into the manufacture of building materials and 10 years later a further diversification spate had occurred which finally resulted in the creation of a holdings company (Borg Holdings Ltd) in which the various investments of the Borg family were represented. Diversification continued up to the present day with a number of divestments in the process.

The shareholdings that the Borgs possess in the various Strategic Business Units (SBUs) vary substantially but tend to fall in three types of categories of SBUs, ranging from majority to minority shareholding interest as follows:

Group Controlled Companies (Major say in company affairs)	Shareholding
SBU1 Construction Machinery Import	100%
SBU2 International Trading	100%
SBU3 Furniture Manufacturing	80%
SBU4 Industrial Machinery Mfg	20%
SBU5 Paper Products Mfg	20%

Associate Interest (Equal say in company affairs)	Shareholding
SBU6 Clothing Mfg	45%
SBU7 Construction Material Mfg	25%

Minority Interest (Minor say in company affairs)	Shareholding
SBU8 Office Equipment Importers	40%

Portfolio of Borg Holdings

An overview of the SBUs involved follows:

SBU1 Construction Machinery Import: This business aims to fulfill local requirements for construction machinery and earthmoving equipment. Growth in these sectors is stable and the SBU's local market share is estimated between 30% and 40%.

SBU2 International Trading: Another recent start-up in the area of international trading. Goods traded are mostly in high growth areas. International trading as a service is also a growth business due to its increasing globalisation. As yet however, the SBU's share is very low. This subsidiary is headed by Peter Borg.

SBU3 Furniture Manufacturing: This business is presently catering for the upmarket segment. The company is mainly geared for export and has a low market share. The SBU is presently finding exporting difficult. The main objective of this SBU is to design and export semi-customised furniture systems. Market growth is stable.

SBU4 Industrial Machinery Mfg: This is a recent, ambitious start-up. The business unit aims at increasingly supplying appropriate technology to developing countries principally in machinery for industrial manufacturing. There is a high growth rate in this particular market segment, due to the import substitution policies practiced by these countries.

SBU5 Paper Products Mfg: There is presently medium growth in the export market in this company's product categories. However, the SBU's share in the export market is very low and the market is slowly reaching maturity.

SBU6 Clothing Mfg: This is a local garment manufacturer producing in a narrow but high-growth segment of the market. The company is market leader in its segment.

SBU7 Construction Material Mfg: This SBU is engaged in the manufacture of concrete products for construction purposes for the local market. This is a low growth sector with a medium-to-high market share. The market segment is price sensitive but on the whole, the market is pretty stable. Presently, however, the company is losing ground to its competitors.

SBU8 Office Equipment Importers: A local market distributor of office equipment, particularly photocopiers, PCs and equipment supplies. A High growth market of which this SBU occupies 40%.

1.3 - Key Issues and Interactions

Aims and Objectives

The aims and objectives of the group and the key issues facing it are highly influenced by (a) the CEO's personality and aspirations, and (b) the 'family business' nature of the whole set-up, i.e. the family culture, its traditions and influence on the business.

Tom Borg, the CEO of Borg Group is in fact informal, adventurous, confident, humorous, and idealistic. The organisation of the Borg Group is characterised by its risk-taking and informal nature, with the latter namely being a lack of formal cost and financial controls and elaborate liaison devices.

Although the Group had diversified substantially in these last thirty years, diversification was never recognised as an objective. Spreading the risk was not a primary objective for diversifying. More so, the founder, as well as his successor (the present CEO), have invested into new ventures chiefly because of the profitability they envisaged.

The Group's top people have always found it comfortable to diversify into new areas. However, expansion was still occurring in the Group's long established businesses, and in some areas, exporting was taking place.

With all these moves, the Group had passed through various growth thresholds. Growth had thus put a substantial amount of pressure and tension on the structure, culture and controls within the organisation. Presently the purpose and objectives of the Group are not clear and the strategies, roles, procedures, duties and responsibilities at Holdings level are not well defined.

The aim of creating the Holdings company in the first place was for tax and estate reasons. This was thought to be an appropriate way for the founder to pool in the various investments and to pass them on to his sons in a fair manner in view of the gradual succession process which 20 years ago had inevitably to start taking place. For this reason, the Holdings company has been very much regarded as a "paper company" in which the bare essential formalities had to take place. This included such tasks as the compiling of the accounts of the various business units for the preparation of the Group's annual report; the collection of income from property leases and the issue of dividends.

Many top managers of the various business units think that Head Office in the Holdings company is not adding value and that it is more a cost and constraint to growth rather than a means to nurture the success of each business unit.

The CEO and Family Influence:

The family influence on the business has evoked a degree of paternalism in the running of the Borg business. The long established businesses of the Borg family had created goodwill and an image of reputation among local consumers and the business community. However, in the mind of Tom Borg this image may be overstretched. The family influence and Tom's strong personality and charismatic qualities are subduing the corporate identity of the Group both in the eyes of the employees within the Group as well as in the eyes of the business community and the customers.

In some areas there is an unclear distinction between what is of the Borg family and what is of the business. Such problems mostly occur in the long-established business units in which the Borgs have a majority shareholding, namely Medalco Ltd (furniture manufacturing) and J.B. & Co. Ltd (construction machinery importers). Managers of these business units claim that "family interference obstructs the professional management of the firm". This has created a certain degree of uncertainty with non-family management becoming defensive, inconsistent, vulnerable and anxious. For example, some incidents arise mainly due to Tom's sociable and influential character. Many employees look up to Tom in a paternalistic way.

On the same vein, clients of the business prefer dealing with Tom rather than with non-family members of the business. This is mostly due to his generous character, especially if they know Tom personally. Due to these factors, short-circuiting of the lines of authority sometimes occurs. For example, the CEO

occasionally handles a client personally himself by communicating straight down to the operational level of the business unit.

A degree of managerial incompetence is present in the two above-mentioned business units. These managers put up smoke screens regarding lack of performance in their business unit by blaming the family owners for using the business for their immediate convenience or for recruiting incompetent family employees. While these claims are to some extent true, such claims are being used as screens to cover the managers' incompetence. Nevertheless, the managers' incompetence is being reinforced by the fact that the CEO is not fully capable of delegating tasks properly. Incompetent managers continually approach the CEO on the most trivial matters and the CEO is asked to assist, which he usually does. This is both a symptom of his paternalistic attitude and his socialising nature both of which keep him from saying "no" to such trivial matters.

Besides relating directly with each of the eight business unit managers, Tom handles directly any possible new ventures or business deals that come along. His management style makes it difficult for him to address fully the overall strategic issues that face the Group.

Presently Tom is undergoing a period of personal change; a sort of "menopause effect". He is becoming slightly less outgoing, less of a jovial person and does not trust people to the same extent that he used to (some business unit managers say that he used to trust excessively). Some factors which have contributed to this are:

- Various incidents of abuse he experienced from partners and managers alike as a result of his trust;
- Age (approaching 50) and stress, as a result of excessive commitment in various aspects of the business;
- Conflict between the wife of Tom and the wife of his brother, Peter, on certain aspects of the overall business of the Borg family;
- A love-hate relationship with his sons.

The latter issue is very much related with the issue of succession which is presently very much on Tom's mind.

Tom is basically a 'new ventures' person; he likes new things, new ideas and "new ways of making money". He invests in new ventures no matter how different they are from the present business areas. This is very evident by the very nature of the portfolio. Tom does not like carrying out administrative tasks and very often he feels overtaken by his own creations when business unit managers consult him on trivial administrative matters. Tom's preferences have recently been changing. His present inclinations are to avoid projects in highly competitive areas and projects which require a high degree of monitoring. Tom's aspirations for the business are increasingly becoming short-term. Tom does not feel that his sons would be good successors (the oldest son, Jim, is 23 years old, while George, 20 who is very creative and design oriented is currently studying Product Design abroad). Peter's has three children two sons who are 17 and 13 years old and a daughter aged 10. None of Peter's children are yet involved in the business.

Jim is the only 3rd generation family member who is as yet involved in the business. Jim's character is different from that of Tom. Jim unlike Tom, tends to be less creative and less dynamic in growing into new business areas, however Jim is much better

than Tom in administrative, organising and planning tasks. Tom believes that his money may be better invested somewhere that does not give him administrative headaches and that perhaps, there may be some investors who would be interested in buying up some or all of the various business units of the Group. Presently Tom prefers to see how to "make a fast buck" and to indulge into short-term 'wheeling and dealing'. Tom has always had many ambitions for the Group. However, he sees the future of the Group in the hands of the Borg family to be uncertain.

When it comes to succession, it is evident that Jim has become his mother's favourite. This is shown by the way she has been supporting him in the family business. To some extent, this is further alienating father from his son. Even worse is that Tom severely criticises his son in what he used to do and in what he does. Then Jim over-reacts in what he does in order to try to show how competent he is. This makes the situation even worse. Jim once said, "In my father's business it's difficult to know where I am. Some people tell me that I'm doing well – but it is hard to distinguish why they are saying it – maybe so that they can gain my father's respect... Funnily enough, while I am trying to repair organisational weaknesses left by my father, I find myself subject to criticism by those non-family managers waiting for me to stumble".

Short-term Orientation

Jim does not like the short-term orientation presently being adopted by his father and prefers building the business for the long-term. For example, there is a difference in opinion between Jim and Tom on whether to sell out two of the business units or not. Jim thinks that they are good investments for the long term, while Tom thinks that these two particular SBUs are causing too much administrative headaches, the present returns on which do not justify the "troubles" being encountered by Tom.

Nevertheless, the short-term 'fast buck syndrome' is not just a recent phenomenon of the Group. It has its origins from the way the Borg family has traditionally done its business. This is not a characteristic unique to the Borg Group, it is typical of the way many diversified family businesses do business. In relation to other groups of companies, therefore, the Borg Group's short-term orientation does not stand out. There are, however, issues which necessitate careful attention and which can harm the Group in the long term unless appropriate action is taken. These issues are:

- Most of the exports of the Group are mainly towards one country which is a relatively closed protected market and politically sensitive. At least two export-oriented business units rely principally on this one country for their sales.
- The group is also constraining its own growth due to its lack of concern on management information and accounting systems. The information produced is not particularly useful for management decision making. Certain information produced can also be misleading. Getting this issue sorted out is not as easy as one might expect. It involves such issues as culture and orientations both within and outside the organisation, and it may mean that the Group may have to forgo certain benefits that it presently enjoys.

Performance

As previously inferred to, performance in the two longest established majority-owned (50%+) business units is declining. In the more recent ventures and in those with associate and minority interest, performance is good. From the point of view of

family interference, J.B. & Co Ltd, being the longest established wholly-owned subsidiary, has been the company mostly tampered with and "abused of". The company is incapacitated with incompetent family employees and incompetent management. Traditionally, this company has played the role of corporate valve for the Borg family, or rather, that part of the Borg 'carpet' under which the family 'dust and garbage' is thrown and hidden.

On the other hand, the other, more recently established business units do not have the same family-related problems. However, their shareholding mix is complex. Controlling interest varies from being majority-owned to associate interest, with one company where the Borgs have a minority interest. In associate SBUs, the Borgs have an equal say as the other partner/s in the running of the business. The complexity is compounded by the fact that in some SBUs the general manager has a shareholding in the business while in others; the general manager does not have a share. Management shareholding also varies from being negligible in some SBUs to being substantial in others. The effect of this is that some managers are owner-managers while others are employee-managers.

All this puts a burden onto the CEO and the Holdings. The diversity of ownership, of industries, of stages of maturity, of growth and of financial performance is putting a severe strain on corporate management in understanding and controlling each of the businesses in a portfolio of this sort.

Many times one can see Tom changing his leadership style as he roves from one business unit to the next. But this requires tough skills at being a good "schizophrenic". Since Tom has a liking for that which is new and enterprising, he has a tendency to spend much more time on the 'budding flowers' than the more mature ones, even though he has got less stake in the budding ones. The mature ones seem to be calling for help most of the time but Tom does not seem to take much heed.

Venture Capitalist Approach

A role that the CEO has been playing is that of an informal venture capitalist. A formal venture capital mechanism nationally has only recently started to take shape and sometimes, entrepreneurs who want to start up, or give a new lease of life to their business have approached Tom for financial support in return for a stake in the company. The decision to invest is mostly based on trust and intuition. With trust coming mainly from Tom's personal knowledge of the entrepreneur's capabilities; while intuition being Tom's vision of the potential that the venture has got. Performance in these ventures has been very satisfactory both in the eyes of the Borgs and in the eyes of the entrepreneurs. The latter normally become owner-managers. The relationship that exists between the CEO and the entrepreneurs is very good. The CEO gives a high degree of autonomy to the owner-managers.

Due to his risk-taking nature, the CEO is usually held back by his brother Peter Borg who is a very objective and logical person, as well as by the Managing Director of the Holdings company (i.e. Anthony Grima, a non-family member of the business who has a financial background). Both Peter and Anthony are conservative and risk-averse in nature. Frequently, Anthony has queries about Tom's investments plans in new or existing SBUs. In these instances, the relationship between the owner-managers and the Holdings company can become strained. For example, situations arise where the CEO reverts from a minuted decision with the owner-manager after Anthony cautions the CEO of the consequences of such a decision.

Head Office Management

Two years ago Anthony Grima was appointed by Government to head a government agency. This was a political appointment, and it was expected that he would remain Chairman of this organisation or some other government agency for as long as the political party which appointed him remained in Government. Due to this appointment, Anthony is only contributing two days a week on work at the Holdings. Clearly, Tom is in a double-bind situation here. Anthony has good contacts that the Group can make use of, but on the other hand, a lot of work that used to be done by Anthony has become either a burden on Tom or is not being done at all. Tom seems to fear the negative consequences that might arise in removing Anthony from the Group or putting him aside. Such consequences have to be seen in terms of the political power that Anthony now has outside the Group. Tom prefers to have Anthony's contacts which lead to short-term gains; however Tom is not happy with the situation and doubts how possible it is to resolve this issue.

Anthony does not have a share in Borg Holdings Ltd. However, he has got a minority share in one of the SBUs. On some occasions this has created a conflict of interest in terms of his position as Managing Director of the Holdings company.

The staff in the Holdings company is made up of Anthony and his personal assistant whose services are shared also by the CEO. Peter Borg is no longer very active at Holdings level and is now mainly involved in one of the subsidiaries of the Group.

Meetings: At Holdings level, no meetings are made by directors so as to discuss important strategic issues. When meetings are held, discussions centre on day-to-day issues and matters arising.

The Group's Future

The determination of the Group's future is very much an equation of the aspirations of the CEO and the relative strength of the forces that presently impinge for or against those aspirations. The equation cannot be quantified. The qualitative aspect of these forces is very dominant and the relationship between them is very dynamic. Various options and directions are open for the Group, but there are a number of questions that still need to be answered:

Questions:

Vision and Mission

1. How would you define the aims and objectives of the group? Does the group have a vision? Do you honestly think the group takes strategic management and planning seriously? To what extent? Why?

Strategic Analysis

2. What type of management structure does the group possess? How would you describe the management style of the group? What type of strategy is the group following? Apply the McKinsey 7-S Framework on Borg Holdings.
3. Highlight the major Competitive /Comparative Advantages and Competitive Disadvantages of the case in an Onion Model format.

Customer Alignment & Competitive Positioning

4. Prepare a strategic audit of the group: Look at strengths, weaknesses, opportunities and threats at Group level. What are your recommendations as a result of this audit? (use the SWOT Matrix to draw out the situation analysis and identify possible recommendations).

Designing Strategic Options & Corporate Strategy

5. Review its portfolio of investments and its strategic business units. What has led the group to diversify? How would you assess the portfolio of the group in terms of the strategic assessment tools used in class for diversified organisations?
6. In terms of your audit in Questions 1 to 5, what changes would you make to its portfolio of Strategic Business Units? Give reasons for any changes in the SBU portfolio? What new vision would you suggest for the Group?

Taking Strategic Action

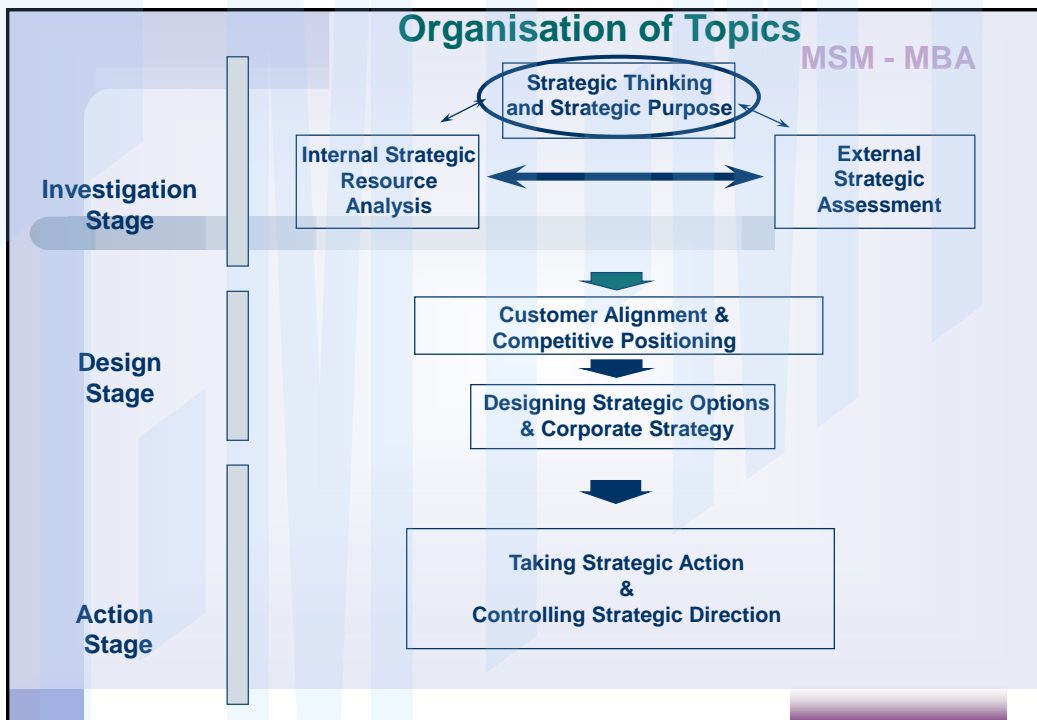
7. What is the role of Head Office? How does Head Office manage the complexity that the diversified subsidiaries bring? Any problems here? How would you deal with the complexity of ownership structure and the varying shareholding relationships? What role should Head Office play (if any) in order to manage the Group of Companies more effectively and efficiently? What changes would you make to the organisational structure to improve its performance? Draw your recommended Organisation Chart?
8. What type of shareholders does the group have? To what extent do the shareholders interact with the business? For example, how does the family interact with the business? Any problems in this regard? How can the family fit better with the needs of the business and how can the business fit better with the needs of the family?
9. If you were the CEO, how would you deal with the succession issue to guarantee the future of the Group?
10. How would you go about improving the strategic management capability of the Group?
11. How is the Group Board of Directors organised? What is your assessment of the Board's performance? What corporate governance improvements do you suggest here?

The team of participants carrying out this project may use any frameworks from the course that are useful in assessing the organisation of the group, its strategy and to come up with recommendations. You should answer with a Question & Answer format in the order of the above questions. YOU NEED TO GIVE ANSWERS TO THE QUESTIONS TO THE TUTOR ON THE DAY IN WHICH WE WILL BE COVERING THE RELATED TOPIC IN CLASS. Topics covered per day can be found in the Subject Outline Form in your notes. The Borg Holding case questions are also exhibited in the slides under each subject heading.

MSM MBA Program

Global Corporate Strategy

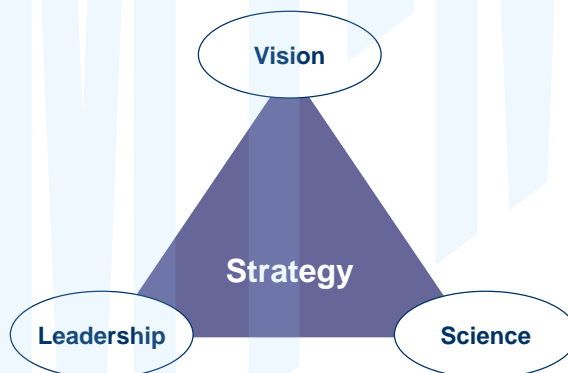
Martin Testa



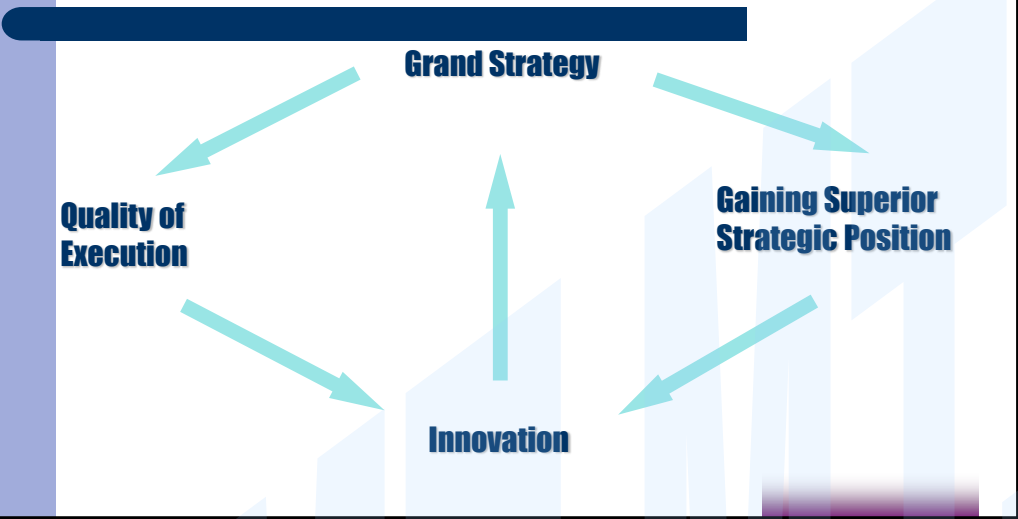
What is Strategy?

- The determination of the long term goals and objectives of the enterprise (Alfred Chandler)
- Strategy is the central reason why firms succeed or fail (Porter)
- The art of generalship; in particular, imposing on the enemy the time, place and conditions of fighting preferred by oneself (Oxford English Dictionary).
- The whole pattern of decisions that sets the long term direction of the company, commits substantial resources, and affects materially the actions of others.
- Victorious warriors win first and then go to war, while defeated warriors go to war first and then seek to win (Sun Tzu).

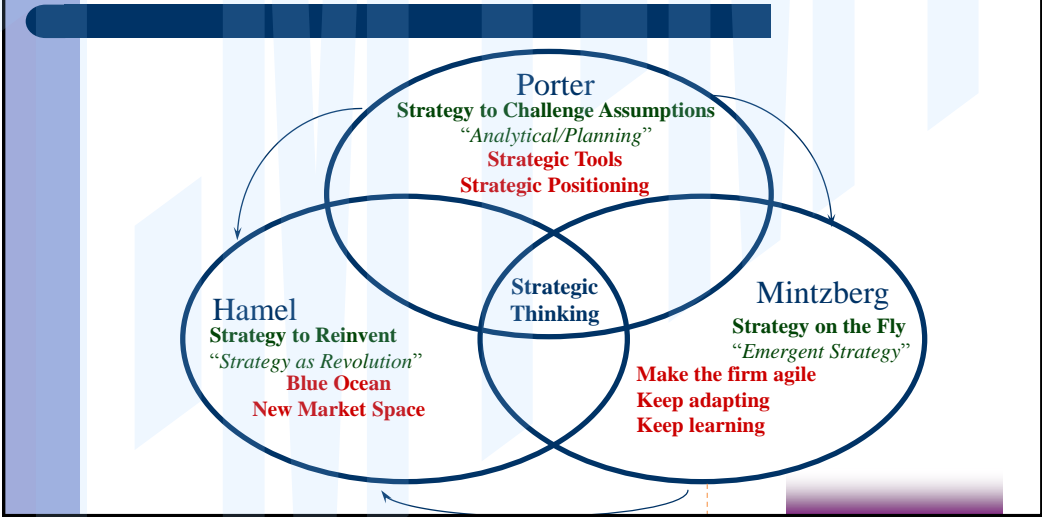
The Ingredients of Strategy



An Agenda for Leadership



Schools of Strategic Thinking



The Domain of Strategy: The levels of Strategy

- Corporate Strategy

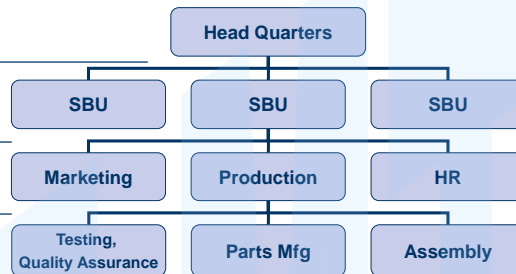
Diversification, Verticalisation, M&A

- Business Strategy

Competition, Products, Markets, Industry

- Functional Strategy

Budgets, Resources, Processes



Mission Statement

A written declaration of an organization's core purpose and focus that normally remains **unchanged** over time. Properly crafted a mission statement:

- (1) serves as a filter to separate what is **important** from what is not. It sets the broad GROUND RULES of conducting business.
- (2) should be CONCISE, but at the same time, it should provide unambiguous guidance stating which **target market** / sector and/or geographic boundaries will be served and in what way, and
- (3) is essentially an INTERNAL working document communicating a sense of intended **direction** to the entire organization and showing the basic essence of the **competitive advantage** which will translate to superior profitability.

Mission and Vision

A mission is different from a vision in that the former is the cause and the latter is the effect; a mission is something to be accomplished whereas a vision is something to be pursued for that accomplishment.

Examples of Mission Statements

- **Nike:** *To bring inspiration and innovation to every athlete in the world.*
- **Starbucks:** *To inspire and nurture the human spirit – one person, one cup and one neighborhood at a time.*
- **Chevron:** *To be the global energy company most admired for its people, partnership, and performance.*
- **Amazon:** *To be the most customer-centric company in the world, where people can find and discover anything they want to buy online.*
- **Intel:** *Delight our customers, employees, and shareholders by relentlessly delivering the platform and technology advancements that become essential to the way we work and live.*
- **Ebay:** *Provide a global trading platform where practically anyone can trade practically anything.*

Analysing the Business Side

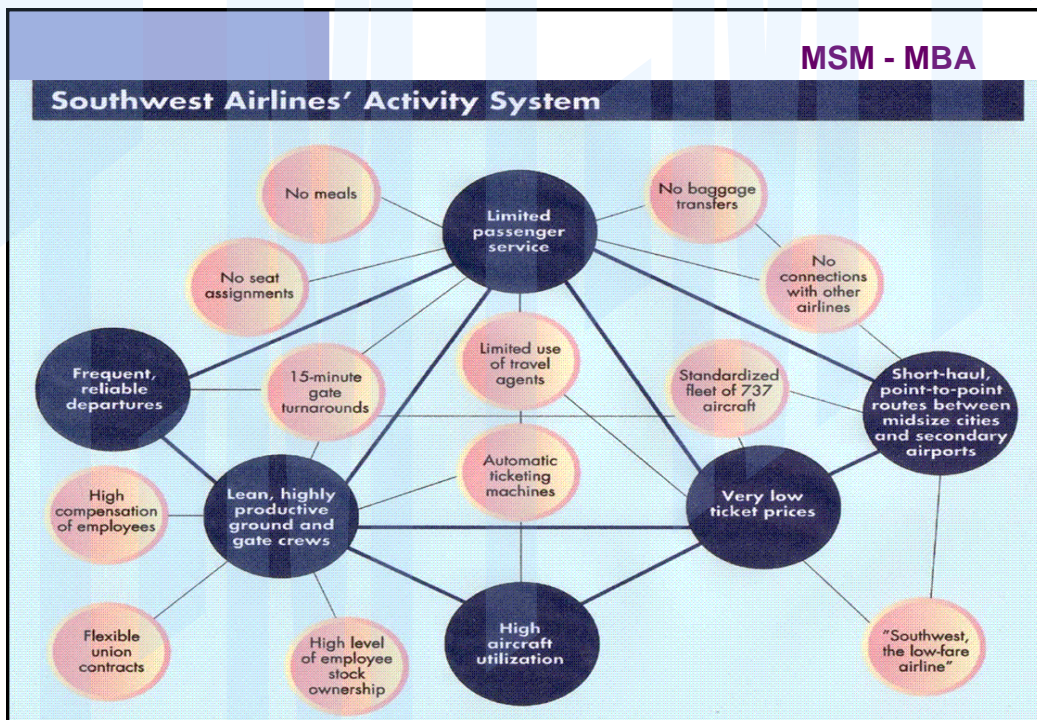
Strategic Principles

- Action Oriented
- Forces Trade-Offs
- Beliefs of what makes you successful & unsuccessful
- Helps you to decide

Southwest
Case of Purpose Nestle

Strategic Principle Examples

- Southwest Airlines: *Meet customers' short-haul travel needs at fares competitive with the cost of automobile travel*
- Dell: *Be Direct*
- Walmart: *Low prices everyday*
- GE: *Be No 1 or No 2 in every industry in which we compete or get out*



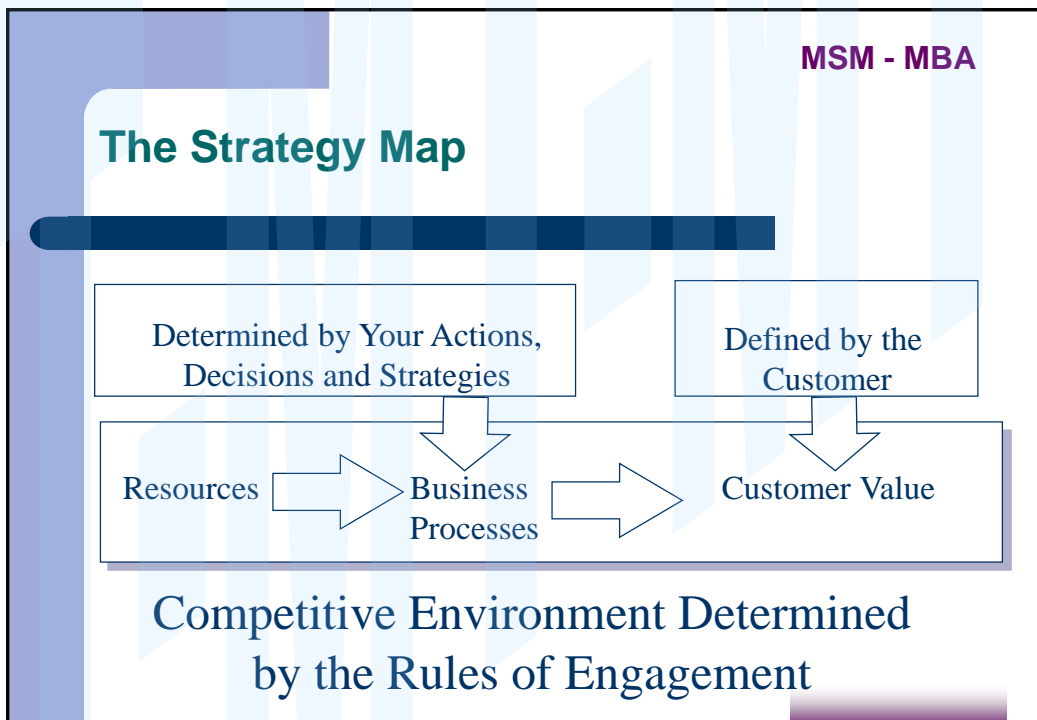
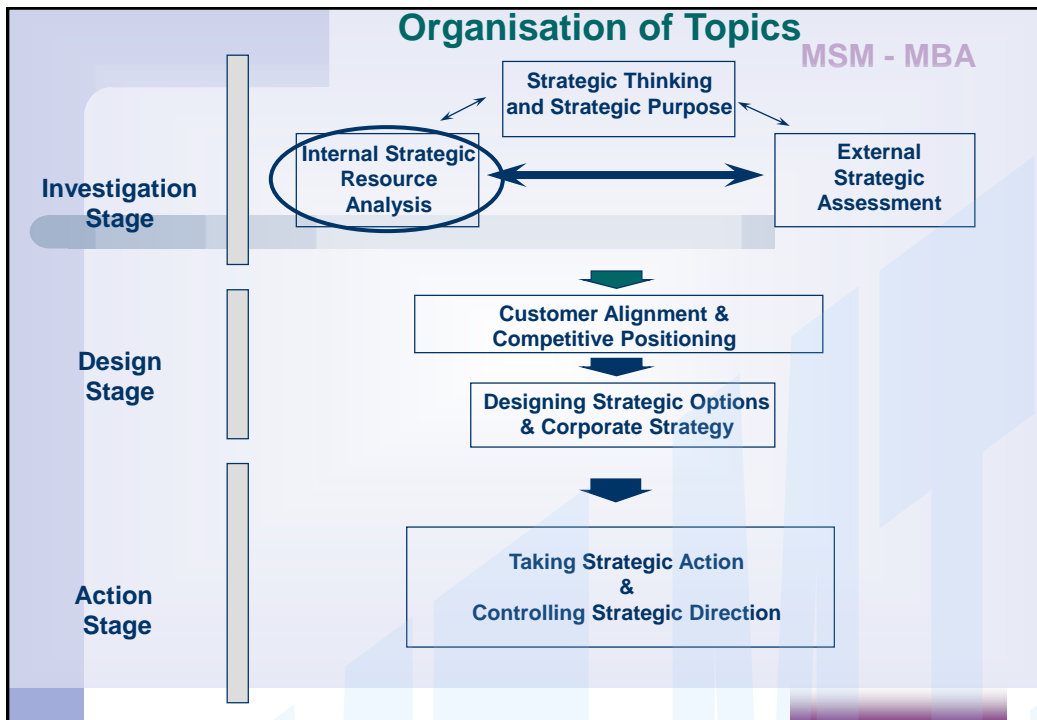
Borg Holdings Case

Answer Question 1:

- How would you define the aims and objectives of the group? Does the group have a vision? Do you honestly think the group takes strategic management and planning seriously? To what extent? Why?

Case Study: Mission and Objectives

- **LIG Case Study**



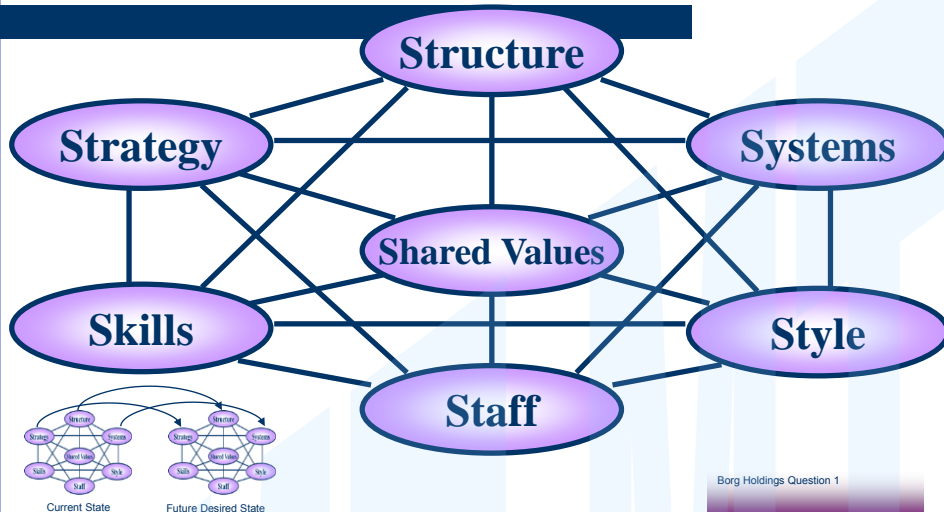
SWOT Analysis Procedure

- 1 Make continuous comparisons with your external competitors. Particularly with at least one strong or potentially strong competitor
- 2 Opportunities and Threats are not found internally in the company but are found in the external environment and are not within the control of top management. Among external factors look also at Political, Economic, Social and Technological factors (PEST factors). Look also at Suppliers, Customers, Substitutes , Competitors and New Entrants.
- 3 The Strengths and Weaknesses of your product or service must be assessed from your customer's perspective in view of other competitive offerings, not your perspective
- 4 Where you are unclear as to whether a particular variable is a strength or a weakness, separate these two aspects out, listing one as a strength and one as a weakness. Do the same if it is an opportunity or threat.
- 5 Rate your degree of strength and weakness on a scale of 1 to 5. Do the same for opportunities and threats.
- 6 Highlight the key areas of the SWOT which are most important for competing effectively

SWOT Questions – What is:

- There is a Currency devaluation?
- I have got a declining market share?
- There are trade tariff reductions in my country?
- My products have a Low Price?
- I have got good access to finance?
- There is an increase in consumer demand?
- New technological developments externally is improving the consumer's lifestyle?
- There is an increase in the number of defects in production?

McKinsey 7-S Framework



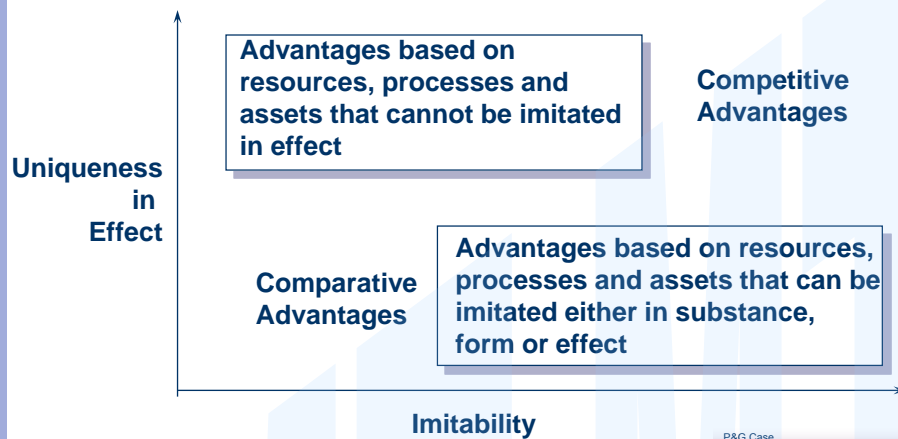
Borg Holdings Question 1

Borg Holdings Case

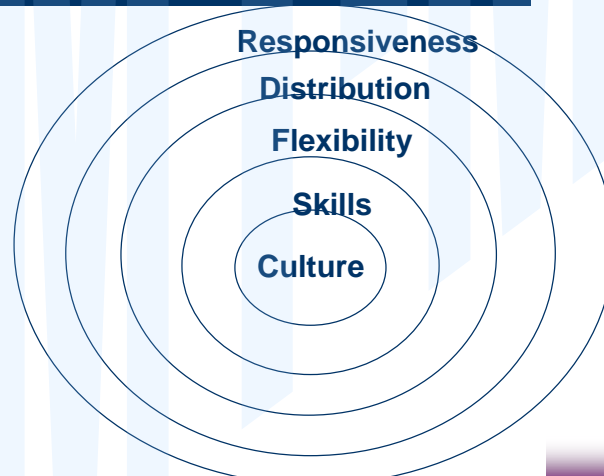
Answer Question 2 of the case:

- What type of management structure does the group possess? How would you describe the management style of the group?
- Apply the McKinsey 7-S Framework on Borg Holdings.

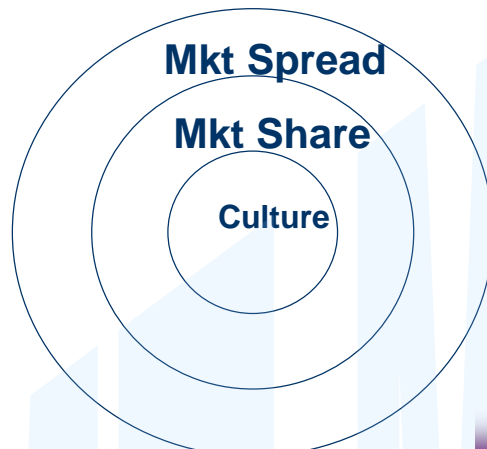
Comparative & Competitive Advantage



ONION MODEL: COMPETITIVE ADVANTAGE



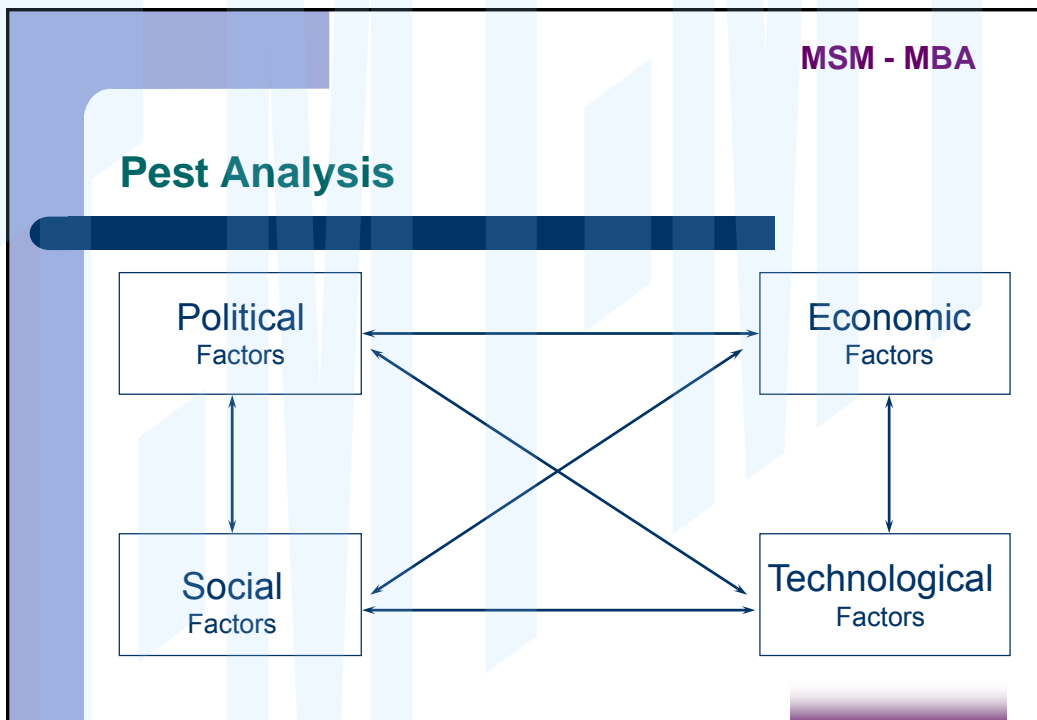
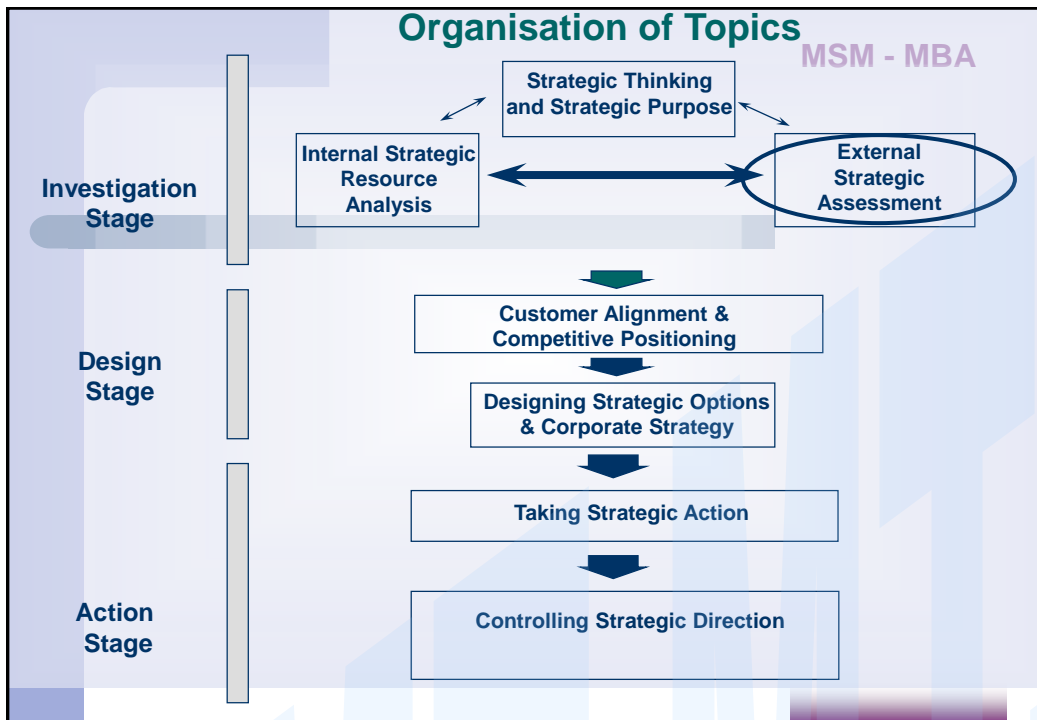
ONION MODEL: COMPETITIVE DISADVANTAGE



Borg Holdings Q2

Borg Holdings Case Question 3

- Answer Question 3 of the Case by highlighting the major Competitive/Comparative Advantages and Competitive Disadvantages of the case in an Onion Model format.



The Five Competitive Forces that Determine Industry Profitability



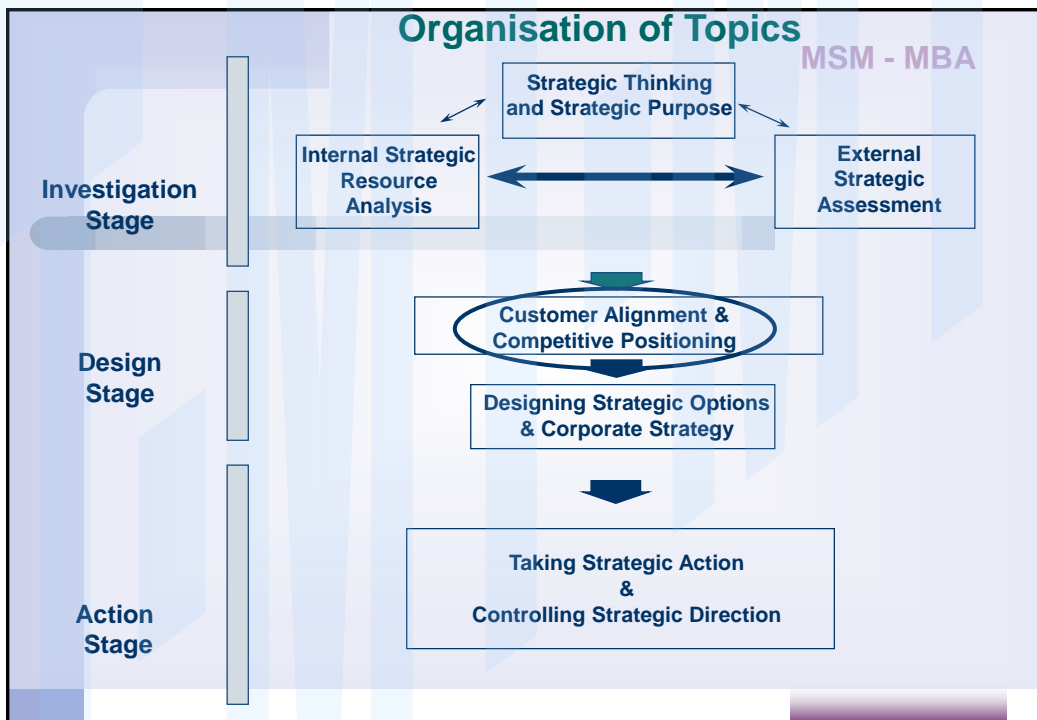
Creating and Sustaining Advantage Through the Five Forces

- Defend the Bases of Differentiation
 - Create switching costs
 - Promote brand/reputation
 - Prevent imitation (proprietary knowledge, processes, products/patents)
 - Discourage imitation (tailored organisation)
 - Lock in customers
 - Control channels of distribution/supply
 - Control the many dimensions of added value
 - Achieve Low(est) Costs

Biotech Industry Case – 5 Forces

Case Exercise

- Biotech Industry Case – Application of the 5 Forces



The Strategy Map

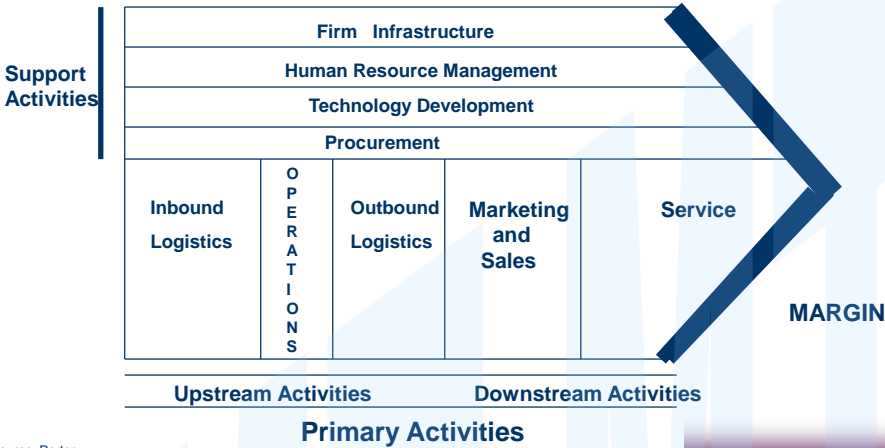
The Process: Strategy - Matching Values to Processes

Resources → Business Processes → Customer Value

Value Adding and Waste Activities

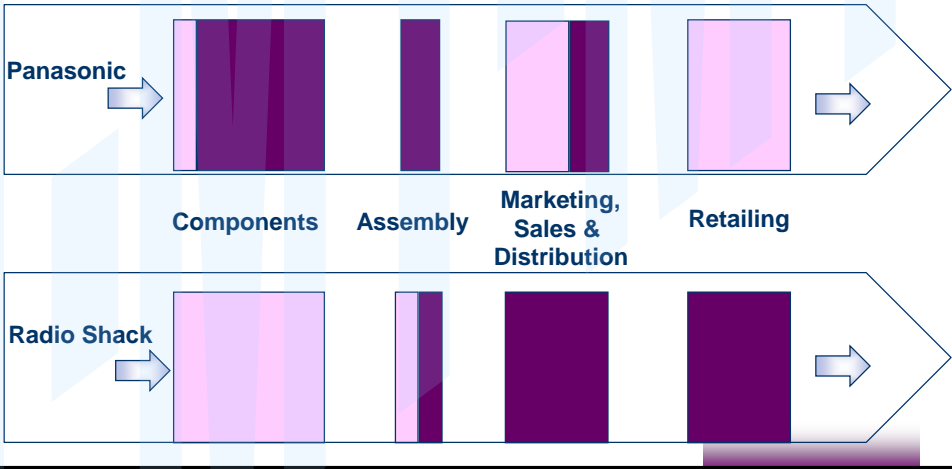
- Value adding activity is activity:
 - that the customer cares about
 - where the product or service is actually transformed and
 - where the activity is done right the first time
- Non-Value Adding Activities (Waste activities) are:
 - Jobs/ information waiting in queues behind other work
 - Jobs being moved to another queue
 - Inspections
 - Production changeovers from one activity to another
 - rework

Porter's Generic Value Chain



Source: Porter

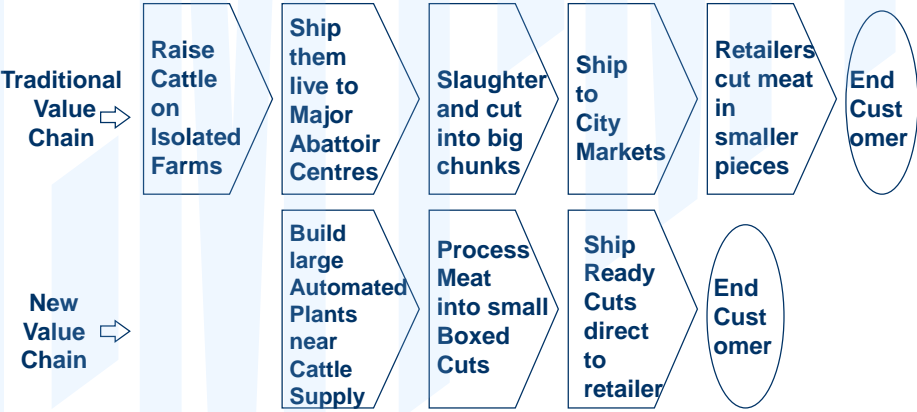
Sources of Value for Panasonic & Radio Shack



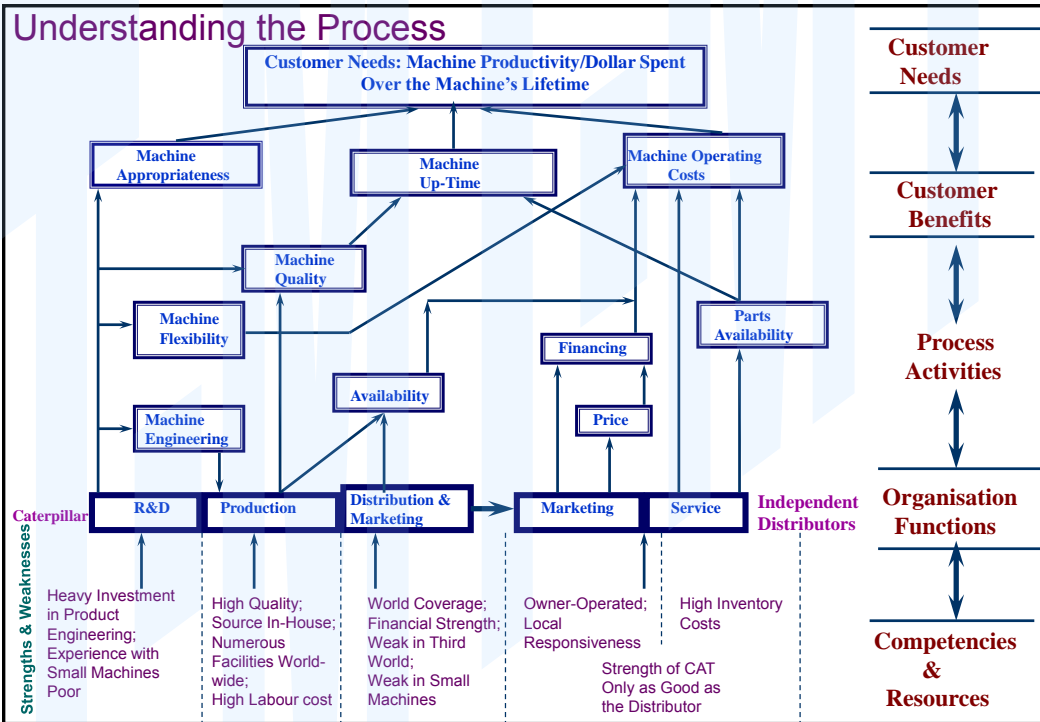
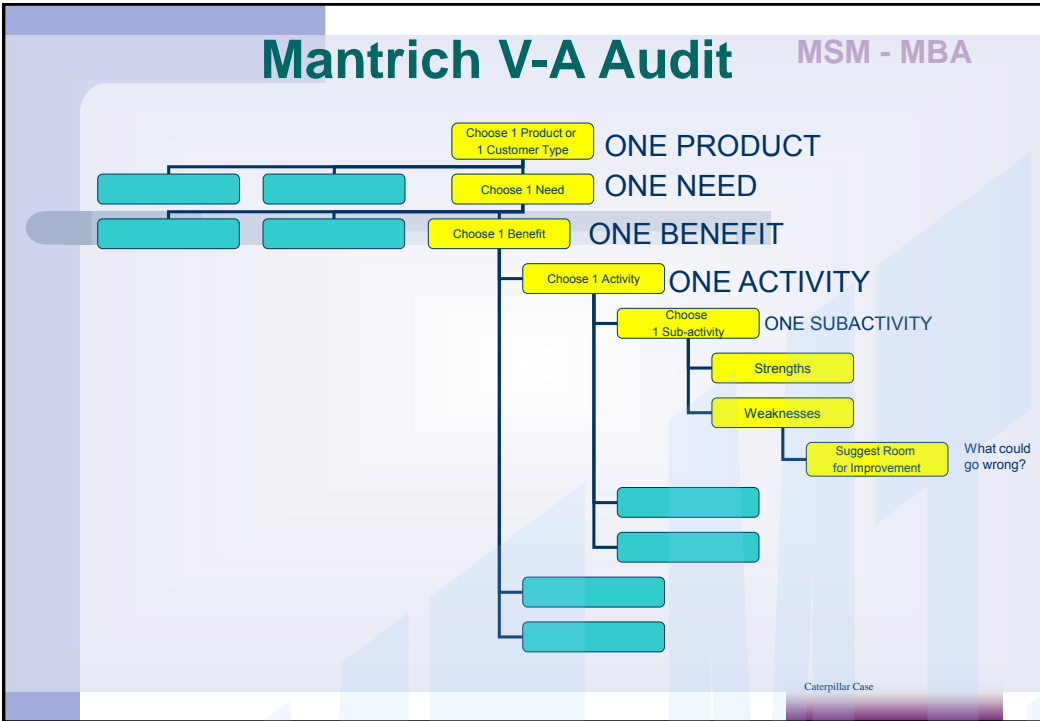
The Value System



Value Chain Improvements



Beef Processing & Distribution in Europe



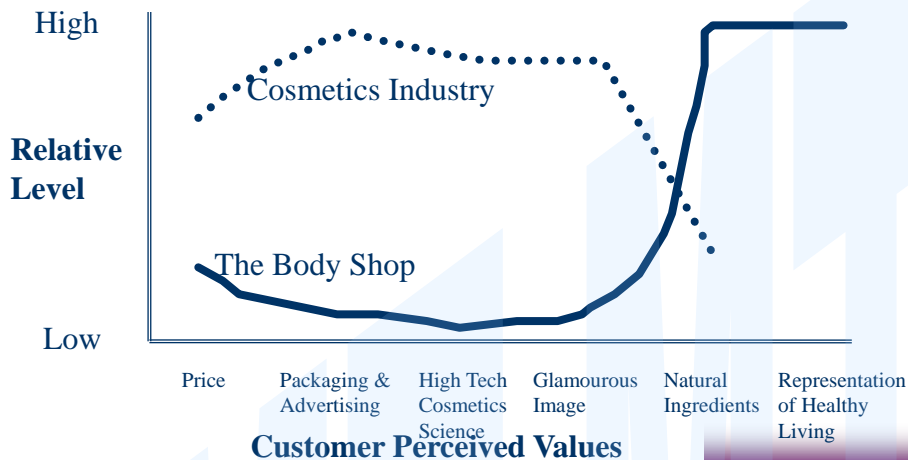
Strategy as Revolution

- Identify 15 most fundamental beliefs that incumbents in your industry share
- What new opportunities present themselves when you relax those beliefs?

Rules of 'Engagement' for the Cosmetics Industry

- Satisfy a psychological need
- Product innovation paramount
- Beauty consultants critical
- High quality packaging and design
- Differentiation
- Full range important to capture critical mass of customers but customers not loyal to the whole line
- Product launches and promotions necessary for distributors
- Consignment sales

Is the Body Shop a Cosmetics Company?



The Process of Creating an Industry Revolution

- Identify the unshakable beliefs that cut across the industry
- Identify fundamental shifts in technology, lifestyle, working habits, etc
- Achieve a deep understand of your core competencies
- Use all this knowledge to identify the revolutionary ideas, the unconventional strategic options, that could be put to work in your competitive domain

The Three Groups of Revolutionaries in your Company:

- Young People - 20 or 30 something
- People at the geographic periphery of the organisation
- Newcomers - People who have not yet been influenced by current industry rules

That which is imposed is seldom embraced

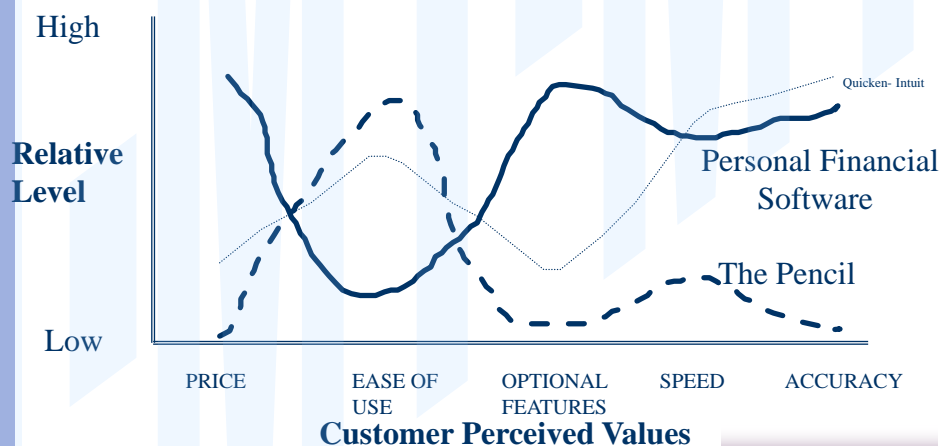
Ways of Finding Compromise-Breaking Opportunities

- How can we Separate Function from Form and Form from Function? (Swatch)
- How can we Radically Improve the Value Equation? (IKEA; overnight car repair)
- How can we Expand the Bound of Universality? (Kodak disposable camera)
- How can we Strive for Individuality? (Levis)

Ways of Finding Compromise-Breaking Opportunities

- What diseconomies exist in the industry's value chain? (beef; Dell)
- What possible analogous solutions exist to the industry's compromises? (Quicken, evening business paper; 2nd hand car warranty)
- What convergence can take place between our industry and other industries? (car banks; insurance hospitals, Aravind Eye Care)

The Value Curve in Personal Finance Before Quicken



Ways of Finding Compromise-Breaking Opportunities

- What Joy of USE can we achieve? (McKessons, virtual accounts; book cafeteria)
- How can we Increase Accessibility? (coke; first direct)
- How can we Rescale our Industry? (baker, cleaner, boutique hotel)

Strategy as Revolution Article - Hamel

Strategy as Revolution Exercise

For an industry of your choice:

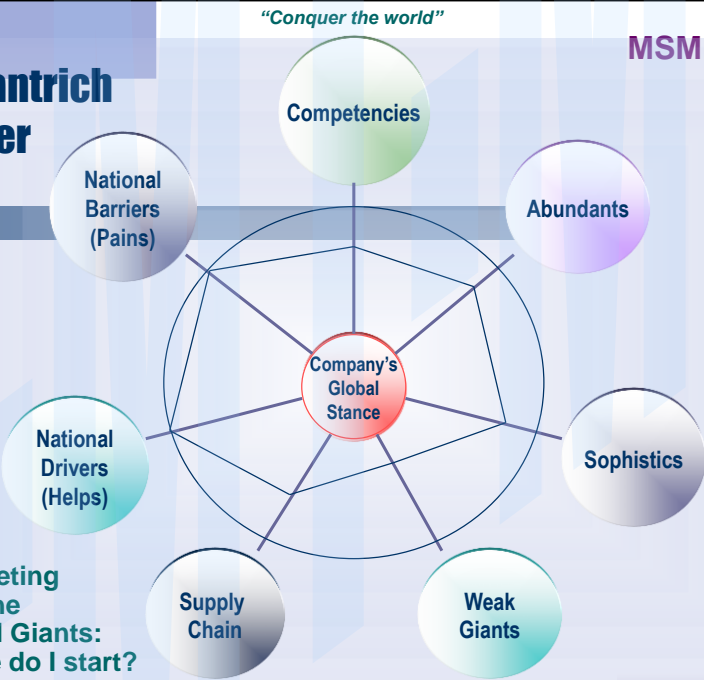
1. Select norms in this industry (incl. Critical Success Factors – “what can make you successful in the Industry”)
2. Split the Group in two: Half the Group who is not involved in this industry will consider breaking each norm and go in the opposite direction (through the “Ways of Finding Compromise-Breaking Opportunities”). The other half will evaluate the feasibility of breaking the norm and pick the most plausible norm to break that can significantly increase business results for the company). Present to your Instructor.

Strategy as Revolution Exercise
+ Article

Fighting the Giants:
Positioning for Emerging Market
Companies

		Competitive Assets	
Pressures to Globalize in the Industry		Customised to home market	Transferable abroad
	High	Dodger Focuses on a locally oriented link in the value chain, enters a joint venture, or sells out to a multinational <i>Furniture Retail, wholesale, Skoda</i>	Contender Focuses on upgrading capabilities & resources to match multinationals globally, often by keeping to niche markets <i>Emerging Multinational: Aravind Eye Care; Tata, Hyundai, Acer (Taiwan), Samsung & Kia (Korea), Cemex divers-to-cement (Mexico)</i>
	Low	Defender Focuses on leveraging local assets in market segments where multinationals are weak <i>Local tastes, local flavours, local requirements</i>	Extender Focuses on expanding into markets similar to those of the home base, using competencies developed at home <i>Jollibee Foods (McDonalds of Asia)</i>

The 7 Mantrich
Globuster
Levers



Competing
with the
Global Giants:
Where do I start?

"Conquer the world"							
MSM - MBA							
The Mantrich Globuster							
With what do I start to compete in global markets?							
	Weight 1 = low relevance 5 = high relevance/ high importance Raw Score 1 = Untrue 5 = Very True	Weight1 -5	Product A (1-5)	Product B (1-5)	Product C (1-5)		
	Globuster Levers scoring example:	3	2	3X2=6	1	3X1=3	3 3X3=9
1	Competencies: Uses your competencies , contacts, resources, skills						
2	Abundants: Uses your Country's abundant resources ; raw materials; supplies, labour & skilled labour; heritage, image or apparent "waste"; nuts in Tanzania, diamonds in South Africa; herbs in North Africa; oil in Middle East						
3	Sophistics: Uses products / services in which customers/workers in your home country are sophisticated in consuming/using/producing both in terms of high quantity and/or high quality; using unique knowledge, unique tastes or unique needs e.g. flowers in Holland; pasta in Italy; wine in France; etc.						
4	Weak Giants: Uses local assets/resources in market segments where multinationals are weak e.g. fulfilling local tastes, local flavours, local requirements similar to those in certain other similar socio-psychographic countries. Jollibee Foods (McDonalds of Asia)						

"Conquer the world"

MSM - MBA

The Mantrich Globuster

With what do I start to compete in global markets?

	Weight 1 = low relevance 5 = high relevance/ high importance Raw Score 1 = Untrue 5 = Very True	Weight1 -5	Product A (1-5)	Product B (1-5)	Product C (1-5)
	Globuster Levers scoring example:	3	2 3X2=6	1 3X1=3	3 3X3=9
5	Supply Chain: Uses products/services which form part of a supply chain or cluster which is know to be strong in your country e.g. fishing in Peru; software in India; leather in Italy				
6	National Drivers (Helps): Takes advantage of local Government support of certain products/ services eg. incentives, education, liberalisation, standards; favourable legislation.				
7	National Barriers (Pains): Avoids or takes advantage of weaknesses in local national systems & structures e.g. weak legislative enforcement; underdeveloped capital markets; excessive Government regulation or bureaucracy; scarce talent; high political uncertainty; lack of democracy, lack of product standards; corruption; lack of copyright enforcement; low consumer protection, ARAVIND EYE CARE = WEAK PUBLIC HEALTH SYSTEMS (Abundance of a problem)				
TOTAL SCORE (add the Weighted Score for all 7 levers)					
			↓	↓	↓

Article: Case Examples of Application of Mantich 7 Globuster Levers

The 3 Emerging Giant Strategies Article

Orascom Telecom Case

The following are the criteria that Orascom's subsidiary utilised in its earlier years in order to decide which countries to target in its global expansion strategy:

- 1) high-growth potential
- 2) sustained economic growth
- 3) low mobile penetration rates
- 4) limited fixed line coverage
- 5) relatively high cost of fixed-line infrastructure deployment
- 6) none or limited amount of competition
- 7) Authoritarian or Semi-Authoritarian Govts.
- 8) high-population concentrations
- 9) emerging markets

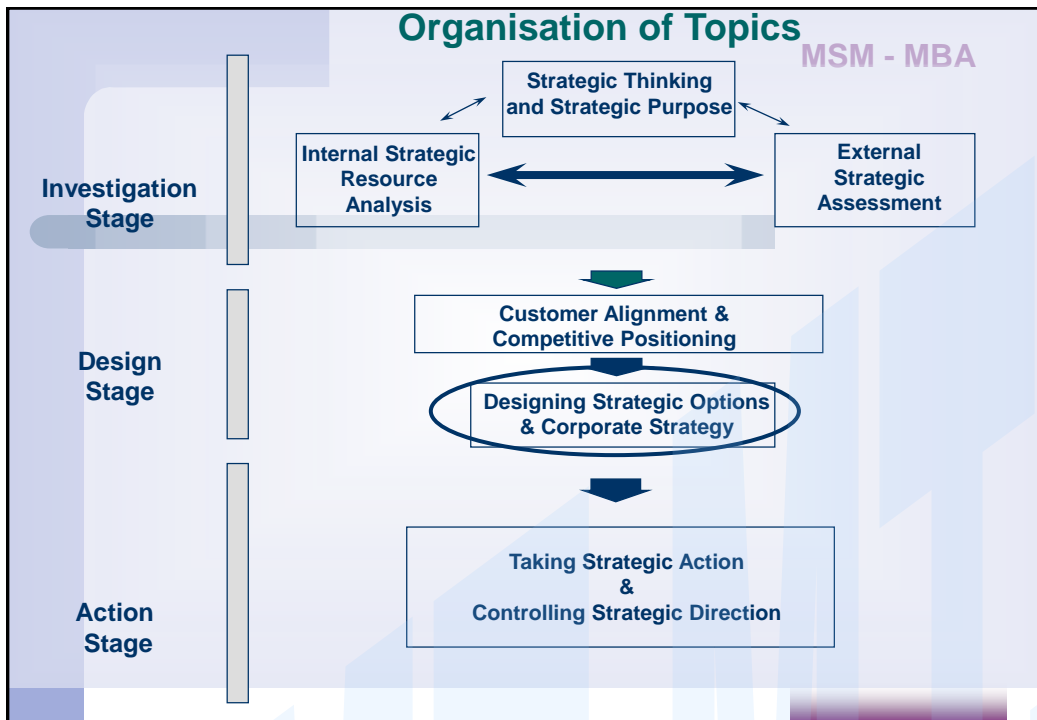
How Orascom's International Expansion Strategy Evolved

Year	Acquires
1998	Mobinil - Egypt
1999	Fastlink - Jordan
2000	Sabafon - Yemen
2000	Mobilink - Pakistan
2000	Various - Subsaharan Africa
2001	Syriatel - Syria Djezzy - Algeria
2002	Tunisiana - Tunisia
2003-5	Iraqna -Iraq
2004	Banglalink -Bangladesh
2005	Wind - Italy Hutchison Telecom (19% stake) - Various in Asia
2007	Wind Hellas - Greece
2008	Koryolink - North Korea Globalive - Canada Various - Subsaharan Africa

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Case

- Sadafco

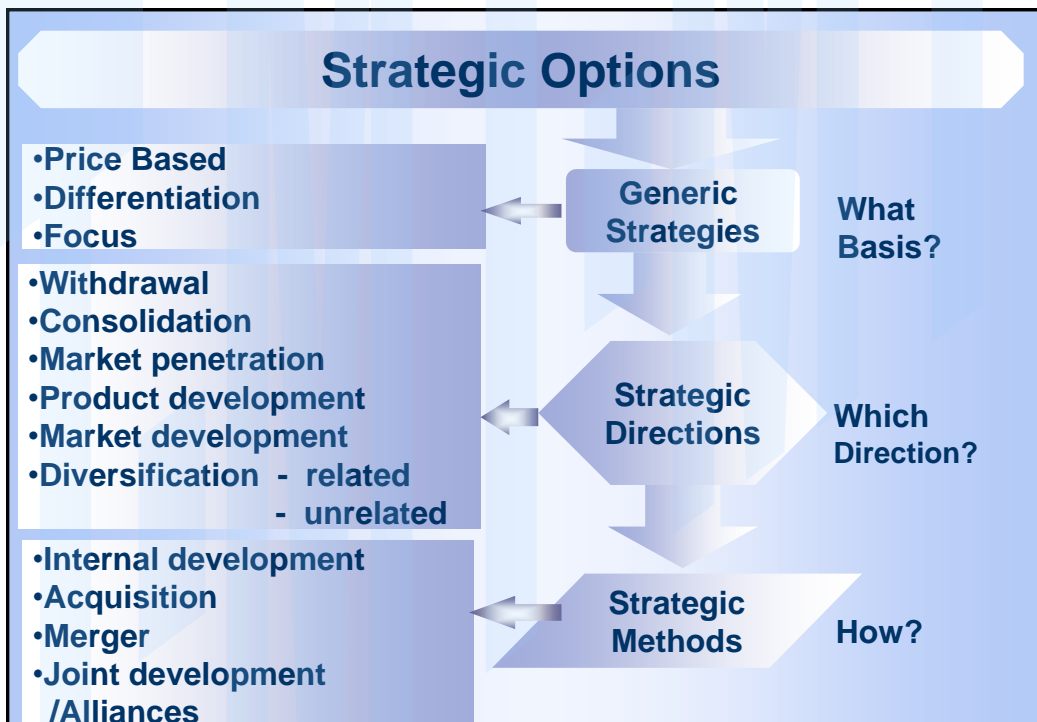


USE OF SWOT MATRIX			MBA
<div>Internal</div> <div>External</div>	Internal	S1 Strengths Hoover's Intl Orientation	W1 Weaknesses High Manufacturing Costs
	External	Opportunities O1 Opening of Eastern Europe	Threats T1 Japanese Appliance companies dominating Asia
		SO Strategies S1+O1 Use Hoover Distrib Channels to Enter into Eastern Europe <small>Generate strategies that use COMPETITIVE ADVANTAGES to take advantage of OPPORTUNITIES</small>	WO Strategies W1+O1 Reduce Manufacturing costs to enter price sensitive markets such as Eastern Europe <small>Generate strategies that take advantage of OPPORTUNITIES by overcoming COMP. DISADV</small>
		ST Strategies S1 + T1 Merge with a Japanese major home appliance company to penetrate Asia <small>Generate strategies that use COMPETITIVE ADVANTAGES to avoid THREATS</small>	WT Strategies W1 + T1 Sell out uncompetitive lines to Japanese firm <small>Generate strategies that minimise COMPETITIVE DISADVANTAGES and avoid THREATS</small>
			See SWOT Analysis Article

Borg Holdings Case Question 4

4. Prepare a strategic audit of the group:

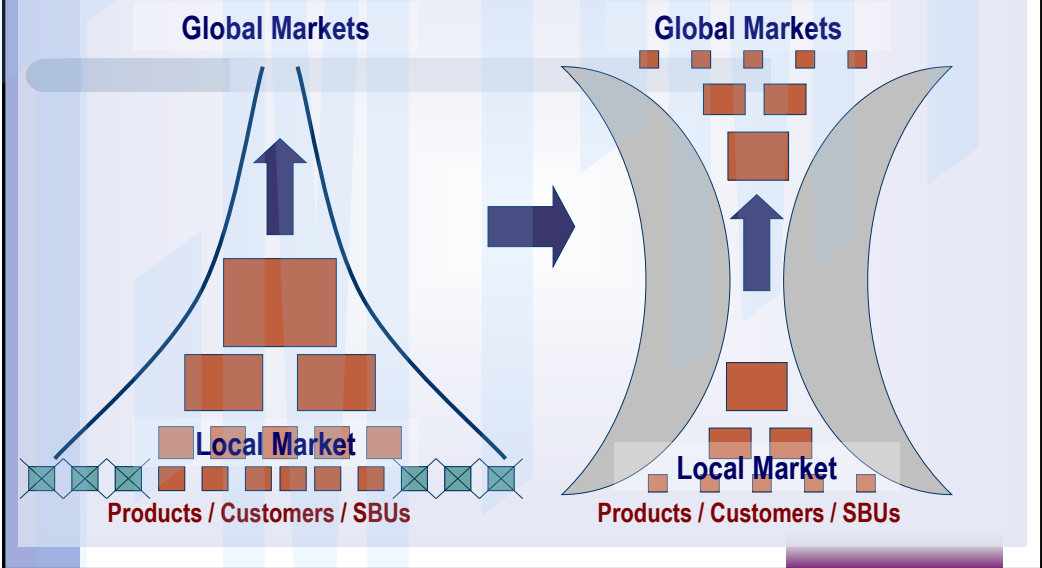
Look at strengths, weaknesses, opportunities and threats at Group level. What are your recommendations as a result of this audit? (use the SWOT Matrix to draw out the situation analysis and identify possible recommendations).



Three Generic Strategies

		COMPETITIVE ADVANTAGE	
		Lower Cost	Differentiation
COMPETITIVE SCOPE	Broad Target	1. Cost Leadership	2. Differentiation
	Narrow Target	3A. Cost Focus	3B. Differentiation Focus

Eiffel Path to Global Expansion

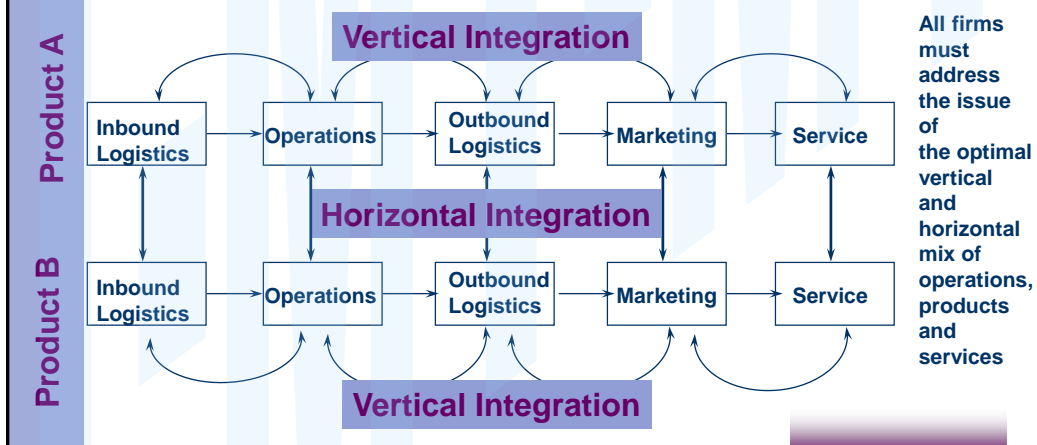


Ansoff Matrix – Growth Strategies

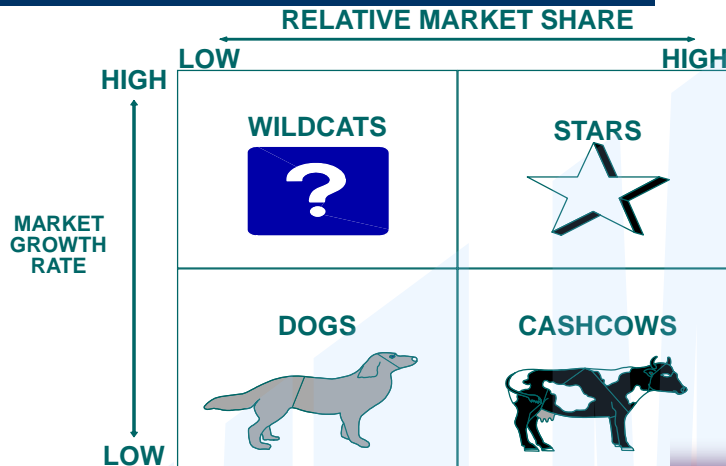
Product \ Market	Present Product	New Product
Present Market	Market Penetration	Product Development
New Market	Market Development	Diversification

Diversification: Horizontal and Vertical

All firms can be viewed on horizontal and vertical dimensions



BOSTON MATRIX (Portfolio Matrix)



Portfolio Analysis Evaluation

Advantages

- Encourages Business Unit Focus
- Stimulates use of external data
- Raises Issue of cash flow management
- Graphically Simple to communicate

Disadvantages

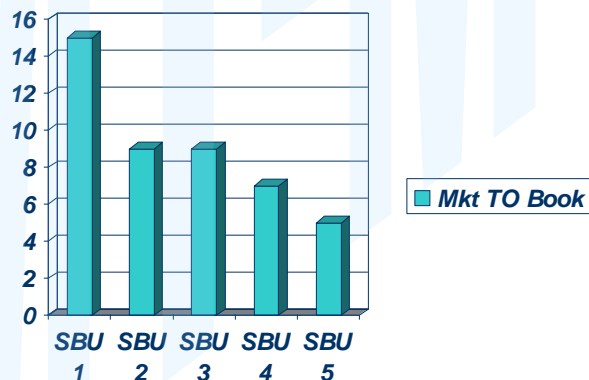
- Defining Mkt Segments is not easy
- Standard strategies are impractical
- Illusion of scientific rigor
- Terminology leads to self-fulfilling prophecies
- Determining life cycle / attractiveness not always possible
- Inappropriate use reduces profitability
- Becomes invalid as the capital market becomes more efficient

When not to Diversify?

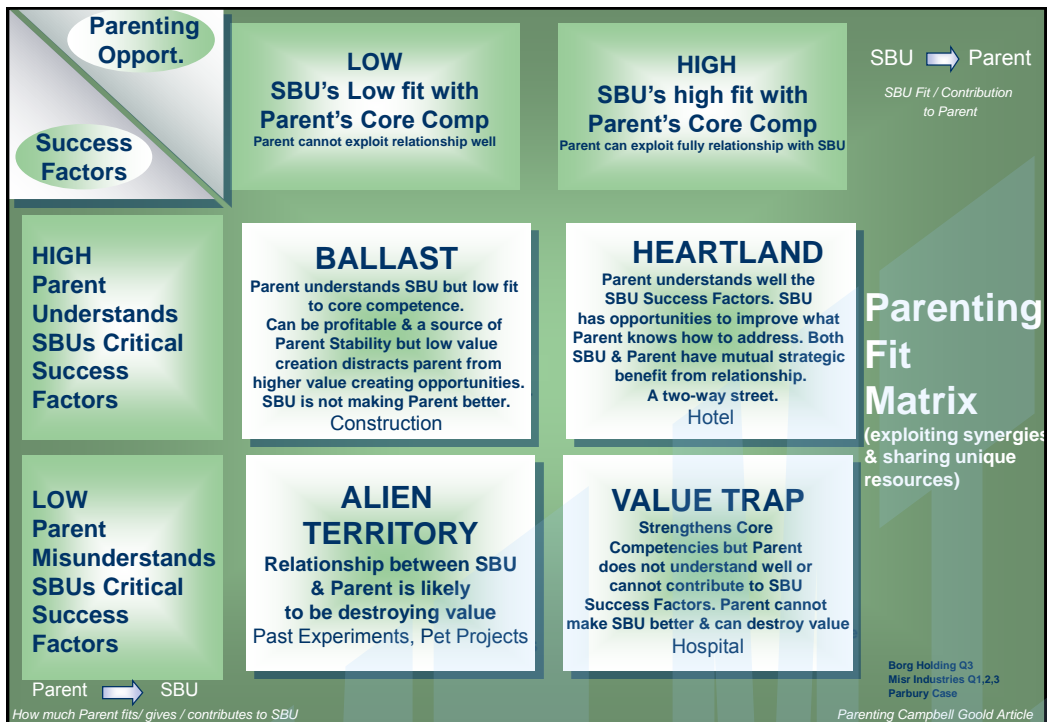
- Managerial Belief leads many a company to think that synergies lurk in every corner
- Investments that can be done by investors should not be done by managers
- Avoiding the Pitfalls

Cheese

Pacific Dunlop Decomposed



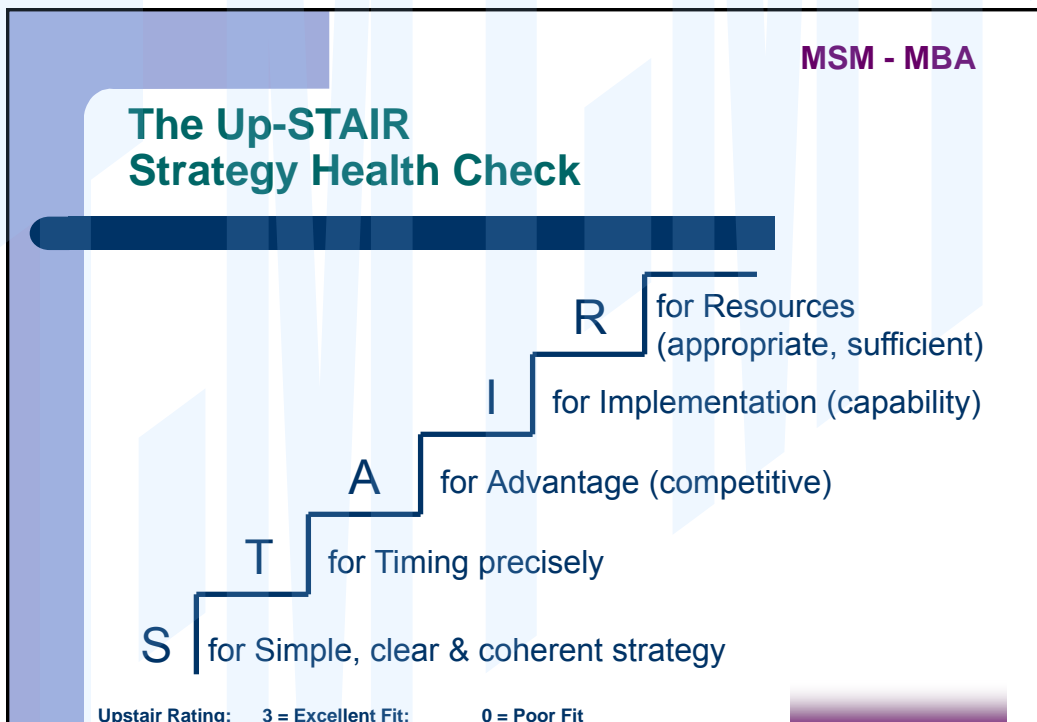
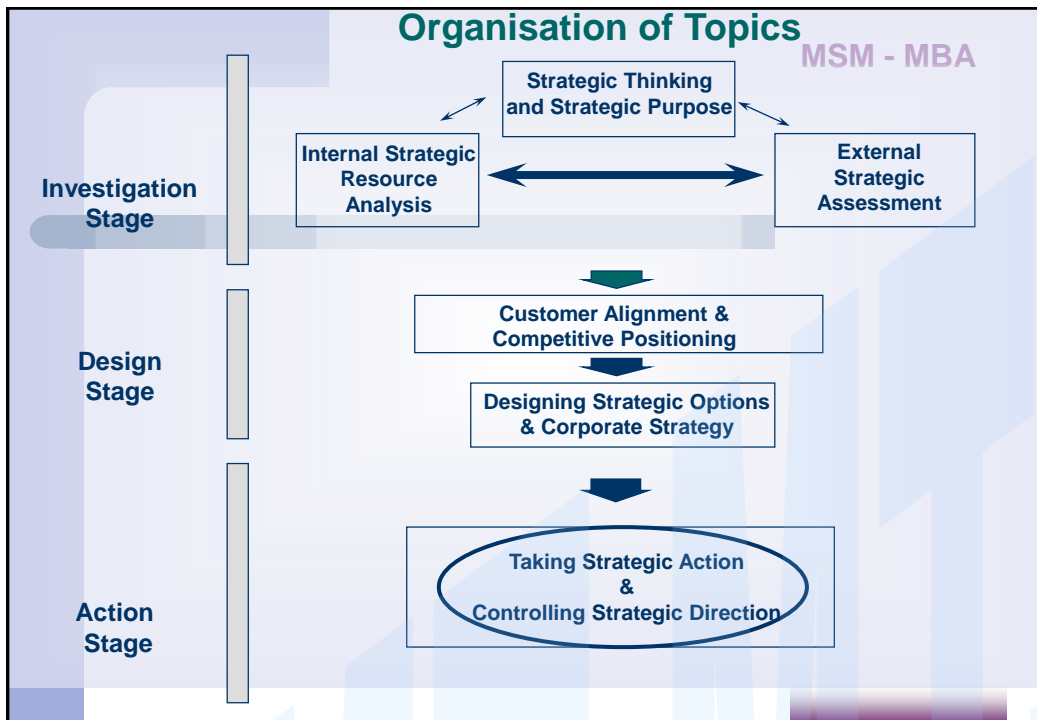
Porter - Comp Adv to Corp Strat



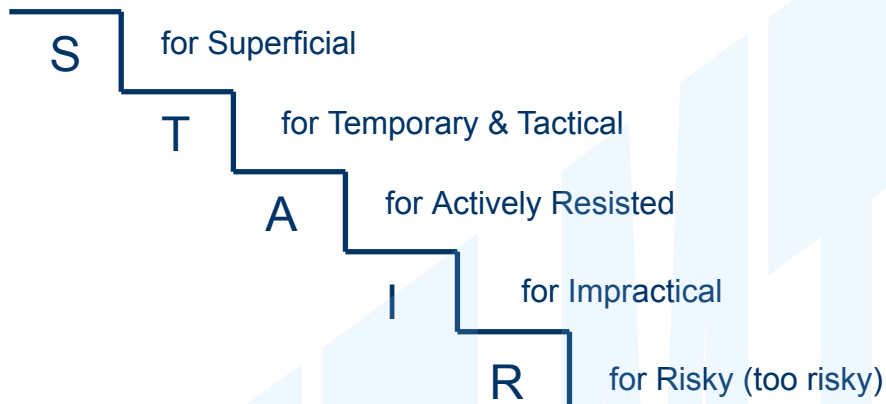
MSM - MBA

Borg Holdings Case Question 5 & 6

- Review its portfolio of investments and its strategic business units. How would you assess the portfolio of the group in terms of the Portfolio Matrix tool used in class for diversified organisations? i.e. Portfolio Matrix;
- In terms of your audit in Questions 1 to 5, what changes would you make to the portfolio of Strategic Business Units (SBUs)? Give reasons for any changes? What new vision would you suggest for the Group? What new Competitive Advantage do you suggest the Group should build? Suggest a Parenting Fit Matrix for Borg Holdings that fits to your new recommended vision and competitive advantage aspiration.



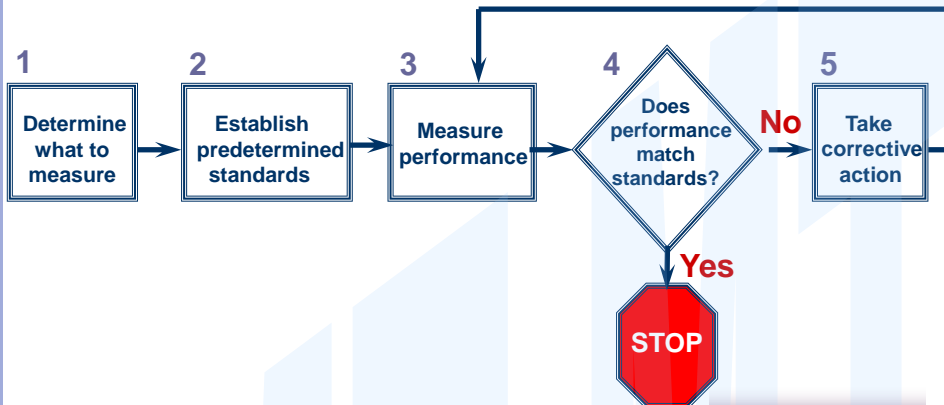
The Down-STAIR Strategy Health Check



Downstair Rating: 0 = Not True; -3 = Very True



Evaluation and Control

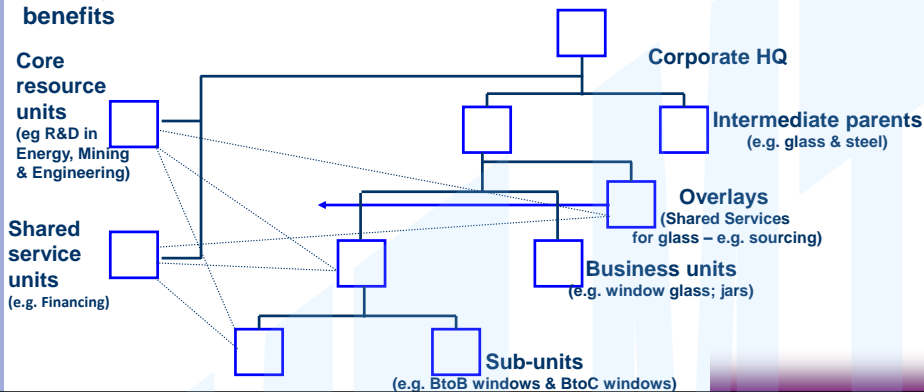


Structures of Control

- Functional
- Matrix
- Team-based (cross-functional, process, etc)
- Project-based
- Virtual Network

Complex Structures

- If a variety of different focus benefits are desirable, complex structures (overlays, sub-units, core resource units, etc) are required to maximise the benefits



Borg Holdings Case Question 7

- What is the role of Head Office in the case?
- How does Head Office manage the complexity that the diversified subsidiaries bring? Any problems here?
- How would you deal with the complexity of ownership structure and the varying shareholding relationships?
- What role should Head Office play (if any) in order to manage the Group of Companies more effectively and efficiently?
- What Changes would you make to the organisational structure to improve its performance? Draw your recommended Organisation Chart?

What is Corporate Governance?

- Corporate Governance is not so much leadership over others, as it is leadership on behalf of others

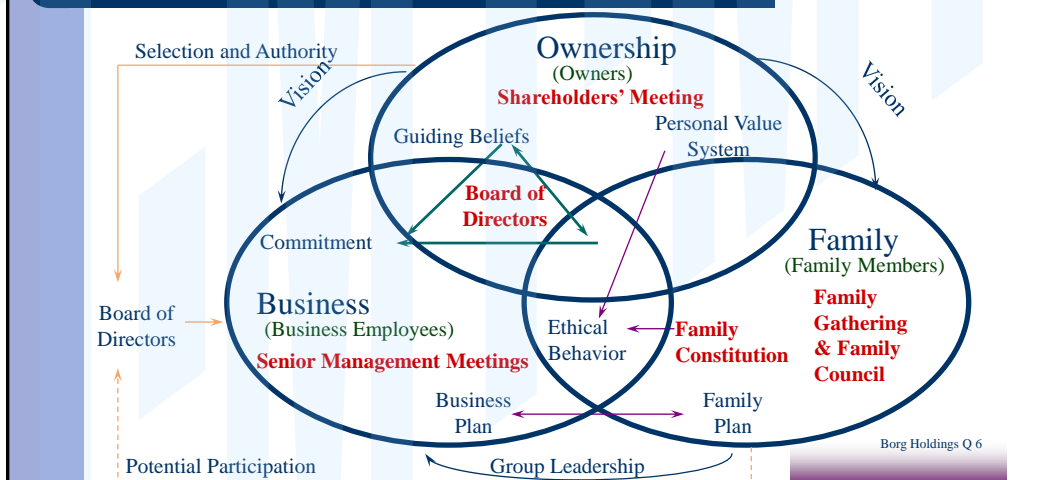
Benefits of Good Corporate Governance Practices

- Win the trust of all inside and outside stakeholders,
- Lead to greater competence in strategic management and internal control.
- Establish better business and decision making processes
- Reduce Risk (litigation, succession, financial, supplier, distributor, political, conflicts of interest, strategic)
- Improve Company's ability to obtain better and cheaper financing for expansion.

Clarity of Roles between Governance Mechanisms

- The Board of Directors is the principal organising mechanism and voice of the Owners/Shareholders
- Senior Management is the organising mechanism and voice of the Employees
- If privately controlled, the Social Group or Family Council and the Family Assembly is the organising mechanisms and the voice of the Family. The Family Council helps to develop policy for the family and act as an information conduit between board/management and family. (The Social Group: is a body of persons united by some common interest or pursuit – not all are owners but some have great influence on the company and this needs to be managed well)

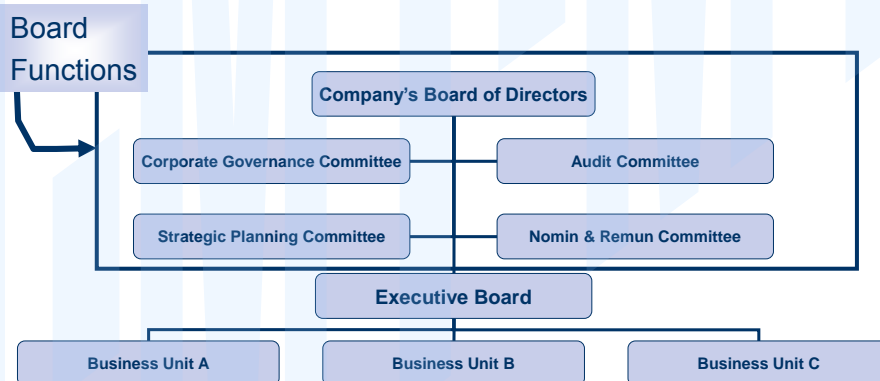
Basic Governance Structures of Family Business Groups



Borg Holdings Case Questions 8 & 9

8. What type of shareholders does the group have? To what extent do the shareholders interact with the business? For example, how does the family interact with the business? Any problems in this regard? How can the family fit better with the needs of the business and how can the business fit better with the needs of the family?
How would you improve the family governance capability of the Group?
9. For example, how would you deal with the succession issue to guarantee the future of the Group

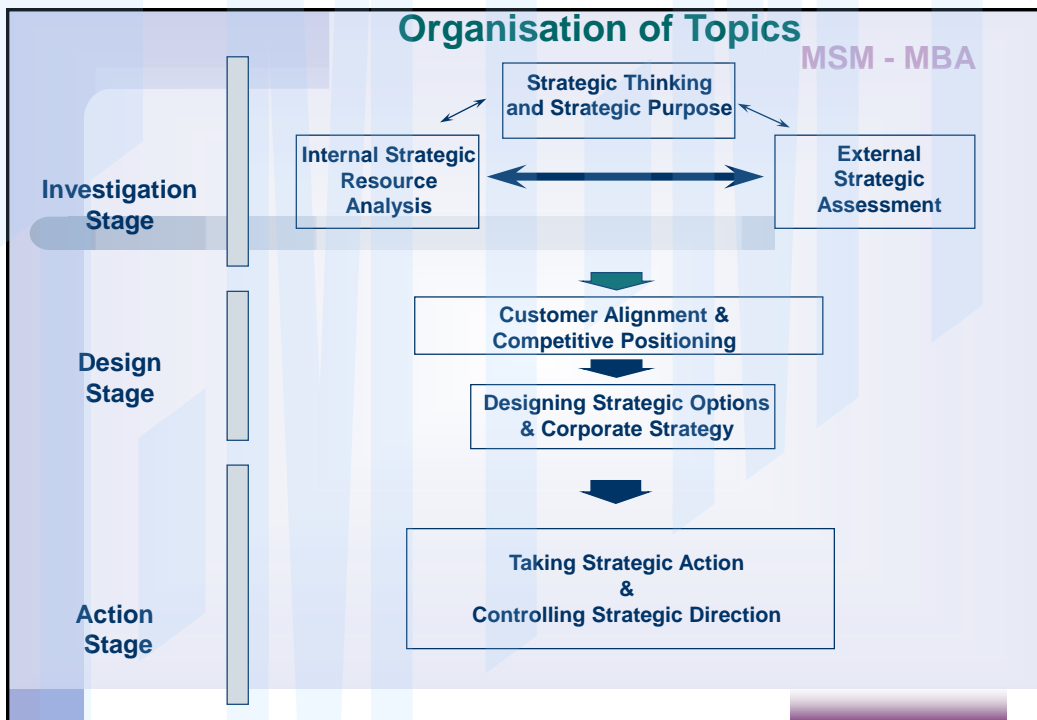
The Fit of the Strategic Management Function within the Board



Borg Holdings Q 5 & 10

Borg Holdings Case Question 10 & 11

10. How would you improve the strategic management capability of the Group?
11. What is your assessment of the Board of Directors' performance? What and corporate governance improvements do you suggest here?



MBA Strategy Alumni

- Join my Emerging Giants Strategy Forum at <http://www.linkedin.com/groups/Link-EMERGING-GIANTS-STRATEGY-innovative-4086800>
- Nobel Mantrich Strategy Institute Forum has a Strategic Board Discussion Group at: www.nobelmantrich.com/strategyforum.htm
- GEGN Membership – Strategy knowledge downloads at www.nobelmantrich.com
- mba@nobelmantrich.com

Br

The Strategic Thinking Process

In today's highly competitive business environment, budget-oriented planning or forecast-based planning methods are insufficient for a large corporation to survive and prosper. The firm must engage in **strategic thinking** that clearly defines objectives and assesses both the internal and external situation to formulate strategy, implement the strategy, evaluate the progress, and make adjustments as necessary to stay on track.

A simplified view of the strategic planning process is shown by the following diagram:

The Strategic Planning Process



Mission and Objectives

The mission statement describes the company's [business vision](#), including the unchanging values and purpose of the firm and forward-looking visionary goals that guide the pursuit of future opportunities.

Guided by the business vision, the firm's leaders can define measurable financial and strategic objectives. Financial objectives involve measures such as sales targets and earnings growth. Strategic objectives are related to the firm's business position, and may include measures such as [market share](#) and reputation.

Environmental Scan

The environmental scan includes the following components:

- Internal analysis of the firm
- Analysis of the firm's industry (task environment)
- External macroenvironment ([PEST analysis](#))

The internal analysis can identify the firm's strengths and weaknesses and the external analysis reveals opportunities and threats. A profile of the strengths, weaknesses, opportunities, and threats is generated by means of a [SWOT analysis](#)

An industry analysis can be performed using a framework developed by Michael Porter known as [Porter's five forces](#). This framework evaluates entry barriers, suppliers, customers, substitute products, and industry rivalry.

Strategy Formulation

Given the information from the environmental scan, the firm should match its strengths to the opportunities that it has identified, while addressing its weaknesses and external threats.

To attain superior profitability, the firm seeks to develop a [competitive advantage](#) over its rivals. A competitive advantage can be based on cost or differentiation. Michael Porter identified three industry-independent [generic strategies](#) from which the firm can choose.

Strategy Implementation

The selected strategy is implemented by means of programs, budgets, and procedures. Implementation involves organization of the firm's resources and motivation of the staff to achieve objectives.

The way in which the strategy is implemented can have a significant impact on whether it will be successful. In a large company, those who implement the strategy likely will be different people from those who formulated it. For this reason, care must be taken to communicate the strategy and the reasoning behind it. Otherwise, the implementation might not succeed if the strategy is misunderstood or if lower-level managers resist its implementation because they do not understand why the particular strategy was selected.

Evaluation & Control

The implementation of the strategy must be monitored and adjustments made as needed.

Evaluation and control consists of the following steps:

1. Define parameters to be measured
2. Define target values for those parameters
3. Perform measurements
4. Compare measured results to the pre-defined standard
5. Make necessary changes

Recommended Reading

Bradford, Robert W., Duncan, Peter J., Tarcy, Brian, [Simplified Strategic Planning: A No-Nonsense Guide for Busy People Who Want Results Fast!](#)

Hierarchical Levels of Strategy

Strategy can be formulated on three different levels:

- corporate level
- business unit level
- functional or departmental level.

While strategy may be about competing and surviving as a firm, one can argue that products, not corporations compete, and products are developed by business units. The role of the corporation then is to manage its business units and products so that each is competitive and so that each contributes to corporate purposes.

Consider Textron, Inc., a successful conglomerate corporation that pursues profits through a range of businesses in unrelated industries. Textron has four core business segments:

- Aircraft - 32% of revenues
- Automotive - 25% of revenues
- Industrial - 39% of revenues
- Finance - 4% of revenues.

While the corporation must manage its portfolio of businesses to grow and survive, the success of a diversified firm depends upon its ability to manage each of its product lines. While there is no single competitor to Textron, we can talk about the competitors and strategy of each of its business units. In the finance business segment, for example, the chief rivals are major banks providing commercial financing. Many managers consider the business level to be the proper focus for strategic planning.

Corporate Level Strategy

Corporate level strategy fundamentally is concerned with the selection of businesses in which the company should compete and with the development and coordination of that portfolio of businesses.

Corporate level strategy is concerned with:

- Reach - defining the issues that are corporate responsibilities; these might include identifying the overall goals of the corporation, the types of businesses in which the corporation should be involved, and the way in which businesses will be integrated and managed.
- Competitive Contact - defining where in the corporation competition is to be localized. Take the case of insurance: In the mid-1990's, Aetna as a corporation was clearly identified with its commercial and property casualty insurance products. The conglomerate Textron was not. For Textron, competition in the insurance markets took place specifically at the business unit level, through its subsidiary, Paul Revere. (Textron divested itself of The Paul Revere Corporation in 1997.)
- Managing Activities and Business Interrelationships - Corporate strategy seeks to develop synergies by sharing and coordinating staff and other resources across business units, investing financial resources across business units, and using business units to complement other corporate business activities. Igor Ansoff introduced the concept of synergy to corporate strategy.
- Management Practices - Corporations decide how business units are to be governed: through direct corporate intervention (centralization) or through more or less autonomous government (decentralization) that relies on persuasion and rewards.

Corporations are responsible for creating value through their businesses. They do so by managing their portfolio of businesses, ensuring that the businesses are successful over the long-term, developing business units, and sometimes ensuring that each business is compatible with others in the portfolio.

Business Unit Level Strategy

A strategic business unit may be a division, product line, or other profit center that can be planned independently from the other business units of the firm.

At the business unit level, the strategic issues are less about the coordination of operating units and more about developing and sustaining a competitive advantage for the goods and services that are produced. At the business level, the strategy formulation phase deals with:

- positioning the business against rivals
- anticipating changes in demand and technologies and adjusting the strategy to accommodate them
- influencing the nature of competition through strategic actions such as vertical integration and through political actions such as lobbying.

Michael Porter identified three [generic strategies](#) (*cost leadership*, *differentiation*, and *focus*) that can be implemented at the business unit level to create a competitive advantage and defend against the adverse effects of the [five forces](#).

Functional Level Strategy

The functional level of the organization is the level of the operating divisions and departments. The strategic issues at the functional level are related to business processes and the value chain. Functional level strategies in marketing, finance, operations, human resources, and R&D involve the development and coordination of resources through which business unit level strategies can be executed efficiently and effectively.

Functional units of an organization are involved in higher level strategies by providing input into the business unit level and corporate level strategy, such as providing information on resources and capabilities on which the higher level strategies can be based. Once the higher-level strategy is developed, the functional units translate it into discrete action-plans that each department or division must accomplish for the strategy to succeed.

Recommended Reading

Mintzberg, Henry, Lampel, J., Ahlstrand, B., [Strategy Safari: A Guided Tour through the Wilds of Strategic Management](#)

The Business Vision and Company Mission Statement

While a business must continually adapt to its competitive environment, there are certain core ideals that remain relatively steady and provide guidance in the process of strategic decision-making. These unchanging ideals form the **business vision** and are expressed in the company **mission statement**.

In their 1996 article entitled *Building Your Company's Vision*, James Collins and Jerry Porras provided a framework for understanding business vision and articulating it in a mission statement.

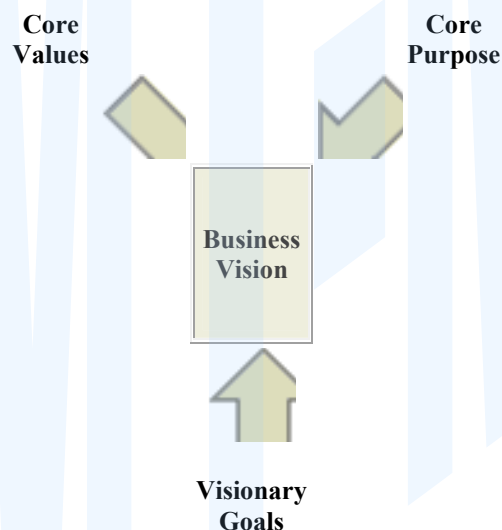
The mission statement communicates the firm's core ideology and visionary goals, generally consisting of the following three components:

1. **Core values** to which the firm is committed
2. **Core purpose** of the firm
3. **Visionary goals** the firm will pursue to fulfill its mission

The firm's core values and purpose constitute its core ideology and remain relatively constant. They are independent of industry structure and the [product life cycle](#).

The core ideology is not created in a mission statement; rather, the mission statement is simply an expression of what already exists. The specific phrasing of the ideology may change with the times, but the underlying ideology remains constant.

The three components of the business vision can be portrayed as follows:



Core Values

The core values are a few values (no more than five or so) that are central to the firm. Core values reflect the deeply held values of the organization and are independent of the current industry environment and management fads.

One way to determine whether a value is a core value is to ask whether it would continue to be supported if circumstances changed and caused it to be seen as a liability. If the answer is that it would be kept, then it is a core value. Another way to determine which values are core is to imagine the firm moving into a totally different industry. The values that would be carried with it into the new industry are the core values of the firm.

Core values will not change even if the industry in which the company operates changes. If the industry changes such that the core values are not appreciated, then the firm should seek new markets where its core values are viewed as an asset.

For example, if innovation is a core value but then 10 years down the road innovation is no longer valued by the current customers, rather than change its values the firm should seek new markets where innovation is advantageous.

The following are a few examples of values that some firms have chosen to be in their core:

- excellent customer service
- pioneering technology
- creativity
- integrity
- social responsibility

Core Purpose

The core purpose is the reason that the firm exists. This core purpose is expressed in a carefully formulated mission statement. Like the core values, the core purpose is relatively unchanging and for many firms endures for decades or even centuries. This purpose sets the firm apart from other firms in its industry and sets the direction in which the firm will proceed.

The core purpose is an idealistic reason for being. While firms exist to earn a profit, the profit motive should not be highlighted in the mission statement since it provides little direction to the firm's employees. What is more important is *how* the firm will earn its profit since the "how" is what defines the firm.

Initial attempts at stating a core purpose often result in too specific of a statement that focuses on a product or service. To isolate the core purpose, it is useful to ask "why" in response to first-pass, product-oriented mission statements. For example, if a market research firm initially states that its purpose is to provide market research data to its customers, asking "why" leads to the fact that the data is to help customers better understand their markets. Continuing to ask "why" may lead to the revelation that the firm's core purpose is to assist its clients in reaching their objectives by helping them to better understand their markets.

The core purpose and values of the firm are not selected - they are discovered. The stated ideology should not be a goal or aspiration but rather, it should portray the firm as it really is. Any attempt to state a value that is not already held by the firm's employees is likely to not be taken seriously.

Visionary Goals

The visionary goals are the lofty objectives that the firm's management decides to pursue. This vision describes some milestone that the firm will reach in the future and may require a decade or more to achieve. In contrast to the core ideology that the firm discovers, visionary goals are selected.

These visionary goals are longer term and more challenging than strategic or tactical goals. There may be only a 50% chance of realizing the vision, but the firm must believe that it can do so. Collins and Porras describe these lofty objectives as "Big, Hairy, Audacious Goals." These goals should be challenging enough so that people nearly gasp when they learn of them and realize the effort that will be required to reach them.

Most visionary goals fall into one of the following categories:

- **Target** - quantitative or qualitative goals such as a sales target or Ford's goal to "democratize the automobile."
- **Common enemy** - centered on overtaking a specific firm such as the 1950's goal of Philip-Morris to displace RJR.
- **Role model** - to become like another firm in a different industry or market. For example, a cycling accessories firm might strive to become "the Nike of the cycling industry."
- **Internal transformation** - especially appropriate for very large corporations. For example, GE set the goal of becoming number one or number two in every market it serves.

While visionary goals may require significant stretching to achieve, many visionary companies have succeeded in reaching them. Once such a goal is reached, it needs to be replaced; otherwise, it is unlikely that the organization will continue to be successful. For example, Ford succeeded in placing the automobile within the reach of everyday people, but did not replace this goal with a better one and General Motors overtook Ford in the 1930's.

Recommended Reading

Jeffrey Abrahams, [*The Mission Statement Book: 301 Corporate Mission Statements from America's Top Companies*](#)

THE IDEA IN BRIEF

SOUTHWEST Airlines keeps soaring. Its stock price rose a compounded 21,000% between 1972 and 1992 and leapt 300% between 1995 and 2000.

Why does Southwest succeed while so many other airlines fail? Because it sticks to its powerful **strategic principle**: "Meet customers' short-haul travel needs at fares competitive with the cost of automobile travel." This pithy, memorable, action-oriented phrase distills Southwest's unique strategy and communicates it throughout the company.

Transforming Corner-Office Strategy into Frontline Action

An effective **strategic principle** lets a company simultaneously:

- maintain strategic focus,
- empower workers to innovate and take risks,
- seize fleeting opportunities,
- create products and services that meet subtle shifts in customers' needs.

In today's rapidly changing world, companies must integrate decentralized decision making *with* coherent, strategic action. A well-crafted, skillfully implemented **strategic principle** lets them strike that delicate balance.

THE IDEA AT WORK

Hallmarks of Powerful Strategic Principles

A successful strategic principle:

- Forces trade-offs between competing resources.

EXAMPLE:

Southwest Airlines' 1983 expansion to the high-traffic Denver area *seemed* sensible. But unusually long delays there due to bad weather and taxi time would have forced Southwest to increase ticket prices—preventing it from adhering to its strategic principle of offering air fares competitive with the cost of auto travel. The company pulled out of Denver.

- Tests the strategic soundness of particular decisions by linking leaders' strategic insights with line operators' pragmatic sense.

EXAMPLE:

AOL's strategic principle, "Consumer connectivity first—anytime, anywhere," tested the wisdom of a powerful business decision: expanding AOL's global network through alliances with local partners, rather than using its own technology everywhere. Partners' understanding of local culture greatly increased customers' connectivity.

- Sets clear boundaries within which employees operate and experiment.

EXAMPLE:

At mutual-fund giant The Vanguard Group, frontline employees conceived a potent idea: Let customers access their accounts on-line, but limit on-line trading. This move kept Vanguard's costs low, enabling the company to stick to its strategic principle: creating "unmatchable value for investors/owners."

Creating and Communicating Your Strategic Principle

Capturing and communicating the essence of your company's strategy in a simple, memorable, actionable phrase isn't easy. These steps can help:

1. Draft a working strategic principle.

Summarize your *corporate strategy*—your plan to allocate scarce resources in order to create value that distinguishes you from competitors—in a brief phrase. That phrase becomes your working *strategic principle*.

2. Test its endurance. A good strategic principle endures. Ask: Does our working strategic principle capture the timeless essence of our company's unique competitive value?

3. Test its communicative power. Ask: Is the phrase clear, concise, memorable? Would you feel proud to paint it on the side of your firm's trucks, as Wal-Mart does?

4. Test its ability to promote and guide action.

Ask: Does the principle exhibit the three essential attributes: forcing trade-offs, testing the wisdom of business moves, setting boundaries for employees' experimentation?

5. Communicate it. Communicate your strategic principle consistently, simply, and repeatedly. You'll know you've succeeded when employees—as well as business writers, MBA students, and competitors—all "chant the rant."

THE IDEA IN BRIEF

Building Your Company's Vision

HEWLETT-PACKARD. 3M. Sony. Companies with exceptionally durable visions that are "built to last." What distinguishes their visions from most others, those empty muddles that get revised with every passing business fad, but never prompt anything more than a yawn? Enduring companies have clear plans for how

they will advance into an uncertain future. But they are equally clear about how they will remain steadfast, about the values and purposes they will always stand for. This *Harvard Business Review* article describes the two components of any lasting vision: core ideology and an envisioned future.

THE IDEA AT WORK

A company's practices and strategies should change continually; its core ideology should not. Core ideology defines a company's timeless character. It's the glue that holds the enterprise together even when everything else is up for grabs. Core ideology is something you *discover*—by looking inside. It's not something you can invent, much less fake.

A core ideology has two parts:

1. **Core values are the handful of guiding principles by which a company navigates.** They require no external justification. For example, Disney's core values of imagination and wholesomeness stem from the founder's belief that these should be nurtured for their own sake, not merely to capitalize on a business opportunity. Instead of changing its core values, a great company will change its markets—seek out different customers—in order to remain true to its core values.
2. **Core purpose is an organization's most fundamental reason for being.** It should not be confused with the company's current product lines or customer segments. Rather, it reflects people's idealistic motivations for doing the company's work. Disney's core purpose is to make people happy—not to build theme parks and make cartoons.

An envisioned future, the second component of an effective vision, has two elements:

1. **Big, Hairy, Audacious Goals (BHAGs) are ambitious plans that rev up the entire organization.** They typically require 10 to 30 years' work to complete.
2. **Vivid descriptions paint a picture of what it will be like to achieve the BHAGs.** They make the goals vibrant, engaging—and tangible.

EXAMPLE:

In the 1950s, Sony's goal was to "become the company most known for changing the world-wide poor-quality image of Japanese products." It made this BHAG vivid by adding, "Fifty years from now, our brand name will be as well known as any in the world ... and will signify innovation and quality. ... 'Made in Japan' will mean something fine, not something shoddy."

Don't confuse your company's core ideology with its envisioned future—in particular, don't confuse a BHAG for a core purpose. A BHAG is a clearly articulated goal that is reachable within 10 to 30 years. But your core purpose can never be completed.

1.8

Case : London International Group

In its earlier years, more than 20 years ago, the London International Group ('LIG') was an apparently successful group which had reasonably healthy financial results. It also had an enlightened attitude to innovation and staff development, and a number of very well known, branded products. Best known for its contraceptives, particularly Durex, the group had exploited its core competence in rubber technology by growth in the fields of surgical gloves and other products.

But several clouds had begun to appear in the corporate sky. First, the UK regulatory body, the Monopolies and Mergers Commission (MMC) placed significant constraints on LIG's access to and share of the UK market. Previously LIG had a virtual monopoly of this market, thus generating a very healthy stream of profits and cash flow.

Understandably, LIG management began to look further afield - both outside their core markets and ultimately outside their existing core competencies to target new areas of development.

They decided to focus on the photoprocessing market, presumably because it was, in those earlier years, relatively fast growing. Also, as a not so enormous group (its total turnover at that time was around £300m) it would have been more difficult to enter a much bigger market. So, LIG elected to grow via niche development.

As the existing photoprocessing market was fragmented, LIG acquired a number of companies with different geographic markets and sometimes differing customer groups.

It appeared that these acquired businesses possessed no particular advantage over their

competitors. Nor was it apparent what value this corporate parent brought to these businesses - their being outside LIG's core competencies, and also their more specific and distinctive areas of competitive advantage.

So, while LIG put more and more time, effort and resource into developing photoprocessing, this diluted the attention on core businesses relative to what it might have been otherwise. This was unfortunate, as new entrants, including the entrepreneurial Virgin Group, captured significant share of the contraceptives market during a time when this was growing - due to AIDS and the associated publicity.

And unforeseen by LIG management, the photoprocessing industry was hit very hard indeed within 5 years of their entry into it. This was primarily due to a recessionary period. Purchases of processed film are very dependent upon discretionary spending on leisure and travel. So they are very likely to be the first thing to be cut when consumer income drops.

LIG's financial results were severely affected by the downturn in the photoprocessing industry. However, in its financial announcements, the board of directors was still apparently very confident that photoprocessing would be turned around. Indeed, even as these announcements were being issued, LIG Group made an acquisition of another photoprocessing company - serving the specific needs of estate agents.

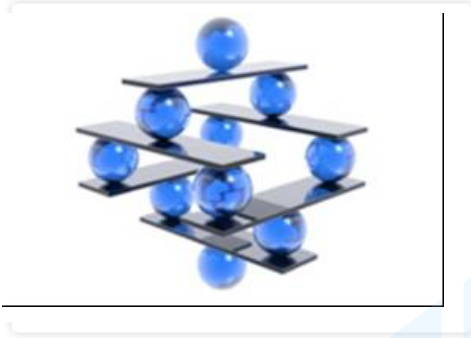
It looks, at least from the outside, as if LIG found it hard - if not impossible - to conduct an objective and realistic reappraisal of their strategies for growth. This was very unfortunate because within a year of their financial announcements the group came very close to financial collapse.

Questions

1. What strategic problems and issues does the LIG case raise?
2. How would a strategic planning process have helped LIG avoid the negative situation it ended up with?

The McKinsey 7S Framework

Ensuring that all parts of your organization work in harmony



How do you go about analyzing how well your organization is positioned to achieve its intended objective? This is a question that has been asked for many years, and there are many different answers. Some approaches look at internal factors, others look at external ones, some combine these perspectives, and others look for congruence between various aspects of the organization being studied. Ultimately, the issue comes down to which factors to study.

While some models of organizational effectiveness go in and out of fashion, one that has persisted is the McKinsey 7S framework. Developed in the early 1980s by Tom Peters and Robert Waterman, two consultants working at the McKinsey & Company consulting firm, the basic premise of the model is that there are seven internal aspects of an organization that need to be aligned if it is to be successful.

The 7S model can be used in a wide variety of situations where an alignment perspective is useful, for example to help you:

- Improve the performance of a company.
- Examine the likely effects of future changes within a company.
- Align departments and processes during a merger or acquisition.
- Determine how best to implement a proposed strategy.

The McKinsey 7S model can be applied to elements of a team or a project as well. The alignment issues apply, regardless of how you decide to define the scope of the areas you study.

The Seven Elements

The McKinsey 7S model involves seven interdependent factors which are categorized as either "hard" or "soft" elements:

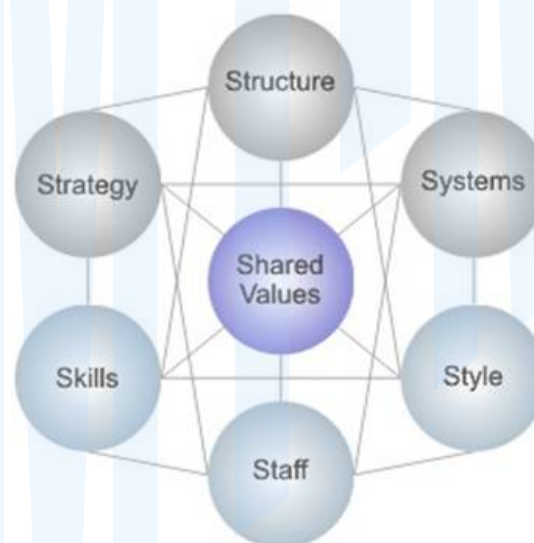
Hard Elements	Soft Elements
Strategy	Shared Values
Structure	Skills
Systems	Style
	Staff

"Hard" elements are easier to define or identify and management can directly influence them: These are strategy statements; organization charts and reporting lines; and formal processes and IT systems.

"Soft" elements, on the other hand, can be more difficult to describe, and are less tangible and more influenced by culture. However, these soft elements are as important as the hard elements if the organization is going to be successful.

The way the model is presented in Figure 1 below depicts the interdependency of the elements and indicates how a change in one affects all the others.

Figure 1: The McKinsey 7S Model



Let's look at each of the elements specifically:

- **Strategy:** the plan devised to maintain and build competitive advantage over the competition.
- **Structure:** the way the organization is structured and who reports to whom.
- **Systems:** the daily activities and procedures that staff members engage in to get the job done.
- **Shared Values:** called "superordinate goals" when the model was first developed, these are the core values of the company that are evidenced in the corporate culture and the general work ethic.
- **Style:** the style of leadership adopted.
- **Staff:** the employees and their general capabilities.
- **Skills:** the actual skills and competencies of the employees working for the company.

Placing Shared Values in the middle of the model emphasizes that these values are central to the development of all the other critical elements. The company's structure, strategy, systems, style, staff and skills all stem from why the organization was originally created, and what it stands for. The original vision of the company was formed from the values of the creators. As the values change, so do all the other elements.

How to Use the Model

Now you know what the model covers, how can you use it?

The model is based on the theory that, for an organization to perform well, these seven elements need to be aligned and mutually reinforcing. So, the model can be used to help identify what needs to be realigned to improve performance, or to maintain alignment (and performance) during other types of change.

Whatever the type of change – restructuring, new processes, organizational merger, new systems, change of leadership, and so on – the model can be used to understand how the organizational elements are interrelated, and so ensure that the wider impact of changes made in one area is taken into consideration.

You can use the 7S model to help analyze the current situation (Point A), a proposed future situation (Point B) and to identify gaps and inconsistencies between them. It's then a question of adjusting and tuning the elements of the 7S model to ensure that your organization works effectively and well once you reach the desired endpoint.

Sounds simple? Well, of course not: Changing your organization probably will not be simple at all! Whole books and methodologies are dedicated to analyzing organizational strategy, improving performance and managing change. The 7S model is a good framework to help you ask the right questions – but it won't give you all the answers. For that you'll need to bring together the right knowledge, skills and experience.

When it comes to asking the right questions, we've developed a Mind Tools checklist and a matrix to keep track of how the seven elements align with each other. Supplement these with your own questions, based on your organization's specific circumstances and accumulated wisdom.

7S Checklist Questions

Here are some of the questions that you'll need to explore to help you understand your situation in terms of the 7S framework. Use them to analyze your current (Point A) situation first, and then repeat the exercise for your proposed situation (Point B).

Strategy:

- What is our strategy?
- How do we intend to achieve our objectives?
- How do we deal with competitive pressure?
- How are changes in customer demands dealt with?
- How is strategy adjusted for environmental issues?

Structure:

- How is the company/team divided?
- What is the hierarchy?
- How do the various departments coordinate activities?
- How do the team members organize and align themselves?
- Is decision making and controlling centralized or decentralized? Is this as it should be, given what we're doing?
- Where are the lines of communication? Explicit and implicit?

Systems:

- What are the main systems that run the organization? Consider financial and HR systems as well as communications and document storage.
- Where are the controls and how are they monitored and evaluated?
- What internal rules and processes does the team use to keep on track?

Shared Values:

- What are the core values?
- What is the corporate/team culture?
- How strong are the values?
- What are the fundamental values that the company/team was built on?

Style:

- How participative is the management/leadership style?

- How effective is that leadership?
- Do employees/team members tend to be competitive or cooperative?
- Are there real teams functioning within the organization or are they just nominal groups?

Staff:

- What positions or specializations are represented within the team?
- What positions need to be filled?
- Are there gaps in required competencies?

Skills:

- What are the strongest skills represented within the company/team?
- Are there any skills gaps?
- What is the company/team known for doing well?
- Do the current employees/team members have the ability to do the job?
- How are skills monitored and assessed?

7S Matrix Questions

Using the information you have gathered, now examine where there are gaps and inconsistencies between elements. Remember you can use this to look at either your current or your desired organization.

Click [here](#) to download our McKinsey 7S Worksheet, which contains a matrix that you can use to check off alignment between each of the elements as you go through the following steps:

- Start with your Shared Values: Are they consistent with your structure, strategy, and systems? If not, what needs to change?
- Then look at the hard elements. How well does each one support the others? Identify where changes need to be made.
- Next look at the other soft elements. Do they support the desired hard elements? Do they support one another? If not, what needs to change?
- As you adjust and align the elements, you'll need to use an iterative (and often time consuming) process of making adjustments, and then re-analyzing how that impacts other elements and their alignment. The end result of better performance will be worth it.

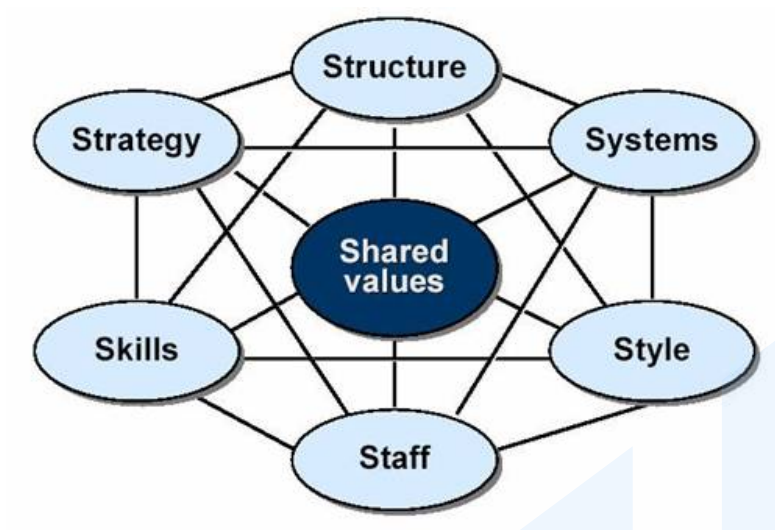
Tip:

For similar approaches to this, see our articles on the [Burke-Litwin Change Model](#), and the [Congruence Model](#). You may also find our articles on the [Change Curve](#), [Impact Analysis](#) and [Lewin's Change Management Model](#) useful.

Key Points:

The McKinsey 7Ss model is one that can be applied to almost any organizational or team effectiveness issue. If something within your organization or team isn't working, chances are there is inconsistency between some of the elements identified by this classic model. Once these inconsistencies are revealed, you can work to align the internal elements to make sure they are all contributing to the shared goals and values.

The process of analyzing where you are right now in terms of these elements is worthwhile in and of itself. But by taking this analysis to the next level and determining the ultimate state for each of the factors, you can really move your organization or team forward.



Description of the 7-S framework of McKinsey

The **7-S framework** of **McKinsey** is a **Value Based Management (VBM) model** that describes how one can *holistically and effectively organize a company*. Together these factors determine the way in which a corporation operates.

Shared Value

The interconnecting center of McKinsey's model is: Shared Values. What does the organization stand for and what it believes in. Central beliefs and attitudes.

Strategy

Plans for the allocation of a firm's scarce resources, over time, to reach identified goals. Environment, competition, customers.

Structure

The way the organization's units relate to each other: centralized, functional divisions (top-down); decentralized (the trend in larger organizations); matrix, network, holding, etc.

System

The procedures, processes and routines that characterize how important work is to be done: financial systems; hiring, promotion and performance appraisal systems; information systems.

Staff

Numbers and types of personnel within the organization.

Style

Cultural style of the organization and how key managers behave in achieving the organization's goals.

[Management Styles.](#)

Skill

Distinctive capabilities of personnel or of the organization as a whole. [Core Competences.](#)

Book: Ethan M. Rasiel, Paul N. Friga - The McKinsey Mind: Understanding and Implementing the Problem-Solving Tools and Management Techniques -

www.amazon.com/exec/obidos/ASIN/0071374299/valuebasedman-20

Also compare with the 7-S Framework: [Strategic Alignment](#)

Competitive Advantage

When a firm sustains profits that exceed the average for its industry, the firm is said to possess a **competitive advantage** over its rivals. The goal of much of business strategy is to achieve a sustainable competitive advantage.

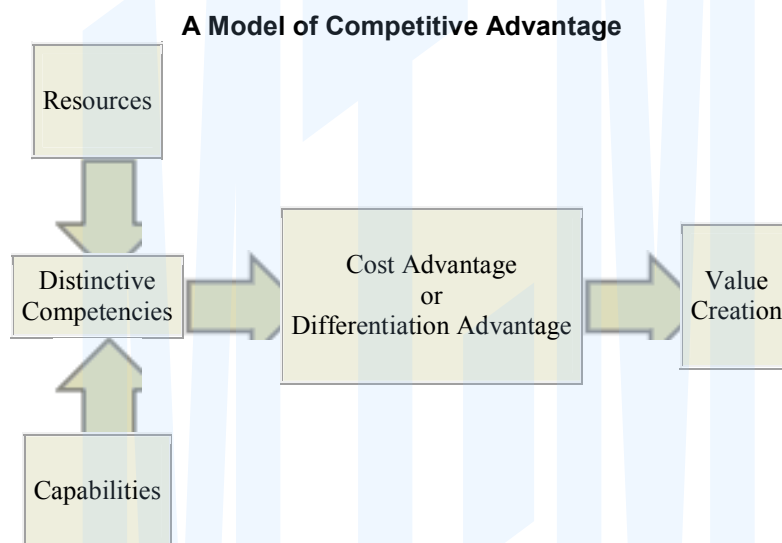
Michael Porter identified two basic types of competitive advantage:

- cost advantage
- differentiation advantage

A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at a lower cost (cost advantage), or deliver benefits that exceed those of competing products (differentiation advantage). Thus, a competitive advantage enables the firm to create superior value for its customers and superior profits for itself.

Cost and differentiation advantages are known as *positional advantages* since they describe the firm's position in the industry as a leader in either cost or differentiation.

A *resource-based view* emphasizes that a firm utilizes its resources and capabilities to create a competitive advantage that ultimately results in superior value creation. The following diagram combines the resource-based and positioning views to illustrate the concept of competitive advantage:



Resources and Capabilities

According to the resource-based view, in order to develop a competitive advantage the firm must have resources and capabilities that are superior to those of its competitors. Without this superiority, the competitors simply could replicate what the firm was doing and any advantage quickly would disappear.

Resources are the firm-specific assets useful for creating a cost or differentiation advantage and that few competitors can acquire easily. The following are some examples of such resources:

- Patents and trademarks
- Proprietary know-how
- Installed customer base
- Reputation of the firm
- Brand equity

Capabilities refer to the firm's ability to utilize its resources effectively. An example of a capability is the ability to bring a product to market faster than competitors. Such capabilities are embedded in the routines of the organization and are not easily documented as procedures and thus are difficult for competitors to replicate.

The firm's resources and capabilities together form its **distinctive competencies**. These competencies enable innovation, efficiency, quality, and customer responsiveness, all of which can be leveraged to create a cost advantage or a differentiation advantage.

Cost Advantage and Differentiation Advantage

Competitive advantage is created by using resources and capabilities to achieve either a lower cost structure or a differentiated product. A firm positions itself in its industry through its choice of low cost or differentiation. This decision is a central component of the firm's competitive strategy.

Another important decision is how broad or narrow a market segment to target. Porter formed a matrix using cost advantage, differentiation advantage, and a broad or narrow focus to identify a set of [generic strategies](#) that the firm can pursue to create and sustain a competitive advantage.

Value Creation

The firm creates value by performing a series of activities that Porter identified as the [value chain](#). In addition to the firm's own value-creating activities, the firm operates in a *value system* of vertical activities including those of upstream suppliers and downstream channel members.

To achieve a competitive advantage, the firm must perform one or more value creating activities in a way that creates more overall value than do competitors. Superior value is created through lower costs or superior benefits to the consumer (differentiation).

Recommended Reading

Porter, Michael E., [Competitive Advantage](#): *Creating and Sustaining Superior Performance*

PEST Market Analysis Tool

PEST analysis method and examples, with PEST template

The PEST analysis is a useful tool for understanding market growth or decline, and as such the position, potential and direction for a business. A PEST analysis is a business measurement tool. PEST is an acronym for Political, Economic, Social and Technological factors, which are used to assess the market for a business or organizational unit. The PEST analysis headings are a framework for reviewing a situation, and can also, like SWOT analysis, and Porter's Five Forces model, be used to review a strategy or position, direction of a company, a marketing proposition, or idea. Completing a PEST analysis is very simple, and is a good subject for workshop sessions. PEST analysis also works well in brainstorming meetings. Use PEST analysis for business and strategic planning, marketing planning, business and product development and research reports. You can also use PEST analysis exercises for team building games. PEST analysis is similar to SWOT analysis - it's simple, quick, and uses four key perspectives. As PEST factors are essentially external, completing a PEST analysis is helpful prior to completing a SWOT analysis (a SWOT analysis - Strengths, Weaknesses, Opportunities, Threats - is based broadly on half internal and half external factors).

A PEST analysis measures a market; a SWOT analysis measures a business unit, a proposition or idea.

N.B. The PEST model is sometimes extended (some would say unnecessarily) to seven factors, by adding Ecological (or Environmental), Legislative (or Legal), and Industry Analysis (the model is then known as PESTELI). Arguably if completed properly, the basic PEST analysis should naturally cover these 'additional' factors: Ecological factors are found under the four main PEST headings; Legislative factors would normally be covered under the Political heading; Industry Analysis is effectively covered under the Economic heading. If you prefer to keep things simple, perhaps use PESTELI only if you are worried about missing something within the three extra headings.

A SWOT analysis measures a business unit or proposition, a PEST analysis measures the market potential and situation, particularly indicating growth or decline, and thereby market attractiveness, business potential, and suitability of access - market potential and 'fit' in other words. PEST analysis uses four perspectives, which give a logical structure, in this case organized by

the PEST format, that helps understanding, presentation, discussion and decision-making. The four dimensions are an extension of a basic two heading list of pro's and con's (free pro's and con's template here).

PEST analysis can be used for marketing and business development assessment and decision-making, and the PEST template encourages proactive thinking, rather than relying on habitual or instinctive reactions.

Here the PEST analysis template is presented as a grid, comprising four sections, one for each of the PEST headings: Political, Economic, Social and Technological. The free PEST template below includes sample questions or prompts, whose answers can be inserted into the relevant section of the PEST grid. The questions are examples of discussion points, and obviously can be altered depending on the subject of the PEST analysis, and how you want to use it. Make up your own PEST questions and prompts to suit the issue being analysed and the situation (ie., the people doing the work and the expectations of them). Like SWOT analysis, it is important to clearly identify the subject of a PEST analysis, because a PEST analysis is four-way perspective in relation to a particular business unit or proposition - if you blur the focus you will produce a blurred picture - so be clear about the market that you use PEST to analyse.

A market is defined by what is addressing it, be it a product, company, brand, business unit, proposition, idea, etc, so be clear about how you define the market being analysed, particularly if you use PEST analysis in workshops, team exercises or as a delegated task. The PEST subject should be a clear definition of the market being addressed, which might be from any of the following standpoints:

- a company looking at its market
- a product looking at its market
- a brand in relation to its market
- a local business unit
- a strategic option, such as entering a new market or launching a new product
- a potential acquisition
- a potential partnership
- an investment opportunity

Be sure to describe the subject for the PEST analysis clearly so that people contributing to the analysis, and those seeing the finished PEST analysis, properly understand the purpose of the PEST assessment and implications.

PORTER'S FIVE COMPETITIVE FORCES

Michael E Porter's five forces of competitive position model and diagrams

Michael Porter's famous Five Forces of Competitive Position model provides a simple perspective for assessing and analysing the competitive strength and position of a corporation or business organization.

American Michael Porter was born in 1947. After initially graduating in aeronautical engineering, Porter achieved an economics doctorate at Harvard, where he was subsequently awarded university professorship, a position he continues to fulfil at Harvard Business School. His research group is based at the Harvard Business School, and separately he co-founded with Mark Kramer the Foundation Strategy Group, 'a mission-driven social enterprise, dedicated to advancing the practice of philanthropy and corporate social investment, through consulting to foundations and corporations'. A prime example of someone operating at a self-actualization level if ever there was one.

After his earlier work on corporate strategy Porter extended the application of his ideas and theories to international economies and the competitive positioning of nations, as featured in his later books. In fact in 1985 Porter was appointed to President Ronald Reagan's Commission on Industrial Competitiveness, which marked the widening of his perspective to national economies. By the 1990's Porter had established a reputation as a strategy guru on the international speaking circuit second only to Tom Peters, and was among the world's highest earning academics.

Porter's first book *Competitive Strategy* (1980), which he wrote in his thirties, became an international best seller, and is considered by many to be a seminal and definitive work on corporate strategy. The book, which has been published in nineteen languages and re-printed approaching sixty times, changed the way business leaders thought and remains a guide of choice for strategic managers the world over.

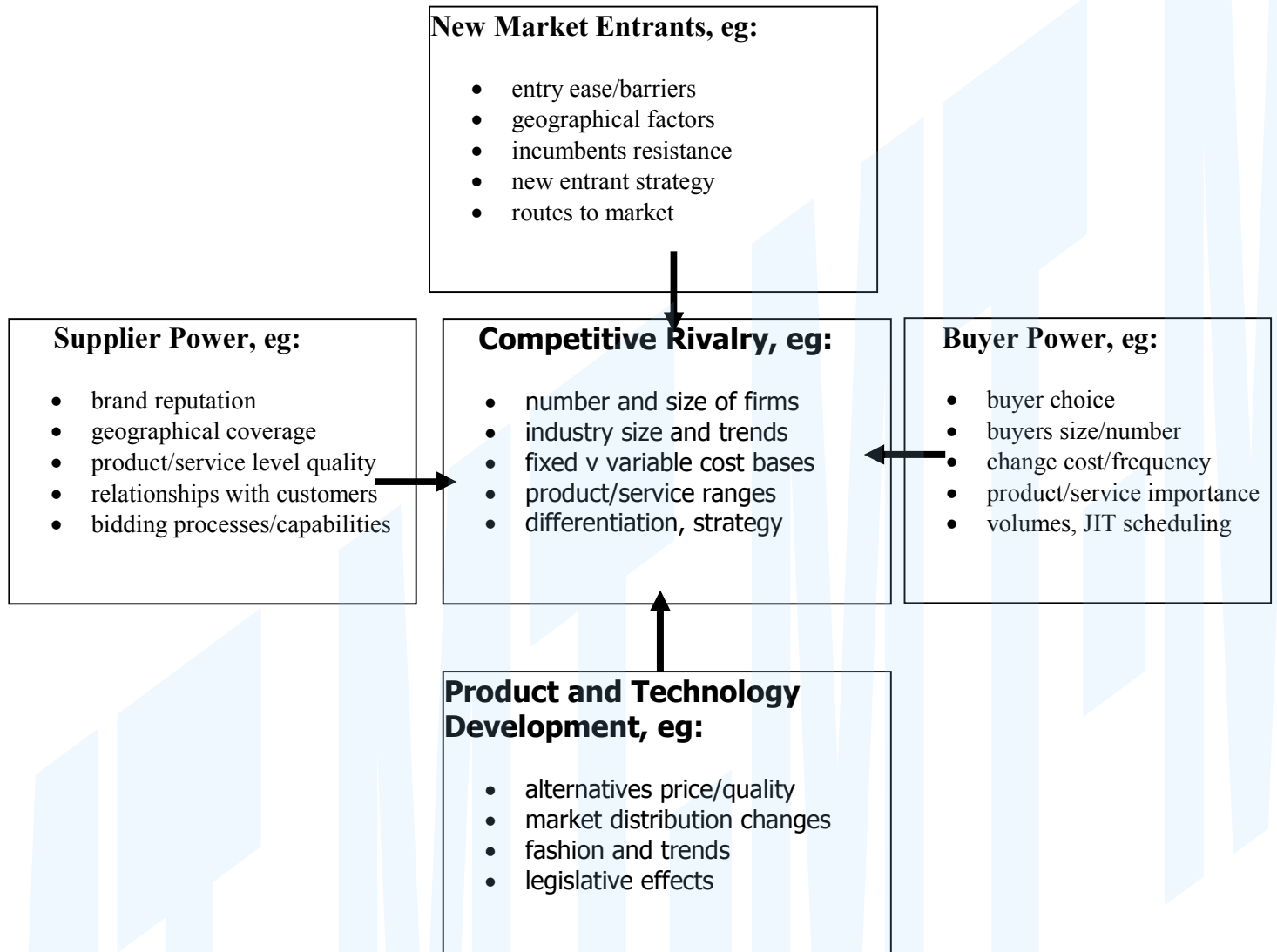
Aside from his innovative thinking, Porter has a special ability to represent complex concepts in relatively easily accessible formats, notably his Five Forces model, in which market factors can be analysed so as to make a strategic assessment of the competitive position of a given supplier in a given market. The five forces that Porter suggests drive competition are:

Porter's five forces

1. **Existing competitive rivalry between suppliers**
2. **Threat of new market entrants**
3. **Bargaining power of buyers**
4. **Power of suppliers**
5. **Threat of substitute products (including technology change)**

Typically this five forces model is shown as a series of five boxes in a cross formation, item 1 being central.

Porter's five forces



Porter's Five Forces model can be used to good analytical effect alongside other models such as the [SWOT](#) and [PEST](#) analysis tools.

Porter's Five Forces model provides suggested points under each main heading, by which you can develop a broad and sophisticated analysis of competitive position, as might be used when creating strategy, plans, or making investment decisions about a business or organization.

Porter is also known for his simple identification of five generic descriptions of industries:

1. **Fragmented** (eg, shoe repairs, gift shops)
2. **Emerging** (eg, space travel)
3. **Mature** (eg, automotive)
4. **Declining** (eg, solid fuels)
5. **Global** (eg, micro-processors)

And Porter is also particularly recognised for his competitive 'diamond' model, used for assessing relative competitive strength of nations, and by implication their industries:

1. **Factor Conditions:** production factors required for a given industry, eg., skilled labour, logistics and infrastructure.
2. **Demand Conditions:** extent and nature of demand within the nation concerned for the product or service.
3. **Related Industries:** the existence, extent and international competitive strength of other industries in the nation concerned that support or assist the industry in question.
4. **Corporate Strategy, Structure and Rivalry:** the conditions in the home market that affect how corporations are created, managed and grown; the idea being that firms that have to fight hard in their home market are more likely to be able to succeed in international markets.

Michael Porter's key books:

Competitive Strategy: Techniques for Analyzing Industries and Competitors, 1980

Competitive Advantage: Creating and Sustaining Superior Performance, 1985

Competition in Global Industries, 1986

The Competitive Advantage of Nations, 1990

OTHER PORTER 5 FORCES DETAILS AND EXAMPLES

Because the subject matter of strategic management is so inherently complex and because each one of us brings his own personal biases to the analysis, it was suggested early on that virtually all case material in the field be analyzed from the perspective of more than one methodology. Profit theory and industrial chains were selected as the first of a number of viable approaches to the analytical process. It would have been equally correct to select the Five Competitive Forces analysis refined by Michael Porter, one of the major figures in the field of strategic management. This methodology addresses the same issues but differs only in the language that they use to describe corporate behavior. The five forces are:

- The threat of new entrants into an industry or a market served by a specific company.
- The bargaining power of suppliers.
- The bargaining power of customers.
- Threat of substitute products or services.
- The intensity of the rivalry among existing firms.

Each of these topics is treated separately in the discussion that follows.

The threat of new entrants

The ease with which firms can enter into a new market or industry is a critical variable in the strategic management process. In some industries the *barriers to entry* are minimal. In other industries, the barriers to entry are formidable. These barriers can take on many forms; among them: the amount of capital needed to enter into a specific industry may be great enough to deter entrants; the current participants in the industry may have product lines protected by patents; the switching costs for the company's customers may be great enough to pose a barrier to entry to a new firm; and other factors discussed below.

For example, there are a large number of small computer-oriented software firms in the United States. Entry into this industry does not require a vast amount of capital. Instead, one needs a rather small number of highly imaginative and qualified programmers able to develop niche-oriented products that find a home in an ever-expanding marketplace. Because the major portion of the costs are incurred in the development phase with production costs absorbing relatively small amounts of money, a successful new product entry can prove to be highly profitable, thus providing the capital and marketing base needed to challenge a firm that may previously have been in a leadership position.

The same cannot be said for the jet aircraft industry. The up-front costs for designing, developing and producing a jet-powered aircraft are estimated to be in the \$4.0 to \$5.0 *billion* category. This would be an immense amount of money for a firm to risk as the cost of entry into an otherwise stable business. Equally important as a barrier to entry would be the lack of availability of a highly skilled management, engineering, and production workforce. From a practical perspective, this group would have to be put together before any initial effort on the design of a new aircraft could go forward. And they would have to be bid away from firms already in the industry with a subsequent disruption of salary and wage scales within the industry.

Patent rights may similarly be a barrier to entry in a specific industry, for example, the ethical drug industry. And many public utilities are, in effect, granted monopoly rights that act as barriers to entry to other firms. As can be seen, given the complexities of the different barriers to entry which will vary from one industry to another, it is best not to generalize about these matters. Instead each potential situation needs to be treated as if it were unique, and subsequent judgements made on this basis.

Here an aside is extremely important. What may be true for a domestic marketplace may not be so for a global marketplace. For many of the reasons discussed above, in the early 1970s, it was unlikely that the American automobile industry (General Motors, Ford and Chrysler) could be upstaged by the entry into the U.S. market of another *U.S. company*. But this did not hold for a foreign competitor with the required resources: capital; complete knowledge of the required technologies; management skills; marketing skills; etcetra. Japanese firms with these *qualities* entered and gradually came to dominate a significant portion of the U.S. market for automobiles. More will be said of this later.

The bargaining power of suppliers and the bargaining power of customers

Though treated separately earlier, it is often impossible to discuss the bargaining power of suppliers and customers separately. This is because of the joint relationship between suppliers and customers in which they normally seek to maximize their bargaining power vis-a-vis one another. And, often times, as will be discussed below, *outsiders* intervene in the process thus establishing new relationships within a previously stable industrial sector. The automobile industry provides some excellent case history here.

Until the mid-to-late 1970s, Ford, Chrysler and General Motors were able to maintain extremely strict franchise relationships with their dealers. One of the covenants of these franchise relationships restricted a dealer to representing only one of the Big Three. Moreover, in keeping with standard practice within the industry, the dealers had to follow business policies and procedures established by their manufacturer. Because most Big Three franchises were then quite profitable, the dealers responded reasonably well to most of the manufacturer's (supplier's) dictates. In other words, for as long as the American consumer was reasonably satisfied with the price and quality of American-made cars, the bargaining power of the Big Three with respect to their dealers went unchallenged. However, the American consumer became disenchanted with many of the products being offered by the Big Three and began looking for alternatives.

It was then that the Japanese entered the U.S. market. Their initial entry was with a line of small, fuel-efficient, low-priced vehicles. However, *consistent with policies established and enforced by the Japanese government*, the Japanese manufacturers were required to attain a quality level in their cars that was superior to that of their American competitors. But they also needed a network of dealers if they were to economically penetrate the U.S. market.

By offering a substantial financial package to potential dealers and avoiding the issue of exclusivity, the Japanese successfully challenged traditional American franchising practices. Given the poor sales, profit, and quality record in the early 1970s of many American brand names, many dealers jumped at the opportunity to challenge the Big Three on their own turf. Although this would earlier have cost them their Big Three franchise, at this juncture they were willing to take the risk, given the alternatives made available to them by a *new force in the marketplace*. In sum, the bargaining relationship between supplier and customer within the automobile industry changed, or perhaps a better word would be...*moderated*. Although the typical dealer has to be extremely responsive to the demands and requirements of the automobile manufacturer, the *multi-firm dealer* has gained a goodly amount of off-setting bargaining power. There are now automobile dealerships with sales in excess of \$600,000,000 a year, with these sales generated by automobiles manufactured by three, four, and sometimes five different manufacturers. This is a supplier-customer relationship that the Big Three would not have tolerated earlier.

The threat of substitute products and services

Technically, the entry of the Japanese automotive industry into the United States should not be characterized as the threat of a new product since an automobile is an automobile. But less technically, it can be regarded as the substitution of Japanese-made cars for American-made cars.

A more clear-cut case of the effective threat of substitute products, and one that is familiar to you as a student, is the substitution of the personal computer for the typewriter. From all practical perspectives, the personal computer has replaced the typewriter as the key writing instrument, both at the office and at home. In the process, an otherwise large, viable, and profitable industry has been upstaged by new product introductions from an otherwise non-competing industry.

A similar but less dramatic case can be found in the substitution of ballpoint pens for the fountain pen that was in common usage not too many years ago. As with the computer/typewriter case, different technological skills

are needed for the mass manufacture of ballpoint as opposed to ink-filled pens. But the factor of price and convenience has clearly been a determining factor here.

However, it should be recognized that an analysis of the potential for substitute products upstaging an existing market is, in point of fact, a difficult task. This is because of the difficulty of imagining or predicting the existence of a substitute product *before it makes its appearance on the market place*. To avoid strategic surprises, senior management must devote adequate resources to the personnel capable of following the marketplace and able to interpret changes in the technological and/or marketing frontier as they occur. In the computer/typewriter industry, the substitute product represented a significant change in technology. In the instance of the automobile, the change was driven more by marketing than by technological factors. In the case of the ballpoint pen, by price and convenience. In other words, each case stands on its own and must be analyzed on a case-by-case basis.

The intensity of rivalry among competing firms

This is the last of the five competitive forces, and the one whose content is the most focussed. Before moving directly into a discussion of this force, it is worthwhile to go back to basic economic theory and review the concept of *oligopolistic competition*. This, as you may remember, is the instance in which there are relatively few firms (usually three or four) competing within an industry, but in such a way as to minimize the effects of price-based competition. Prior to the entry of the Japanese into the U.S. marketplace, the domestic automobile industry was a classic example of this form of competition. With its 53% share of the U.S. market, General Motors was then the *price leader* within the industry. In the late, summer just prior to the introduction of its latest line of cars, it would announce its new price schedules. Shortly thereafter, both Ford and Chrysler would do the same but with price changes virtually equal to those set earlier by General Motors. There was no collusion involved! Rather, each of the firms understood that price-based competition would not necessarily lead to increases in the size of the market place and, thus, each fastidiously avoided price-based competition. There was even a year when General Motors announced that it was increasing its prices by 10% to offset a predicted decline of 10% in market demand.

Similar *administered price policies* obtained across many large-scale U.S. industries in which a limited number of large firms controlled a major portion of the market. It is not that these firms would not actively compete with each other but rather that price was not the cutting edge of their various strategies. This, of course, changed when foreign competitors with protected domestic markets elected to compete in the United States. With their home markets often protected by tariff and non-tariff barriers, foreign producers could use price as a major element in their overall international corporate strategies. Their longer-term goals were, of course, market share and the economies of scale that market share brings. In other words, their strategy was one of intense rivalry with price used as the initial cutting edge of their strategic plan.

The transition to competitive factors other than price in the strategic management equation can be illustrated by the history of the Wal-Mart organization. Having established itself as the hallmark within the discount industry, Wal-Mart can now successfully compete on other than a low-price basis.

However, in the small-to-medium-size business sector, the intensity of rivalry among competing firms can be extremely strenuous, especially if the firms are competing within a relatively stable, slow growth industry. In its early days, The Home Depot (construction and do-it-yourself materials and supplies) was a classic case in this regard. In order to establish its position in a slow-growing, relatively stable, and most assuredly unromantic marketplace, Home Depot used price as a major strategic wedge. Today, as the major factor in its industry, it can mute its competitive posture vis-a-vis the relatively few large scale competitors left within the industry. Like Wal-Mart, it can now afford to be the *elder statesman* of the industry much as General Motors was until the mid-1970s.

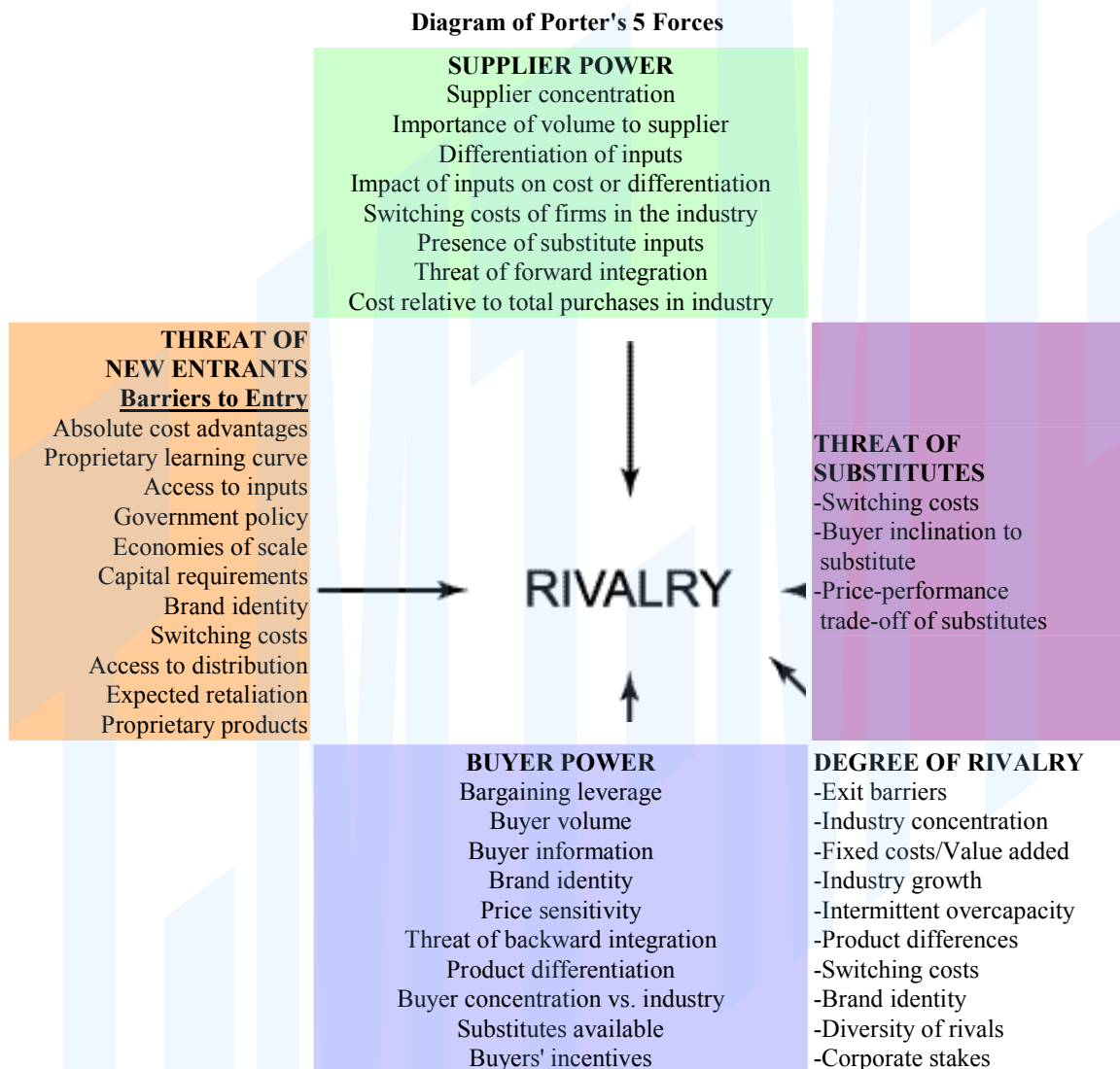
An essential component of any strategic management analysis is a determination of the intensity of rivalry among existing firms. However, data should be collected and *analyzed sensitively*. Competition is fierce within some industries and less so in others.

Porter's Five Forces

A MODEL FOR INDUSTRY ANALYSIS

The model of pure competition implies that risk-adjusted rates of return should be constant across firms and industries. However, numerous economic studies have affirmed that different industries can sustain different levels of profitability; part of this difference is explained by industry structure.

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates.



I. Rivalry

In the traditional economic model, competition among rival firms drives profits to zero. But competition is not perfect and firms are not unsophisticated passive price takers. Rather, firms strive for a [competitive advantage](#) over their rivals. The intensity of rivalry among firms varies across industries, and strategic analysts are interested in these differences.

Economists measure rivalry by indicators of [industry concentration](#). The Concentration Ratio (CR) is one such measure. The Bureau of Census periodically reports the CR for major Standard Industrial Classifications (SIC's). The CR indicates the percent of [market share](#) held by the four largest firms (CR's for the largest 8, 25, and 50 firms in an industry also are available). A high concentration ratio indicates that a high concentration of market share is held by the largest firms - the industry is concentrated. With only a few firms holding a large market share, the competitive landscape is less competitive (closer to a monopoly). A low concentration ratio indicates that the industry is characterized by many rivals, none of which has a significant market share. These *fragmented* markets are said to be competitive. The concentration ratio is not the only available measure; the trend is to define industries in terms that convey more information than distribution of market share.

If rivalry among firms in an industry is low, the industry is considered to be disciplined. This discipline may result from the industry's history of competition, the role of a leading firm, or informal compliance with a generally understood code of conduct. Explicit *collusion* generally is illegal and not an option; in low-rivalry industries competitive moves must be constrained informally. However, a maverick firm seeking a competitive advantage can displace the otherwise disciplined market.

When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage.

In pursuing an advantage over its rivals, a firm can choose from several competitive moves:

- Changing prices - raising or lowering prices to gain a temporary advantage.
- Improving product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself.
- Creatively using channels of distribution - using [vertical integration](#) or using a distribution channel that is novel to the industry. For example, with high-end jewelry stores reluctant to carry its watches, Timex moved into drugstores and other non-traditional outlets and cornered the low to mid-price watch market.
- Exploiting relationships with suppliers - for example, from the 1950's to the 1970's Sears, Roebuck and Co. dominated the retail household appliance market. Sears set high quality standards and required suppliers to meet its demands for product specifications and price.

The intensity of rivalry is influenced by the following industry characteristics:

1. **A larger number of firms** [increases](#) rivalry because more firms must compete for the same customers and resources. The rivalry intensifies if the firms have similar market share, leading to a struggle for market leadership.
2. **Slow market growth** [causes firms to fight](#) for market share. In a growing market, firms are able to improve revenues simply because of the expanding market.
3. **High fixed costs** result in an economy of scale effect that [increases rivalry](#). When total costs are mostly fixed costs, the firm must produce near capacity to attain the lowest unit costs. Since the

firm must sell this large quantity of product, high levels of production lead to a fight for market share and results in increased rivalry.

4. **High storage costs or highly perishable products** cause a producer to sell goods as soon as possible. If other producers are attempting to unload at the same time, competition for customers intensifies.
5. **Low switching costs** increases rivalry. When a customer can freely switch from one product to another there is a greater struggle to capture customers.
6. **Low levels of product differentiation** is associated with higher levels of rivalry. Brand identification, on the other hand, tends to constrain rivalry.
7. **Strategic stakes are high** when a firm is losing market position or has potential for great gains. This intensifies rivalry.
8. **High exit barriers** place a high cost on abandoning the product. The firm must compete. High exit barriers cause a firm to remain in an industry, even when the venture is not profitable. A common exit barrier is asset specificity. When the plant and equipment required for manufacturing a product is highly specialized, these assets cannot easily be sold to other buyers in another industry. Litton Industries' acquisition of Ingalls Shipbuilding facilities illustrates this concept. Litton was successful in the 1960's with its contracts to build Navy ships. But when the Vietnam war ended, defense spending declined and Litton saw a sudden decline in its earnings. As the firm restructured, divesting from the shipbuilding plant was not feasible since such a large and highly specialized investment could not be sold easily, and Litton was forced to stay in a declining shipbuilding market.
9. **A diversity of rivals** with different cultures, histories, and philosophies make an industry unstable. There is greater possibility for mavericks and for misjudging rival's moves. Rivalry is volatile and can be intense. The hospital industry, for example, is populated by hospitals that historically are community or charitable institutions, by hospitals that are associated with religious organizations or universities, and by hospitals that are for-profit enterprises. This mix of philosophies about mission has lead occasionally to fierce local struggles by hospitals over who will get expensive diagnostic and therapeutic services. At other times, local hospitals are highly cooperative with one another on issues such as community disaster planning.
10. **Industry Shakeout**. A growing market and the potential for high profits induces new firms to enter a market and incumbent firms to increase production. A point is reached where the industry becomes crowded with competitors, and demand cannot support the new entrants and the resulting increased supply. The industry may become crowded if its growth rate slows and the market becomes saturated, creating a situation of excess capacity with too many goods chasing too few buyers. A shakeout ensues, with intense competition, price wars, and company failures.

BCG founder Bruce Henderson generalized this observation as the Rule of Three and Four: a stable market will not have more than three significant competitors, and the largest competitor will have no more than four times the market share of the smallest. If this rule is true, it implies that:

- If there is a larger number of competitors, a shakeout is inevitable
- Surviving rivals will have to grow faster than the market
- Eventual losers will have a negative cash flow if they attempt to grow
- All except the two largest rivals will be losers
- The definition of what constitutes the "market" is strategically important.

Whatever the merits of this rule for stable markets, it is clear that market stability and changes in supply and demand affect rivalry. Cyclical demand tends to create cutthroat competition. This is true in the disposable diaper industry in which demand fluctuates with birth rates, and in the greeting card industry in which there are more predictable business cycles.

II. Threat Of Substitutes

In Porter's model, substitute products refer to products in other industries. To the economist, a threat of substitutes exists when a product's demand is affected by the price change of a substitute product. A product's [price elasticity](#) is affected by substitute products - as more substitutes become available, the demand becomes more elastic since customers have more alternatives. A close substitute product constrains the ability of firms in an industry to raise prices.

The competition engendered by a Threat of Substitute comes from products outside the industry. The price of aluminum beverage cans is constrained by the price of glass bottles, steel cans, and plastic containers. These containers are substitutes, yet they are not rivals in the aluminum can industry. To the manufacturer of automobile tires, tire retreads are a substitute. Today, new tires are not so expensive that car owners give much consideration to retreading old tires. But in the trucking industry new tires are expensive and tires must be replaced often. In the truck tire market, retreading remains a viable substitute industry. In the disposable diaper industry, cloth diapers are a substitute and their prices constrain the price of disposables.

While the threat of substitutes typically impacts an industry through price competition, there can be other concerns in assessing the threat of substitutes. Consider the substitutability of different types of TV transmission: local station transmission to home TV antennas via the airways versus transmission via cable, satellite, and telephone lines. The new technologies available and the changing structure of the entertainment media are contributing to competition among these substitute means of connecting the home to entertainment. Except in remote areas it is unlikely that cable TV could compete with free TV from an aerial without the greater diversity of entertainment that it affords the customer.

III. Buyer Power

The power of buyers is the impact that customers have on a producing industry. In general, when buyer power is strong, the relationship to the producing industry is near to what an economist terms a **monopsony** - a market in which there are many suppliers and one buyer. Under such market conditions, the buyer sets the price. In reality few pure monopsonies exist, but frequently there is some asymmetry between a producing industry and buyers. The following tables outline some factors that determine buyer power.

Buyers are Powerful if:	Example
Buyers are concentrated - there are a few buyers with significant market share	DOD purchases from defense contractors
Buyers purchase a significant proportion of output - distribution of purchases or if the product is standardized	Circuit City and Sears' large retail market provides power over appliance manufacturers
Buyers possess a credible backward integration threat - can threaten to buy producing firm or rival	Large auto manufacturers' purchases of tires
Buyers are Weak if:	Example
Producers threaten forward integration - producer can take over own distribution/retailing	Movie-producing companies have integrated forward to acquire theaters
Significant buyer switching costs - products not	IBM's 360 system strategy in the 1960's

standardized and buyer cannot easily switch to another product	
Buyers are fragmented (many, different) - no buyer has any particular influence on product or price	Most consumer products
Producers supply critical portions of buyers' input - distribution of purchases	Intel's relationship with PC manufacturers

IV. Supplier Power

A producing industry requires raw materials - labor, components, and other supplies. This requirement leads to buyer-supplier relationships between the industry and the firms that provide it the raw materials used to create products. Suppliers, if powerful, can exert an influence on the producing industry, such as selling raw materials at a high price to capture some of the industry's profits. The following tables outline some factors that determine supplier power.

Suppliers are Powerful if:	Example
Credible forward integration threat by suppliers	Baxter International, manufacturer of hospital supplies, acquired American Hospital Supply, a distributor
Suppliers concentrated	Drug industry's relationship to hospitals
Significant cost to switch suppliers	Microsoft's relationship with PC manufacturers
Customers Powerful	Boycott of grocery stores selling non-union picked grapes
Suppliers are Weak if:	Example
Many competitive suppliers - product is standardized	Tire industry relationship to automobile manufacturers
Purchase commodity products	Grocery store brand label products
Credible backward integration threat by purchasers	Timber producers relationship to paper companies
Concentrated purchasers	Garment industry relationship to major department stores
Customers Weak	Travel agents' relationship to airlines

V. Threat of New Entrants and Entry Barriers

It is not only incumbent rivals that pose a threat to firms in an industry; the possibility that new firms may enter the industry also affects competition. In theory, any firm should be able to enter and exit a market, and if free entry and exit exists, then profits always should be nominal. In reality, however, industries possess characteristics that protect the high profit levels of firms in the market and inhibit additional rivals from entering the market. These are *barriers to entry*.

Barriers to entry are more than the normal equilibrium adjustments that markets typically make. For example, when industry profits increase, we would expect additional firms to enter the market to take advantage of the high profit levels, over time driving down profits for all firms in the industry. When profits decrease, we would expect some firms to exit the market thus restoring a market equilibrium. Falling prices, or the expectation that future prices will fall, deters rivals from entering a market. Firms also may be reluctant to enter markets that are extremely uncertain, especially if entering involves expensive start-up costs. These are normal accommodations to market conditions. But if firms individually (collective action would be illegal collusion) keep prices artificially low as a strategy to prevent potential entrants from entering the market, such **entry-detering pricing** establishes a barrier.

Barriers to entry are unique industry characteristics that define the industry. Barriers reduce the rate of entry of new firms, thus maintaining a level of profits for those already in the industry. From a strategic perspective, barriers can be created or exploited to enhance a firm's competitive advantage. Barriers to entry arise from several sources:

1. **Government creates barriers.** Although the principal role of the government in a market is to preserve competition through anti-trust actions, government also restricts competition through the granting of monopolies and through regulation. Industries such as utilities are considered natural monopolies because it has been more efficient to have one electric company provide power to a locality than to permit many electric companies to compete in a local market. To restrain utilities from exploiting this advantage, government permits a monopoly, but regulates the industry. Illustrative of this kind of barrier to entry is the local cable company. The franchise to a cable provider may be granted by competitive bidding, but once the franchise is awarded by a community a monopoly is created. Local governments were not effective in monitoring price gouging by cable operators, so the federal government has enacted legislation to review and restrict prices.

The regulatory authority of the government in restricting competition is historically evident in the banking industry. Until the 1970's, the markets that banks could enter were limited by state governments. As a result, most banks were local commercial and retail banking facilities. Banks competed through strategies that emphasized simple marketing devices such as awarding toasters to new customers for opening a checking account. When banks were deregulated, banks were permitted to cross state boundaries and expand their markets. Deregulation of banks intensified rivalry and created uncertainty for banks as they attempted to maintain market share. In the late 1970's, the strategy of banks shifted from simple marketing tactics to mergers and geographic expansion as rivals attempted to expand markets.

2. **Patents and proprietary knowledge serve to restrict entry into an industry.** Ideas and knowledge that provide competitive advantages are treated as private property when patented, preventing others from using the knowledge and thus creating a barrier to entry. Edwin Land introduced the Polaroid camera in 1947 and held a monopoly in the instant photography industry. In 1975, Kodak attempted to enter the instant camera market and sold a comparable camera. Polaroid sued for patent infringement and won, keeping Kodak out of the instant camera industry.
3. **Asset specificity inhibits entry into an industry.** Asset specificity is the extent to which the firm's assets can be utilized to produce a different product. When an industry requires highly specialized technology or plants and equipment, potential entrants are reluctant to commit to acquiring specialized assets that cannot be sold or converted into other uses if the venture fails. Asset specificity provides a barrier to entry for two reasons: First, when firms already hold specialized assets they fiercely resist efforts by others from taking their market share. New entrants can anticipate aggressive rivalry. For example, Kodak had much capital invested in its photographic equipment business and aggressively resisted efforts by Fuji to intrude in its market. These assets are both large and industry specific. The second reason is that potential entrants are reluctant to make investments in highly specialized assets.

4. **Organizational (Internal) Economies of Scale.** The most cost efficient level of production is termed **Minimum Efficient Scale (MES)**. This is the point at which unit costs for production are at minimum - i.e., the most cost efficient level of production. If MES for firms in an industry is known, then we can determine the amount of market share necessary for low cost entry or cost parity with rivals. For example, in long distance communications roughly 10% of the market is necessary for MES. If sales for a long distance operator fail to reach 10% of the market, the firm is not competitive.

The existence of such an economy of scale creates a barrier to entry. The greater the difference between industry MES and entry unit costs, the greater the barrier to entry. So industries with high MES deter entry of small, start-up businesses. To operate at less than MES there must be a consideration that permits the firm to sell at a premium price - such as product differentiation or local monopoly.

Barriers to exit work similarly to barriers to entry. Exit barriers limit the ability of a firm to leave the market and can exacerbate rivalry - unable to leave the industry, a firm must compete. Some of an industry's entry and exit barriers can be summarized as follows:

<p>Easy to Enter if there is:</p> <ul style="list-style-type: none"> • Common technology • Little brand franchise • Access to distribution channels • Low scale threshold 	<p>Difficult to Enter if there is:</p> <ul style="list-style-type: none"> • Patented or proprietary know-how • Difficulty in brand switching • Restricted distribution channels • High scale threshold
<p>Easy to Exit if there are:</p> <ul style="list-style-type: none"> • Salable assets • Low exit costs • Independent businesses 	<p>Difficult to Exit if there are:</p> <ul style="list-style-type: none"> • Specialized assets • High exit costs • Interrelated businesses

DYNAMIC NATURE OF INDUSTRY RIVALRY

Our descriptive and analytic models of industry tend to examine the industry at a given state. The nature and fascination of business is that it is not static. While we are prone to generalize, for example, list GM, Ford, and Chrysler as the "Big 3" and assume their dominance, we also have seen the automobile industry change. Currently, the entertainment and communications industries are in flux. Phone companies, computer firms, and entertainment are merging and forming strategic alliances that re-map the information terrain. Schumpeter and, more recently, Porter have attempted to move the understanding of industry competition from a static economic or industry organization model to an emphasis on the interdependence of forces as dynamic, or *punctuated equilibrium*, as Porter terms it.

In Schumpeter's and Porter's view the dynamism of markets is driven by innovation. We can envision these forces at work as we examine the following changes:

Top 10 US Industrial Firms by Sales 1917 - 1988

	1917	1945	1966	1983	1988
1	US Steel	General Motors	General Motors	Exxon	General Motors
2	Swift	US Steel	Ford	General Motors	Ford
3	Armour	Standard Oil - NJ	Standard Oil -NJ (Exxon)	Mobil	Exxon
4	American Smelting	US Steel	General Electric	Texaco	IBM
5	Standard Oil -NJ	Bethlehem Steel	Chrysler	Ford	General Electric
6	Bethlehem Steel	Swift	Mobil	IBM	Mobil
7	Ford	Armour	Texaco	Socal (Oil)	Chrysler
8	DuPont	Curtiss-Wright	US Steel	DuPont	Texaco
9	American Sugar	Chrysler	IBM	Gulf Oil	DuPont
10	General Electric	Ford	Gulf Oil	Standard Oil of Indiana	Philip Morris

10 Largest US Firms by Assets, 1909 and 1987

	1909	1987
1	US STEEL	GM (Not listed in 1909)
2	STANDARD OIL, NJ (Now, EXXON #3)	SEARS (1909 = 45)
3	AMERICAN TOBACCO (Now, American Brands #52)	EXXON (Standard Oil trust broken up in 1911)
4	AMERICAN MERCANTILE MARINE (Renamed US Lines; acquired by Kidde, Inc., 1969; sold to McLean Industries, 1978; bankruptcy, 1986)	IBM (Ranked 68, 1948)
5	INTERNATIONAL HARVESTER (Renamed Navistar #182); divested farm equipment	FORD (Listed in 1919)
6	ANACONDA COPPER (acquired by ARCO in 1977)	MOBIL OIL
7	US LEATHER (Liquidated in 1935)	GENERAL ELECTRIC (1909= 16)
8	ARMOUR (Merged in 1968 with General Host; in 1969 by Greyhound; 1983 sold to ConAgra)	CHEVRON (Not listed in 1909)
9	AMERICAN SUGAR REFINING (Renamed AMSTAR. In 1967 =320) Leveraged buyout and sold in pieces)	TEXACO (1909= 91)
10	PULLMAN, INC (Acquired by Wheelabrator Frye, 1980; spun-off as Pullman-Peabody, 1981; 1984 sold to Trinity Industries)	DU PONT (1909= 29)

GENERIC STRATEGIES TO COUNTER THE FIVE FORCES

Strategy can be formulated on three [levels](#):

- corporate level
- business unit level
- functional or departmental level.

The business unit level is the primary context of industry rivalry. Michael Porter identified three [generic strategies](#) (*cost leadership*, *differentiation*, and *focus*) that can be implemented at the business unit level to create a competitive advantage. The proper generic strategy will position the firm to leverage its strengths and defend against the adverse effects of the five forces.

Recommended Reading

Porter, Michael E., [Competitive Strategy: Techniques for Analyzing Industries and Competitors](#)

ELEMENTS OF INDUSTRY STRUCTURE

1 ENTRY BARRIERS

Economies of scale
 Extent of product differentiation
 Proprietary barriers
 Switching costs of Buyers
 Capital requirements
 Access to distribution channels
 Access to necessary Inputs
 Complexity of Input Information
 Extent of grip on process or technological knowhow
 Govt subsidies, protective barriers, etc.
 Expected retaliation to entrant
 Beliefs about entry barriers to the Industry

2 DETERMINANTS OF COMPETITIVE INTENSITY

Industry growth
 Fixed costs or storage costs
 Flexibility of capacity in sectors with volatile demand
 Switching costs of Buyers
 Extent of differentiation
 Concentration of Competitors
 Availability of information about Competitors
 Diversity of ownership structure of Competitors
 Strategic importance of Industry to Owners
 Emotional importance of Industry to Owners
 Exit barriers
 Beliefs of Competitors & potential Competitors

3 DETERMINANTS OF SUBSTITUTION THREATS

Relative price performance of Substitutes
 Availability of Substitutes
 Diversity of Substitutes
 Switching costs of Buyers
 Buyer propensity to substitute
 Entry barriers of Firms producing Substitutes
 Cooperative capability of Competitors against Substitutes
 Intensity of Competition in Substitute's Industry
 Beliefs of Firms producing Substitutes about this Industry

4 DETERMINANTS OF BUYER POWER

Buyer concentration vs Firm concentration
 Buyer volume
 Switching costs of Buyers vs Firms
 Transaction & negotiation costs
 Buyer information
 Complexity of purchasing decision
 Ability of integration by Buyers vs integration by Firms
 Substitute products
 Extent of Product Differentiation
 Brand consciousness of Buyers
 Buyer needs vs Firms' capabilities
 Extent of impact of input on Buyer's quality of output
 Cost of input vs total cost of all inputs of the Buyer
 Buyers' profits in relation to price of input
 Incentives given by Buyer to its Decision Maker
 Beliefs of Buyer about the Industry

5 DETERMINANTS OF SUPPLIER POWER

Extent of differentiation of inputs
 Switching costs of Suppliers vs Firms
 Presence of substitute inputs
 Supplier concentration vs concent. of firms
 Importance of Industry to Supplier
 Supplier's item cost relative to total purchases of the Firm

Impact of input on Firm's product differentiation
 Importance of input on quality of Firm's output
 Ability of integration by Suppliers vs integration by Firms
 Degree of organisation of HR supply
 HR Supply Growth Constraints
 Beliefs of the Suppliers about the Industry

How Competitive Forces Shape Strategy

Awareness of these forces can help a company stake out a position in its industry that is less vulnerable to attack

by Michael E. Porter

The essence of strategy formulation is coping with competition. Yet it is easy to view competition too narrowly and too pessimistically. While one sometimes hears executives complaining to the contrary, intense competition in an industry is neither coincidence nor bad luck.

Moreover, in the fight for market share, competition is not manifested only in the other players. Rather, competition in an industry is rooted in its underlying economics, and competitive forces exist that go well beyond the established combatants in a particular industry. Customers, suppliers, potential entrants, and substitute products are all competitors that may be more or less prominent or active depending on the industry.

The state of competition in an industry depends on five basic forces, which are diagrammed in the Exhibit on page 6. The collective strength of these forces determines the ultimate profit potential of an industry. It ranges from *intense* in industries like tires, metal cans, and steel, where no company earns spectacular returns on investment, to *mild* in industries like oil field services and equipment, soft

drinks, and toiletries, where there is room for quite high returns.

In the economists' "perfectly competitive" industry, jockeying for position is unbridled and entry to the industry very easy. This kind of industry structure, of course, offers the worst prospect for long-run profitability. The weaker the forces collectively, however, the greater the opportunity for superior performance.

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Whatever their collective strength, the corporate strategist's goal is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favor. The collective strength of the forces may be painfully apparent to all the antagonists; but to cope with them, the strategist must delve below the surface and analyze the sources of each. For example, what makes the industry vulnerable to entry? What determines the bargaining power of suppliers?

Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic agenda of action. They highlight the critical strengths and weaknesses of the company, animate the positioning of the company in its industry, clarify the areas where strategic changes may yield the greatest payoff, and highlight the places where industry trends promise to hold the greatest significance as either opportunities or threats. Understanding these sources also proves to be of help in considering areas for diversification.

Contending forces

The strongest competitive force or forces determine the profitability of an industry and so are of greatest importance in strategy formulation. For example, even a company with a strong position in an industry unthreatened by potential entrants will earn low returns if it faces a superior or a lower-cost substitute product—as the leading manufacturers of vacuum tubes and coffee percolators have learned to their sorrow. In such a situation, coping with the substitute product becomes the number one strategic priority.

Different forces take on prominence, of course, in shaping competition in each industry. In the ocean-going tanker industry the key force is probably the buyers (the major oil companies), while in tires it is powerful OEM buyers coupled with tough competitors. In the steel industry the key forces are foreign competitors and substitute materials.

Every industry has an underlying structure, or a set of fundamental economic and technical characteristics, that gives rise to these competitive forces. The strategist, wanting to position his or her company to cope best with its industry environment or to influence that environment in the company's favor, must learn what makes the environment tick.

This view of competition pertains equally to industries dealing in services and to those selling products. To avoid monotony in this article, I refer to both products and services as "products." The same general principles apply to all types of business.

A few characteristics are critical to the strength of each competitive force. I shall discuss them in this section.

Threat of entry

New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources. Companies diversifying through acquisition into the industry from other markets often leverage their resources to cause a shake-up, as Philip Morris did with Miller beer.

The seriousness of the threat of entry depends on the barriers present and on the reaction from existing competitors that entrants can expect. If barriers to entry are high and newcomers can expect sharp retaliation from the entrenched competitors, obviously the newcomers will not pose a serious threat of entering.

There are six major sources of barriers to entry:

1. *Economies of scale*—These economies deter entry by forcing the aspirant either to come in on a large scale or to accept a cost disadvantage. Scale economies in production, research, marketing, and service are probably the key barriers to entry in the mainframe computer industry, as Xerox and GE sadly discovered. Economies of scale can also act as hurdles in distribution, utilization of the sales force, financing, and nearly any other part of a business.

2. *Product differentiation*—Brand identification creates a barrier by forcing entrants to spend heavily to overcome customer loyalty. Advertising, customer service, being first in the industry, and product differences are among the factors fostering brand identification. It is perhaps the most important entry barrier in soft drinks, over-the-counter drugs, cosmetics, investment banking, and public accounting. To create high fences around their businesses, brewers couple brand identification with economies of scale in production, distribution, and marketing.

3. *Capital requirements*—The need to invest large financial resources in order to compete creates a barrier to entry, particularly if the capital is required for unrecoverable expenditures in up-front advertising or R&D. Capital is necessary not only for fixed facilities but also for customer credit, inventories, and absorbing start-up losses. While major corporations have the financial resources to invade almost any industry, the huge capital requirements in certain fields, such as computer manufacturing and mineral extraction, limit the pool of likely entrants.

4. *Cost disadvantages independent of size*—Entrenched companies may have cost advantages not

The Experience Curve as an Entry Barrier

In recent years, the experience curve has become widely discussed as a key element of industry structure. According to this concept, unit costs in many manufacturing industries (some dogmatic adherents say in *all* manufacturing industries) as well as in some service industries decline with "experience," or a particular company's cumulative volume of production. (The experience curve, which encompasses many factors, is a broader concept than the better known learning curve, which refers to the efficiency achieved over a period of time by workers through much repetition.)

The causes of the decline in unit costs are a combination of elements, including economies of scale, the learning curve for labor, and capital-labor substitution. The cost decline creates a barrier to entry because new competitors with no "experience" face higher costs than established ones, particularly the producer with the largest market share, and have difficulty catching up with the entrenched competitors.

Adherents of the experience curve concept stress the importance of achieving market leadership to maximize this barrier to entry, and they recommend aggressive action to achieve it, such as price cutting in anticipation of falling costs in order to build volume. For the combatant that cannot achieve a healthy market share, the prescription is usually, "Get out."

Is the experience curve an entry barrier on which strategies should be built? The answer is: not in every industry. In fact, in some industries, building a strategy on the experience curve can be potentially disastrous. That costs decline with experience in some industries is not news to corporate executives. The significance of the experience curve for strategy depends on what factors are causing the decline.

If costs are falling because a growing company can reap economies of scale through more efficient, automated facilities and vertical integration, then the cumulative volume of production is unimportant to its relative cost position. Here the lowest-cost producer is the one with the largest, most efficient facilities.

A new entrant may well be more efficient than the more experienced competitors; if it has built the newest plant, it will face no disadvantage in having to catch up. The strategic prescription, "You must have

the largest, most efficient plant," is a lot different from, "You must produce the greatest cumulative output of the item to get your costs down."

Whether a drop in costs with cumulative (not absolute) volume erects an entry barrier also depends on the sources of the decline. If costs go down because of technical advances known generally in the industry or because of the development of improved equipment that can be copied or purchased from equipment suppliers, the experience curve is no entry barrier at all—in fact, new or less experienced competitors may actually enjoy a cost *advantage* over the leaders. Free of the legacy of heavy past investments, the newcomer or less experienced competitor can purchase or copy the newest and lowest-cost equipment and technology.

If, however, experience can be kept proprietary, the leaders will maintain a cost advantage. But new entrants may require less experience to reduce their costs than the leaders needed. All this suggests that the experience curve can be a shaky entry barrier on which to build a strategy.

While space does not permit a complete treatment here, I want to mention a few other crucial elements in determining the appropriateness of a strategy built on the entry barrier provided by the experience curve:

□ The height of the barrier depends on how important costs are to competition compared with other areas like marketing, selling, and innovation.

□ The barrier can be nullified by product or process innovations leading to a substantially new technology and thereby creating an entirely new experience curve.* New entrants can leapfrog the industry leaders and alight on the new experience curve, to which those leaders may be poorly positioned to jump.

□ If more than one strong company is building its strategy on the experience curve, the consequences can be nearly fatal. By the time only one rival is left pursuing such a strategy, industry growth may have stopped and the prospects of reaping the spoils of victory long since evaporated.

*For an example drawn from the history of the automobile industry see William J. Abernathy and Kenneth Wayne, "The Limits of the Learning Curve," HBR.

available to potential rivals, no matter what their size and attainable economies of scale. These advantages can stem from the effects of the learning curve (and of its first cousin, the experience curve), proprietary technology, access to the best raw materials sources, assets purchased at preinflation prices, government subsidies, or favorable locations. Sometimes cost advantages are legally en-

forceable, as they are through patents. (For an analysis of the much-discussed experience curve as a barrier to entry, see the ruled insert above.)

5. *Access to distribution channels*—The newcomer on the block must, of course, secure distribution of its product or service. A new food product, for example, must displace others from the supermarket shelf via price breaks, promotions, intense

selling efforts, or some other means. The more limited the wholesale or retail channels are and the more that existing competitors have these tied up, obviously the tougher that entry into the industry will be. Sometimes this barrier is so high that, to surmount it, a new contestant must create its own distribution channels, as Timex did in the watch industry in the 1950s.

6. *Government policy*—The government can limit or even foreclose entry to industries with such controls as license requirements and limits on access to raw materials. Regulated industries like trucking, liquor retailing, and freight forwarding are noticeable examples; more subtle government restrictions operate in fields like ski-area development and coal mining. The government also can play a major indirect role by affecting entry barriers through controls such as air and water pollution standards and safety regulations.

The potential rival's expectations about the reaction of existing competitors also will influence its decision on whether to enter. The company is likely to have second thoughts if incumbents have previously lashed out at new entrants or if:

- ☐ The incumbents possess substantial resources to fight back, including excess cash and unused borrowing power, productive capacity, or clout with distribution channels and customers.
- ☐ The incumbents seem likely to cut prices because of a desire to keep market shares or because of industrywide excess capacity.
- ☐ Industry growth is slow, affecting its ability to absorb the new arrival and probably causing the financial performance of all the parties involved to decline.

Changing conditions

From a strategic standpoint there are two important additional points to note about the threat of entry.

First, it changes, of course, as these conditions change. The expiration of Polaroid's basic patents on instant photography, for instance, greatly reduced its absolute cost entry barrier built by proprietary technology. It is not surprising that Kodak plunged into the market. Product differentiation in printing has all but disappeared. Conversely, in the auto industry economies of scale increased enormously with post-World War II automation and vertical integration—virtually stopping successful new entry.

Second, strategic decisions involving a large segment of an industry can have a major impact on the conditions determining the threat of entry. For ex-

ample, the actions of many U.S. wine producers in the 1960s to step up product introductions, raise advertising levels, and expand distribution nationally surely strengthened the entry roadblocks by raising economies of scale and making access to distribution channels more difficult. Similarly, decisions by members of the recreational vehicle industry to vertically integrate in order to lower costs have greatly increased the economies of scale and raised the capital cost barriers.

Powerful suppliers & buyers

Suppliers can exert bargaining power on participants in an industry by raising prices or reducing the quality of purchased goods and services. Powerful suppliers can thereby squeeze profitability out of an industry unable to recover cost increases in its own prices. By raising their prices, soft drink concentrate producers have contributed to the erosion of profitability of bottling companies because the bottlers, facing intense competition from powdered mixes, fruit drinks, and other beverages, have limited freedom to raise *their* prices accordingly. Customers likewise can force down prices, demand higher quality or more service, and play competitors off against each other—all at the expense of industry profits.

The power of each important supplier or buyer group depends on a number of characteristics of its market situation and on the relative importance of its sales or purchases to the industry compared with its overall business.

A *supplier* group is powerful if:

- ☐ It is dominated by a few companies and is more concentrated than the industry it sells to.
- ☐ Its product is unique or at least differentiated, or if it has built up switching costs. Switching costs are fixed costs buyers face in changing suppliers. These arise because, among other things, a buyer's product specifications tie it to particular suppliers, it has invested heavily in specialized ancillary equipment or in reaming how to operate a supplier's equipment (as in computer software), or its production lines are connected to the supplier's manufacturing facilities (as in some manufacture of beverage containers).
- ☐ It is not obliged to contend with other products for sale to the industry. For instance, the competition between the steel companies and the aluminum companies to sell to the can industry checks the power of each supplier.
- ☐ It poses a credible threat of integrating forward into the industry's business. This provides a check against the industry's ability to improve the terms on which it purchases.

□ The industry is not an important customer of the supplier group. If the industry is an important customer, suppliers' fortunes will be closely tied to the industry, and they will want to protect the industry through reasonable pricing and assistance in activities like R&D and lobbying.

A buyer group is powerful if:

□ It is concentrated or purchases in large volumes. Large volume buyers are particularly potent forces if heavy fixed costs characterize the industry—as they do in metal containers, corn refining, and bulk chemicals, for example—which raise the stakes to keep capacity filled.

□ The products it purchases from the industry are standard or undifferentiated. The buyers, sure that they can always find alternative suppliers, may play one company against another, as they do in aluminum extrusion.

□ The products it purchases from the industry form a component of its product and represent a significant fraction of its cost. The buyers are likely to shop for a favorable price and purchase selectively. Where the product sold by the industry in question is a small fraction of buyers' costs, buyers are usually much less price sensitive.

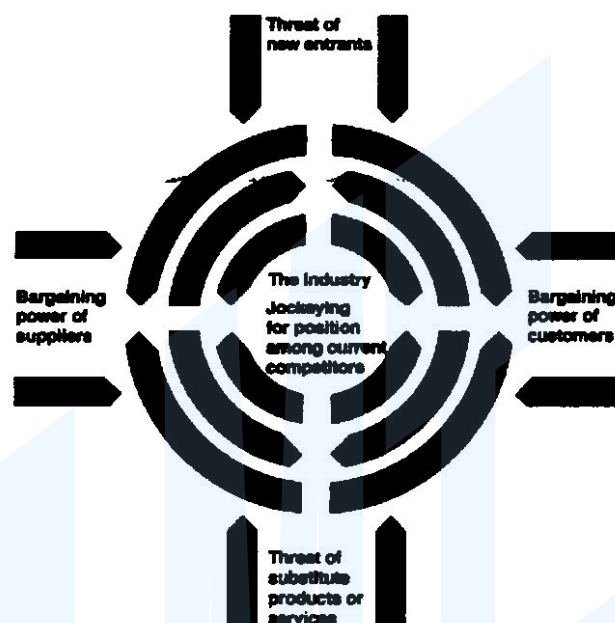
□ It earns low profits, which create great incentive to lower its purchasing costs. Highly profitable buyers, however, are generally less price sensitive (that is, of course, if the item does not represent a large fraction of their costs).

□ The industry's product is unimportant to the quality of the buyers' products or services. Where the quality of the buyers' products is very much affected by the industry's product, buyers are generally less price sensitive. Industries in which this situation obtains include oil field equipment, where a malfunction can lead to large losses, and enclosures for electronic medical and test instruments, where the quality of the enclosure can influence the user's impression about the quality of the equipment inside.

□ The industry's product does not save the buyer money. Where the industry's product or service can pay for itself many times over, the buyer is rarely price sensitive; rather, he is interested in quality. This is true in services like investment banking and public accounting, where errors in judgment can be costly and embarrassing, and in businesses like the logging of oil wells, where an accurate survey can save thousands of dollars in drilling costs.

□ The buyers pose a credible threat of integrating backward to make the industry's product. The Big Three auto producers and major buyers of cars have often used the threat of self-manufacture as a bar-

Exhibit Forces governing competition in an industry



gaining lever. But sometimes an industry engenders a threat to buyers that its members may integrate forward.

Most of these sources of buyer power can be attributed to consumers as a group as well as to industrial and commercial buyers; only a modification of the frame of reference is necessary. Consumers tend to be more price sensitive if they are purchasing products that are undifferentiated, expensive relative to their incomes, and of a sort where quality is not particularly important.

The buying power of retailers is determined by the same rules, with one important addition. Retailers can gain significant bargaining power over manufacturers when they can influence consumers' purchasing decisions, as they do in audio components, jewelry, appliances, sporting goods, and other goods.

Strategic action

A company's choice of suppliers to buy from or buyer groups to sell to should be viewed as a crucial strategic decision. A company can improve its strategic posture by finding suppliers or buyers who possess the least power to influence it adversely.

Most common is the situation of a company being able to choose whom it will sell to—in other words, buyer selection. Rarely do all the buyer groups a company sells to enjoy equal power. Even

if a company sells to a single industry, segments usually exist within that industry that exercise less power (and that are therefore less price sensitive) than others. For example, the replacement market for most products is less price sensitive than the overall market.

As a rule, a company can sell to powerful buyers and still come away with above-average profitability only if it is a low-cost producer in its industry or if its product enjoys some unusual, if not unique, features. In supplying large customers with electric motors, Emerson Electric earns high returns because its low cost position permits the company to meet or undercut competitors' prices.

If the company lacks a low cost position or a unique product, selling to everyone is self-defeating because the more sales it achieves, the more vulnerable it becomes. The company may have to muster the courage to turn away business and sell only to less potent customers.

Buyer selection has been a key to the success of National Can and Crown Cork & Seal. They focus on the segments of the can industry where they can create product differentiation, minimize the threat of backward integration, and otherwise mitigate the awesome power of their customers. Of course, some industries do not enjoy the luxury of selecting "good" buyers.

As the factors creating supplier and buyer power change with time or as a result of a company's strategic decisions, naturally the power of these groups rises or declines. In the ready-to-wear clothing industry, as the buyers (department stores and clothing stores) have become more concentrated and control has passed to large chains, the industry has come under increasing pressure and suffered falling margins. The industry has been unable to differentiate its product or engender switching costs that lock in its buyers enough to neutralize these trends.

Substitute products

By placing a ceiling on prices it can charge, substitute products or services limit the potential of an industry. Unless it can upgrade the quality of the product or differentiate it somehow (as via marketing), the industry will suffer in earnings and possibly in growth.

Manifestly, the more attractive the price-performance trade-off offered by substitute products, the firmer the lid placed on the industry's profit potential. Sugar producers confronted with the large-scale commercialization of high-fructose corn syrup, a sugar substitute, are learning this lesson today.

Substitutes not only limit profits in normal times; they also reduce the bonanza an industry can reap in boom times. In 1978 the producers of fiberglass insulation enjoyed unprecedented demand as a result of high energy costs and severe winter weather. But the industry's ability to raise prices was tempered by the plethora of insulation substitutes, including cellulose, rock wool, and styrofoam. These substitutes are bound to become an even stronger force once the current round of plant additions by fiberglass insulation producers has boosted capacity enough to meet demand (and then some).

Substitute products that deserve the most attention strategically are those that (a) are subject to trends improving their price-performance trade-off with the industry's product, or (b) are produced by industries earning high profits. Substitutes often come rapidly into play if some development increases competition in their industries and causes price reduction or performance improvement.

Jockeying for position

Rivalry among existing competitors takes the familiar form of jockeying for position—using tactics like price competition, product introduction, and advertising slugfests. Intense rivalry is related to the presence of a number of factors:

- ☐ Competitors are numerous or are roughly equal in size and power. In many U.S. industries in recent years foreign contenders, of course, have become part of the competitive picture.
- ☐ Industry growth is slow, precipitating fights for market share that involve expansion-minded members.
- ☐ The product or service lacks differentiation or switching costs, which lock in buyers and protect one combatant from raids on its customers by another.
- ☐ Fixed costs are high or the product is perishable, creating strong temptation to cut prices. Many basic materials businesses, like paper and aluminum, suffer from this problem when demand slackens.
- ☐ Capacity is normally augmented in large increments. Such additions, as in the chlorine and vinyl chloride businesses, disrupt the industry's supply-demand balance and often lead to periods of overcapacity and price cutting.
- ☐ Exit barriers are high. Exit barriers, like very specialized assets or management's loyalty to a particular business, keep companies competing even though they may be earning low or even negative returns on investment. Excess capacity remains functioning, and the profitability of the healthy competitors suffers as the sick ones hang on.¹ If the

entire industry suffers from overcapacity, it may seek government help—particularly if foreign competition is present.

□ The rivals are diverse in strategies, origins, and “personalities.” They have different ideas about how to compete and continually run head-on into each other in the process.

As an industry matures, its growth rate changes, resulting in declining profits and (often) a shakeout. In the booming recreational vehicle industry of the early 1970s, nearly every producer did well, but slow growth since then has eliminated the high returns, except for the strongest members, not to mention many of the weaker companies. The same profit story has been played out in industry after industry—snowmobiles, aerosol packaging, and sports equipment are just a few examples.

An acquisition can introduce a very different personality to an industry, as has been the case with Black & Decker's takeover of McCullough, the producer of chain saws. Technological innovation can boost the level of fixed costs in the production process, as it did in the shift from batch to continuous-line photo finishing in the 1960s.

While a company must live with many of these factors—because they are built into industry economics—it may have some latitude for improving matters through strategic shifts. For example, it may try to raise buyers' switching costs or increase product differentiation. A focus on selling efforts in the fastest-growing segments of the industry or on market areas with the lowest fixed costs can reduce the impact of industry rivalry. If it is feasible, a company can try to avoid confrontation with competitors having high exit barriers and can thus sidestep involvement in bitter price cutting.

Formulation of strategy

Once having assessed the forces affecting competition in an industry and their underlying causes, the corporate strategist can identify the company's strengths and weaknesses. The crucial strengths and weaknesses from a strategic standpoint are the company's posture vis-à-vis the underlying causes of each force. Where does it stand against substitutes? Against the sources of entry barriers?

Then the strategist can devise a plan of action that may include (1) positioning the company so that its capabilities provide the best defense against the competitive force, and/or (2) influencing the balance of the forces through strategic moves, thereby improving the company's position, and/or (3) anticipating shifts in the factors underlying the

forces and responding to them, with the hope of exploiting change by choosing a strategy appropriate for the new competitive balance before opponents recognize it. I shall consider each strategic approach in turn.

Positioning the company

The first approach takes the structure of the industry as given and matches the company's strengths and weaknesses to it. Strategy can be viewed as building defenses against the competitive forces or as finding positions in the industry where the forces are weakest.

Knowledge of the company's capabilities and of the causes of the competitive forces will highlight the areas where the company should confront competition and where avoid it. If the company is a low-cost producer, it may choose to confront powerful buyers while it takes care to sell them only products not vulnerable to competition from substitutes.

The success of Dr Pepper in the soft drink industry illustrates the coupling of realistic knowledge of corporate strengths with sound industry analysis to yield a superior strategy. Coca-Cola and Pepsi-Cola dominate Dr Pepper's industry, where many small concentrate producers compete for a piece of the action. Dr Pepper chose a strategy of avoiding the largest-selling drink segment, maintaining a narrow flavor line, forgoing the development of a captive bottler network, and marketing heavily. The company positioned itself so as to be least vulnerable to its competitive forces while it exploited its small size.

In the \$11.5 billion soft drink industry, barriers to entry in the form of brand identification, large-scale marketing, and access to a bottler network are enormous. Rather than accept the formidable costs and scale economies in having its own bottler network—that is, following the lead of the Big Two and of Seven-Up—Dr Pepper took advantage of the different flavor of its drink to “piggyback” on Coke and Pepsi bottlers who wanted a full line to sell to customers. Dr Pepper coped with the power of these buyers through extraordinary service and other efforts to distinguish its treatment of them from that of Coke and Pepsi.

Many small companies in the soft drink business offer cola drinks that thrust them into head-to-head competition against the majors. Dr Pepper, however, maximized product differentiation by maintaining a narrow line of beverages built around an unusual flavor.

Finally, Dr Pepper met Coke and Pepsi with an advertising onslaught emphasizing the alleged

uniqueness of its single flavor. This campaign built strong brand identification and great customer loyalty. Helping its efforts was the fact that Dr Pepper's formula involved lower raw materials cost, which gave the company an absolute cost advantage over its major competitors.

There are no economies of scale in soft drink concentrate production, so Dr Pepper could prosper despite its small share of the business (6%). Thus Dr Pepper confronted competition in marketing but avoided it in product line and in distribution. This artful positioning combined with good implementation has led to an enviable record in earnings and in the stock market.

Influencing the balance

When dealing with the forces that drive industry competition, a company can devise a strategy that takes the offensive. This posture is designed to do more than merely cope with the forces themselves; it is meant to alter their causes.

Innovations in marketing can raise brand identification or otherwise differentiate the product. Capital investments in large-scale facilities or vertical integration affect entry barriers. The balance of forces is partly a result of external factors and partly in the company's control.

Exploiting industry change

Industry evolution is important strategically because evolution, of course, brings with it changes in the sources of competition I have identified. In the familiar product life-cycle pattern, for example, growth rates change, product differentiation is said to decline as the business becomes more mature, and the companies tend to integrate vertically.

These trends are not so important in themselves; what is critical is whether they affect the sources of competition. Consider vertical integration. In the maturing minicomputer industry, extensive vertical integration, both in manufacturing and in software development, is taking place. This very significant trend is greatly raising economies of scale as well as the amount of capital necessary to compete in the industry. This in turn is raising barriers to entry and may drive some smaller competitors out of the industry once growth levels off.

Obviously, the trends carrying the highest priority from a strategic standpoint are those that affect the most important sources of competition in the industry and those that elevate new causes to the forefront. In contract aerosol packaging, for example, the trend toward less product differentiation is now dominant. It has increased buyers' power, lowered the barriers to entry, and intensified competi-

tion.

The framework for analyzing competition that I have described can also be used to predict the eventual profitability of an industry. In long-range planning the task is to examine each competitive force, forecast the magnitude of each underlying cause, and then construct a composite picture of the likely profit potential of the industry.

The outcome of such an exercise may differ a great deal from the existing industry structure. Today, for example, the solar heating business is populated by dozens and perhaps hundreds of companies, none with a major market position. Entry is easy, and competitors are battling to establish solar heating as a superior substitute for conventional methods.

The potential of this industry will depend largely on the shape of future barriers to entry, the improvement of the industry's position relative to substitutes, the ultimate intensity of competition, and the power captured by buyers and suppliers. These characteristics will in turn be influenced by such factors as the establishment of brand identities, significant economies of scale or experience curves in equipment manufacture wrought by technological change, the ultimate capital costs to compete, and the extent of overhead in production facilities.

The framework for analyzing industry competition has direct benefits in setting diversification strategy. It provides a road map for answering the extremely difficult question inherent in diversification decisions: "What is the potential of this business?" Combining the framework with judgment in its application, a company may be able to spot an industry with a good future before this good future is reflected in the prices of acquisition candidates.

Multifaceted rivalry

Corporate managers have directed a great deal of attention to defining their businesses as a crucial step in strategy formulation. Theodore Levitt, in his classic 1960 article in HBR, argued strongly for avoiding the myopia of narrow, product-oriented industry definition.² Numerous other authorities have also stressed the need to look beyond product to function in defining a business, beyond national boundaries to potential international competition, and beyond the ranks of one's competitors today to those that may become competitors tomorrow. As a result of these urgings, the proper definition of a company's industry or industries has become an endlessly debated subject.

One motive behind this debate is the desire to exploit new markets. Another, perhaps more important motive is the fear of overlooking latent sources of competition that someday may threaten the industry. Many managers concentrate so single-mindedly on their direct antagonists in the fight for market share that they fail to realize that they are also competing with their customers and their suppliers for bargaining power. Meanwhile, they also neglect to keep a wary eye out for new entrants to the contest or fail to recognize the subtle threat of substitute products.

The key to growth—even survival—is to stake out a position that is less vulnerable to attack from head-to-head opponents, whether established or

new, and less vulnerable to erosion from the direction of buyers, suppliers, and substitute goods. Establishing such a position can take many forms—solidifying relationships with favorable customers, differentiating the product either substantively or psychologically through marketing, integrating forward or backward, establishing technological leadership.

¹~~For a more complete discussion of exit barriers and their implications for strategy, see my article, "Please Note Location of Nearest Exit,"~~ California Management Review,

²Theodore Levitt. "Marketing Myopia," reprinted as an HBR Classic.

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CASE : Five Forces and The Biotechnology Industry*

Porter's five forces model can be illustrated with reference to the biotechnology industry in the United States. Biotechnology is the use of living organisms to synthesise products for commercial application. In 1992, approximately 77 percent of public biotech companies in the US were developing pharmaceutical applications, 53 percent were primarily involved in therapeutics, and 24 percent were involved in diagnostics.

In 1991, there were 1,100 biotechnology firms in the US with sales exceeding US\$4 billion, about 200 of which were public companies. The intensity of rivalry among existing competitors is immediately apparent. Most biotechnology companies, both large and small, were struggling to survive in the early 1990s. Although conventional wisdom in the industry suggested that top scientists and secure funding were sufficient for success, even firms with these resources faced significant competitive challenges. In 1991, 82 percent of biotechnology companies were unprofitable and 76 percent employed fewer than 50 people. Only about 30 companies had grown large enough to employ more than 300 people.

The large number of firms indicates that barriers to entry in the biotech industry are not significant. Traditional drug companies typically screened thousands of compounds in search of one that could cure disease. Using this trial and error method, the cost to research, develop and commercialise a drug is enormous. With biotech, such trial and error methods are unnecessary. What is needed is a thorough understanding of a particular disease to identify and

synthesise a genetically engineered product that will be an effective treatment. Many firms count on one or two blockbuster products to build their success. A major therapeutic could generate as much as US\$1 billion in sales.

The use of patents can grant a company 17 years free of competition for a patented product. However, biotechnology research is easy to imitate, and these patents are not easily defended, since minor changes in the manufacturing or formulation process can generate a technically new product with the same qualities. Conflicts over patent rights are common in this industry, with cross-licensing a possible solution. Large-scale manufacturing of some biotech products is based on two standard and relatively inexpensive techniques: fermentation and cell culture. Economies of scale are not necessarily significant.

Pressure from substitute products occurs when biotech products treat the same problem as chemically-produced drugs. Although biotech drugs are thought to be safer and more effective than chemically-produced drugs, they are often considerably more expensive. The benefits of biotech products can be outweighed by these costs.

Biotherapeutics are sold to physicians, pharmacies and hospitals, both directly and through wholesale distributors. In hospital sales, the hospital's pharmacy and therapeutics committee decides what products the pharmacy should stock. An effective sales force for US hospitals could be as small as 25 people, indicating considerable buying power on the part of hospitals. Sales to individual pharmacies or physicians require many more sales calls and a sales

force of around 1,500. Sellers also have significant bargaining power, since most companies market their products through larger biotech or pharmaceutical companies with established relationships and reputations in the health care marketplace. The licensing of marketing rights is a common practice. In the case of diagnostic pharmaceuticals, 73 percent of firms have marketing alliances. In areas

where biotech firms are geographically concentrated, they have formed buying groups to collectively negotiate the best prices from distributors of laboratory supplies.

**Source:* This example is adapted from Harvard Business School Case 9-792-082, *Biotechnology Strategies*.

Exercises

1. Draw out a picture of Porter's Five Forces as you see it apply to the Biotechnology Industry.
2. In view of these Five Forces what could a biotech company do to improve its current industry position?

PORTER'S VALUE CHAIN

The value chain methodology has been left until after internal and external analysis for a number of reasons. First, like the SWOT analysis, it can be used to assess the strengths and weaknesses of a corporation.

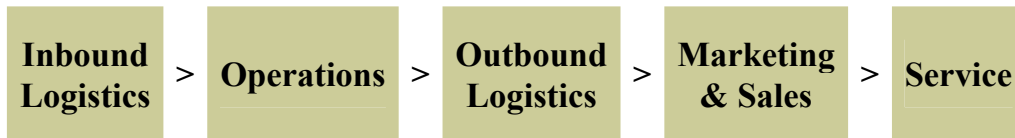
Second, it is somewhat of a first cousin to a functional area analysis in that it provides a basis for analyzing discrete corporate operations. However, because it requires a substantial amount of information on internal corporate operations not always available in a case analysis, the descriptors used in a value chain analysis tend to be more useful in an *audit* of corporate operations than in a case-based analysis of corporate strategy. However, the methodology has its own champions and has significant analytical merit.

Many managers chart strategy without a full understanding of the sources and distribution of profits in their industry. Sometimes they focus their sights on revenues instead of profits, mistakenly assuming that revenue growth will eventually translate into profit growth. In other cases, they simply lack the data or the analytical tools required to isolate and measure variations in profitability. The Value Chain is a way to think clearly about where the money's being made in any industry. It is a framework for analyzing how profits are distributed among the activities that form an industry's value chain. Such an analysis can provide a company's managers with a rich understanding of their industry's profit structure--enabling them to identify which activities are generating disproportionately large or small shares of profits. Even more important, a value chain analysis opens a window onto the underlying structure of the industry, helping managers see the various forces that are determining the distribution of profits. As such, an analysis provides a solid basis for strategic thinking.

A two-part taxonomy is used in value chain analyses: *primary activities* and *support activities*. Each of these categories is described below. Note that the term *line operations* can be substituted for the primary activity category. Similarly, the term *staff operations* can be substituted for the support activity category.

The primary activities

Primary Value Chain Activities



The goal of these activities is to create value that exceeds the cost of providing the product or service, thus generating a profit margin.

- *Inbound logistics:*

- Maintaining efficient raw material and inventory control systems, and related warehousing activities.

- *Operations:*

- Plant (factory) layout, effective and efficient production systems scaled to corporate needs.
 - Automated machinery and equipment consistent with both technological and market requirements.

- *Outbound logistics*

- On-time delivery of orders.
 - Efficient warehouse, location, layout, and control systems.

- *Marketing and Sales*

- Effective market research programs.
 - Innovation in sales promotions and advertising activities.
 - Distribution channels consistent with customers' needs.
 - Motivated and experienced sales force.
 - Development of a quality image and reputation.
 - Level of brand loyalty among customers.
 - Level of market dominance within relevant markets.
 - Feedback system for integrating marketing and sales systems with senior-level corporate planning process and procedures.

- *Service*

- Continual customer input to product improvements and innovations.
 - Prompt attention to customer complaints.
 - Warranty and guarantee programs where appropriate.
 - Customer education and training.
 - Proper attention to aftermarket needs for repairs and spare parts.

Unlike some of the earlier methodologies included in this student guide, a value chain analysis is centered on analyzing operations at the *micro-level*. No attempt should be made in a value chain analysis to gain a global view of corporate operations. Indeed, with the exception of sections on marketing and sales, the analytical approach is similar to that used in the industrial engineering field.

Any or all of these primary activities may be vital in developing a competitive advantage. For example, logistics activities are critical for a provider of distribution

services, and service activities may be the key focus for a firm offering on-site maintenance contracts for office equipment.

These five categories are generic and portrayed here in a general manner. Each generic activity includes specific activities that vary by industry.

The support activities

The primary value chain activities described above are facilitated by support activities. Porter identified four generic categories of support activities, the details of which are industry-specific.

- *Firm infrastructure*

- Coordination and integration of the functional areas.
- Quality of the strategic management process.
- Access to adequate financial resources.
- Management information systems geared to both strategic and administrative needs.
- Public image.
- Active search for new investments through the capital budgeting process.

- *Human resource management*

- Ability to recruit and retain high quality personnel.
- Equitable salary and reward system.
- Employee training programs.
- Employee "self-empowerment" programs where appropriate.
- Active participation in professional organizations.

- *Technology development*

- Success of research and development activities as measured by successful product introductions and/or innovations.
- Ability of the research and development group to meet production and/or marketing timetables.
- Senior-level integration of the research and development group with their finance, marketing and production counterparts.
- Quality of laboratories.
- Quality of technology personnel.

- *Procurement*

- Procurement of raw material on a timely and cost-effective basis.
- Fair and equitable treatment of all suppliers.
- Where appropriate, integration of suppliers' design, engineering, and production procedures with in-house capabilities.
- Market-scanning procedures for new materials, technologies and vendors.

Support activities often are viewed as "overhead", but some firms successfully have used them to develop a competitive advantage, for example, to develop a cost advantage through innovative management of information systems

As in the case of the primary activities, the data gathering and analysis process is, once again, concentrated, for the most part, on narrowly defined activities.

Value Chain Analysis

In order to better understand the activities leading to a competitive advantage, one can begin with the generic value chain and then identify the relevant firm-specific activities. Process flows can be mapped, and these flows used to isolate the individual value-creating activities.

Once the discrete activities are defined, linkages between activities should be identified. A linkage exists if the performance or cost of one activity affects that of another. Competitive advantage may be obtained by optimizing and coordinating linked activities.

The value chain also is useful in outsourcing decisions. Understanding the linkages between activities can lead to more optimal make-or-buy decisions that can result in either a cost advantage or a differentiation advantage.

The Value System

The firm's value chain links to the value chains of upstream suppliers and downstream buyers. The result is a larger stream of activities known as the value system. The development of a competitive advantage depends not only on the firm-specific value chain, but also on the value system of which the firm is a part.

EXAMPLES

The Hewlett-Packard Company (HP), *no debt policy* is an example of how one part of the value chain can help in a company's competitiveness. This policy has had a number of important effects on corporate operations. First, the company must control its costs to the *nth* degree. This is, of course, an accounting and control responsibility which in the value chain is known as a support activity under the term: "Firm Infrastructure". Second, it must be able to develop and market products whose value to the customer is greater than the price charged for the product. This is both a production and a marketing responsibility. Third, the company must always be at the cutting edge technologically in order to sustain its ability to keep profits high enough to fund all growth internally. Last, the company must be able to incrementally improve its products in a way which creates significant *switching cost* barriers for many of its industrial customers, without however *jeopardizing their ability to control and manage their own costs*.

Pilkington Bros., PLC, is a pioneer in the development of float glass technology. Float glass is the glass that we all use today in windows and doors. At one point Pilkington had a strategic decision to take: Whether it should license its revolutionary and proprietary technologies to firms that previously had been among its world-wide competitors. Pilkington was interested in doing this since it wanted (a) to protect their earlier investment in new technologies, (b) to set the standards for an industry in which they are the leader, and (c) to switch investment burden to firms other than their own. By implementing this strategic decision, Pilkington focused its attention on part of the value chain it knew very well: i.e. "Technology Development" as a "Support Activity" in the Value Chain. By focusing on this part of the chain it relieved itself from the manufacturing operation as a "Primary Activity" leaving this activity to those who are better positioned in terms of cost in this part of the Value Chain.

Recommended Reading

Porter, Michael E., [*Competitive Advantage: Creating and Sustaining Superior Performance*](#)

Caterpillar is the world's largest producer of heavy construction equipment in the world. However, unlike its major competitor, Komatsu, Caterpillar chose to operate primarily as a product development and production company and not a retailer and service provider. Caterpillar, develops and produces equipment but leaves the sales and service to a small number of country and local distributors. These are not, however, small operations. The average Caterpillar distributor does more than \$200 million a year in business. The exhibit below shows how one can build business process activities based on an understanding of the sources of

Customer Needs
Machine Productivity/Dollar Spent Over the Machine's Lifetime

Machine Appropriateness
Machine Up-Time
Machine Operating Costs

Machine Quality
Machine Flexibility
Machine Engineering
Availability
Financing
Price
Parts Availability

Caterpillar
R&D
Production
Distribution & Marketing
Marketing
Service

Independent Distributors

Strengths and Weaknesses

Heavy Investment in Product Engineering
Experience with Small Machines
Poor

High Quality
Source In-House
Numerous Facilities World-Wide
High Labour Cost

World Coverage
Financial Strength
Weak in Third World
Weak in Small Machines

Owner-Operated
Local Responsiveness
Strength of CAT Only as Good as the Distributor

High Inventory Costs

Customer Needs
Customer Benefits
Process Activities
Organisation Functions
Competencies & Resources

product availability, and the sources of value that are used to affect them. Caterpillar can affect machine quality, machine flexibility, and machine appropriateness through its R&D activities. Machine quality is affected not only by R&D but by production, and these two areas help determine machine up-time. Alternatively, although machine flexibility can affect machine operating costs we see that this is influenced much more heavily by the actions of the local distributors. Now the question is what determines Caterpillar's competitive advantage at each business process activity. In the case of R&D we see that Caterpillar has heavy investment in product engineering, however, it has very little experience in the small machine market. In the case of production, Caterpillar has high labour costs but flexibility and transport cost advantages are generated by its numerous facilities world-wide. Its distributors give it local responsiveness, however, it is heavily dependent in the sense that Caterpillar's reputation is linked one-for-one with its

customers' perceptions of its distributor's quality. Operationally, the "customer value - business process" breakdown tells us a lot about what we need to do to satisfy customer value. Suppose that we find that customers actually value machine up-time very heavily (say 60% of their value comes from this). What does this imply strategically? Caterpillar can affect machine up-time either by more effectively engineering and producing the product or by putting pressure on distributors to hold more parts inventory. It is clear that this will lead to a natural conflict since R&D and production require large costs for Caterpillar while inventory costs are a major concern of the distributors. The distributors could correctly argue, and Caterpillar should probably listen to them, that by better engineering the machine not only do they have an impact on the 60% of customer value driven by machine up-time but have an impact on the remaining 40% of value represented by machine, appropriateness and machine operating costs.

Exercise

Taking the above case as an example and guideline, now take a look at your organisation (or an organisation you know about) and carry out the following exercise on it:

1. Identify **one** of many **products** that your organisation provides and then choose **one** of a number of important **needs as perceived from the eyes of the customer** for that product.
2. Then identify **one benefit** emerging from that need that your customers value most from the chosen product or service that your organisation delivers to them?
3. What are the **process activities** and **subactivities** within your organisation that affect the quality of that benefit to the customer?
4. Attempt to **build a map** of all the process activities and subactivities which affect the benefit that your customers value most in your product/service.
5. Identify the major **strengths** and **weaknesses** of those activities/subactivities which make part of this business process of delivery.

"We've reached the limits of incrementalism. Squeezing another penny out of costs, getting a product to market a few weeks earlier, responding to customer inquiries a little bit faster, ratcheting quality up one more notch, capturing another point of market share--these are the obsessions of managers today. But pursuing incremental advantage when rivals are reinventing the industry is fiddling while Rome burns."

The Ideology of Revolution

Dr. Gary Hamel

[This extract is from Strategy as Revolution published in the July-August 1996 issue of Harvard Business Review. © 1996 Gary Hamel]

Not all revolutions succeed. But unless you are an industry leader with an unassailable position (something that, given the lessons of history, not even Microsoft would not be wise to claim for itself), you probably have a greater stake in revolution than in preserving the status quo. Nine key ideas form the ideological base for industry revolution. None may be as compelling as Patrick Henry's "Give me liberty or give me death," but each offers companies the hope of wresting control of their destiny away from the industrial oligarchy.

Reconceiving the product concept

One: Dramatically Improving the Value Equation

In every industry there is some general ratio that relates price to performance. The challenge is, "how to radically improve the value ratio in an industry?" The goal is to improve value by 5, 10 or 15 times, not by 10 or 20 per cent. Fidelity Investments wondered why the cost of investing in foreign equity markets couldn't be tens or hundreds of dollars, rather than thousands. On a recent flight I heard one flight attendant say to another, "I just moved some of my investments from the Euro Fund to the Dragon Fund." Such a comment would have been inconceivable a decade or two ago, but the value equation has been fundamentally redefined. ValuJet Airlines, Ikea, Hewlett Packard's printer business are other value revolutionaries.

When was the last time you challenged your organization to come up with a non-linear shift in price/performance? Such a challenge

forces a fundamental reconception of the product or service; it unfreezes the dominant product or service design.

Two: Separating Form and Function

Another way to radically challenge existing product and service concepts is to separate core benefits (function) from the ways in which those benefits are currently embodied in a product or service.

A credit card delivers two functions: trust and permission. A merchant generally trusts that you are who your card says you are. Your name is embossed on the card, your signature appears on the back, and your photo may even appear on the front. Nevertheless, credit card fraud is a rapidly escalating problem. In what form will "trust" be delivered in the future? Probably via biometric data--a hand print, voice print, or retinal scan. Any credit card maker that is not investing in these new technologies today may be surprised by new interlopers. A credit card gives you permission to charge. What new opportunities appear if one can distinguish permission, as a general function, from the particular case of permission to charge? Today in many hotels you insert a card with a magnetic strip and are given permission to enter your hotel room. The credit card makers couldn't separate form from function, so the card security market is largely owned by newcomers.

Any company that can distinguish form from function has the chance to create an industry revolution.

Three: Achieving Joy-of-Use

When was the last time a product made you smile, or gave you a warm and fuzzy feeling inside? When was the last time you were really emotionally involved in a product or service? We live in a world that increasingly takes "ease-of-use" for granted. It took a long time for Microsoft to successfully mimic Apple's user interface, but customers weren't going to let Microsoft get away with anything less. But ease-of-use is yesterday's hurdle. The bar is higher today. Customers want to be amused, entertained and seduced. In an increasingly impersonal world, we want our products and services to be whimsical, tactile, heart-warming, informative, experiential and just plain fun. Anyone who can wrap these attributes around a mundane product or service has the chance to be an industry revolutionary.

What's the most profitable food retailing operation in the US on a per square foot basis? Probably Trader Joe's, a zany cross between a gourmet deli and a discount warehouse which its President, John Shields, calls a "fashion food retailer." Essentially without competition, Trader Joe's 74 stores average sales of \$1,000 per square foot per year, twice that of conventional supermarkets, and more than three times that of most specialty food shops. Customers shop Trader Joe's as much for entertainment as for sustenance. One can find dozens of off-beat foods--from jasmine fried rice to salmon burgers and raspberry salsa--as well as carefully selected, keenly priced staples like brie and Cote du Rhone wines. By turning shopping from a chore into a culinary treasure hunt, Trader Joe's has managed to more than double its sales over the last five years to \$605 million. Is your product or service fun, or just functional?

Redefining Market Space

Four: Pushing the Bounds of Universality

Every company has some implicit notion of its served market--some view of who the customer is. But the question to ask is not, "what is our served market," but "what is the total imaginable market?"

A few years back who would have thought children a likely market for 35 mm film? Would you have given your \$500 Nikon to an 8-year-old? Today's parents think nothing of giving a disposable camera to a child--for a day at the beach, for a birthday party, or the family vacation. In 1995 the single-use camera market was 50 million units big, and worth close to \$1 billion at retail. The single-use camera has made access to photography virtually universal.

Never accept conventional assumptions about who is and isn't a consumer. From class to mass, adults to kids, professional to consumer, or national to global, revolutionaries push hard on the traditional boundaries of market space.

Five: The quest for individuality

No one wants to be part of a mass market. The mass market was an illusion--we'll all buy the same things, but only if we have to.

A woman who wants an absolutely perfectly-fitting pair of jeans can get measured at one of Levi's "Personal Pair" outlets, and a computer will pick out exactly the right size from approximately 400 choices. Her specifications are sent to Levi's by computer, and her jeans arrive a few days later. The price? Just about ten bucks more than an off-the-shelf pair. Levi's plans to roll the Personal Pair concept out to nearly 200 stores by the end of the decade. The company is counting on its revolutionary approach to put a significant dent in the growing market for private label jeans.

Deep in our need to be ourselves, to be unique, are the seeds for industry revolution.

Six: Accessibility

Not only do we want uniquely-tailored products, we want them RIGHT NOW! RIGHT HERE! In the past retailers defined the boundaries of time and space--you made your purchase in their facilities, during their hours. No more. Today industry revolutionaries are making it possible for you to define the time and place of purchase.

When were you last in a bank? With ATMs, debit cards and the like, there is less and less reason to set foot in a bank. And for the half-million customers of First Direct, the world's leading telephone-only bank, there is absolutely no reason. The fastest-growing bank in Britain, First Direct, was opening 10,000 new accounts per month in mid-1995--the equivalent of two or three branches. But there's no ivy-clad bricks and mortar here, just a cavernous hanger with rows of 24-hour bankers who can pay bills, buy stocks or arrange a mortgage. The professionals and workaholics who make up First Direct's clientele carry, on average, a balance that's 10 times higher than at Midland Bank, First Direct's parent, while overall costs per client are 61% less.

As with every other revolutionary idea, the opportunities for using accessibility to stage an industrial insurrection are many and mostly unexplored. Cyberspace is redefining market space and even the humble telephone can be a gateway.

Redrawing Industry Boundaries

Seven: Rescaling industries

As industry revolutionaries seek out and exploit new national and global economies of scale, industries around the world are consolidating at a fearsome pace. Any industry that was local, like consumer banking, is becoming national. Anything that was national, like the airline business, is becoming global.

There is opportunity for rescaling anywhere there is a very low level of industry concentration. Many previously fragmented industries have begun to concentrate, from office cleaning (International Service System), to haircutting (Supercuts), and there is probably no industry where further consolidation will not take place. Every minute-and-a-half, Service Corporation International buries or cremates someone, somewhere in the world. Performing 320,000 funerals a year, Houston-based SCI is the world's largest funeral operator. Historically, the funeral industry was very fragmented, with most funeral operators family-owned. By buying up small operators, Service Corp. found it could reap economies of scale in purchasing, in capital utilization (sharing hearses among operators, for example), in marketing and administration. But Service Corp. doesn't change everything when it takes over a small operator. It still leaves the family name over the door--none of us want to end up at McFuneral! Between 1993 and 1994, SCI's revenues were up 22% to \$1.1b, and income climbed 30% to \$131 million.

An industry can be down-scaled down, as well as up-scaled. The increased popularity of bed & breakfast inns, micro-breweries, local bakeries and specialty retailing are examples of de-scaling. When the giants reduce product variety, and offer customers nothing but boring sameness, revolutionaries will find opportunities to de-scale an industry.

Eight: Industry Compression

The cognoscenti call it disintermediation--and the word means just what it says, intermediaries disappear. An infomercial is a form of disintermediation--there is no intervening retailer between the producer and the consumer. Wal-Mart is an example of disintermediation. Wal-Mart essentially turned the warehouse into

a store, thus disintermediating the traditional small-scale retailer.

Xerox is attempting to disintermediate the trucking companies from the printing business. Why, asks Xerox, when it is possible to transmit information digitally, should annual reports, user manuals, catalogs, employee handbooks, and other paper output be hauled across the country in trucks, which have a nasty habit of pumping great globs of pollution into the sky? Why not send the data digitally, and have it printed remotely, close to where it will be needed?

How many purchases did you, as an individual consumer, put out to bid last year? Probably not many. In the future, almost everything you buy will go out to bid--and the bids will probably go direct to the producer. There will be no place for channel inefficiencies to hide. Any would-be revolutionary better be hip to the opportunity for industry compression.

Nine: Convergence

Not only do revolutionaries radically change the value-added structure within industries, they fundamentally blur the boundaries between industries. Today a consumer can get a credit card from General Motors, a mortgage from Prudential or GE Capital, a retirement account at Fidelity, and a checkbook from Charles Schwab. Convergence has blurred the traditional boundaries within the financial services industry, the communications industry, and others too.

Innovative hospitals "capitate" lives (guaranteeing to provide an individual with a full range of health services for a fixed sum per year), thus encroaching on the turf of insurance companies. Boston Market offers harried parents hot family-style meals for take-out. And supermarkets respond by offering an ever-wider selection of deli menu items, further blurring the boundary between the grocery industry and fast food. In Britain, more than a million households get their telephone service from cable TV providers.

Industry revolutionaries don't ask, "What industry are we in?" They know that industry boundaries today are about as meaningful as borders in the Balkans.

HOW TO USE STRATEGY TO ACHIEVE SIGNIFICANT BREAKTHROUGHS IN YOUR INDUSTRY AND CREATE NEW MARKETSPACE

Could you and your team debate a trend for eight hours? Most managers spend far too little energy forging a long-term view of their industry.

by Gary Hamel and CK Prahalad

ARE YOU competing to dominate your industry's future? To find out, ask yourself three questions we often ask senior managers: First, what percentage of your time is spent on external rather than internal issues-understanding, for example, the implications of a particular new technology vs. debating corporate overhead allocations?

Second, of this time spent looking outward, how much is spent considering how the world could be different in five or ten years, as opposed to worrying about winning the next big contract or how to respond to a competitor's pricing move?

Third, of the time devoted to looking outward and forward, how much is spent in consultation with colleagues, where the objective is to build a deeply shared, well-tested view of the future, as opposed to a personal and idiosyncratic view?

The answers typically conform to what we call the 40-30-20 rule. In our experience about 40% of senior executive time is spent looking outward, and of this time about 30% is spent peering three or more years into the future. And of the time spent looking forward, no more than 20% is spent attempting to build a collective view of the future (the other 80% is spent looking at the future of the manager's particular business). Thus, on average, senior management is devoting less than 3% ($40\% \times 30\% \times 20\% = 2.4\%$) of its energy building a corporate perspective on the future. In some companies the figure is less than 1%.

Our experience suggests that to develop a prescient and distinctive point of view about the future, a senior management team must be willing to spend 20% to 50% of its time over a period of months. It must then be willing to continually revisit that point of view, elaborating and adjusting it as the future unfolds.

The vital first step in competing for the future is the quest for industry

foresight. This is the race to gain an understanding deeper than competitors, of the trends and discontinuities-technological, demographic, regulatory, or lifestyle-that could be used to transform industry boundaries and create new competitive space.

Industry foresight gives a company the potential to get to the future first and stake out a leadership position. It informs corporate direction and lets a company control the evolution of its industry and, thereby, its own destiny. The trick is to see the future before it arrives.

We don't believe any company can get along without a well-articulate point of view about tomorrow's opportunities and challenges. Today many companies seem convinced that foresight is the easy part; it's implementation that's the killer. We believe that creating industry foresight and achieving operational excellence are equally challenging. Many times what are described as today's implementation failures are really yesterday's failures of foresight in disguise. The quality deficit, which cost U.S. automakers so much market share in the 1970 and 1980s, was more than just "poor execution." Detroit didn't suddenly get sloppy, and Japanese carmakers didn't start out with a quality advantage. Japanese auto companies realized decades ago that new and formidable competitive weapons would be needed to beat U.S. car companies in their home market. The new weapons they set about developing were quality, cycle time, and flexibility.

Twenty years later, Toyota's foresight had become GM's implementation nightmare.

For a variety of reasons we prefer the word foresight to vision. Vision connotes a dream or an apparition, but there is more to industry foresight than a single blinding flash of insight. Industry foresight is based on deep insights into the trends in technology, demographics, regulation, and lifestyles that can be harnessed to rewrite industry rules and create new competitive space. While understanding the potential implications of such trends requires creativity and imagination, any "vision" that is not based on a solid factual foundation is likely to be fantastical.

To get to the future first, top management must either see opportunities not seen by other top teams or be able to exploit opportunities, by virtue of

preemptive and consistent capability-building, that other companies can't. We find few senior management teams that can paint an enticing picture of the new industry space their company hopes to stake out over the next decade, few that spend as much time on opportunity management as they do

on operations management.

Industry foresight requires a curiosity as deep as it is boundless. Gaining enough insight into potential discontinuities to actually draw conclusions about what to do—which alliances to form, how much to invest, what kind of people to hire—demands a significant expenditure of intellectual energy by senior management. The half-day or day-long planning review meetings that typically serve as forums to debate the future are utterly inadequate if the goal is to build an assumption base about the future that is more prescient and better-founded than the competitors'.

Recently one of us spent a day with the top officers of a well-known U.S. company. The question put to these managers was simple: What are the forces already at work in this industry that have the potential to profoundly transform industry structure? A heated discussion followed, and a dozen discontinuities were identified. One of the potential drivers was picked at random, and the top team was asked, "Could you sustain a debate for a full day, among yourselves, about the implications of this trend to your company and the industry? Do you understand how fast this trend is emerging in different markets around the world, the technologies that are propelling it, the technology choices competitors are making, which companies are in the lead, who has the most to gain and to lose, the investment strategies of your competitors vis-a-vis this trend, and the variety of ways in which this trend may influence customer demands and needs?"

The top team agreed that it simply didn't know enough about this critical driving force to answer these questions, and certainly couldn't keep a detailed, intelligent debate going for a full day. A few people suggested that these questions weren't really fair.

They were then asked, "Could you sustain a debate for eight hours on the issue of how you allocate corporate overheads, set sales targets, and manage transfer prices?" Now this was a fair question. "On this we could keep going for eight days, no sweat," replied a senior executive.

Suddenly the point hit them: This group of managers was not in control of their company's destiny. They had surrendered control of that destiny to competitors who were willing to devote the time and intellectual energy necessary to understand and influence the forces shaping the future of the industry.

THE FIRST response to this painful realization was typical: "I'll set up a couple of days when each of my divisional vice presidents can come in and pitch their view of the future." Back came our argument: It takes more than two

days to develop industry foresight; building foresight is not about "pitching" and "reviewing," but about exploring and learning. To really understand the future, to have the courage to commit, top management must get more than just a fleeting glimpse of the future. The required effort is measured in weeks and months, not in hours and days.

The outcome of this second painful realization was the establishment of a dozen or so "headlights" teams that worked for several months to refine and extend top management's initial list of industry drivers. The teams then proceeded to investigate each discontinuity in great depth. They sought answers to a variety of questions: How might this trend influence our current customers? How might it influence our current "economic engine"? What are the dynamics of this trend—how fast is it developing, and what are the factors that may accelerate or decelerate the trend? Who is moving to exploit this trend, or indeed, who is causing it—essentially, who is in the driver's seat, who is a passenger, and who is a bystander? Who has the most to lose and the most to gain from this discontinuity? What new opportunities—products or services—might be created by this discontinuity? What are our options for gaining further insight into this trend, influencing its direction and speed, or actually intercepting it?

As tentative answers emerged, they were debated in marathon sessions involving business unit and corporate managers. At the conclusion of the exercise, top management felt confident that it had developed the most penetrating set of headlights in its industry. To see the future first, top management must have a curiosity that is as deep as it is broad.

Customers are notoriously lacking in foresight. Meeting only the articulated needs of customers you already serve cedes vast opportunities to more farsighted competitors.

Building industry foresight demands that senior management be willing to move far beyond the issues on which it can claim expert status. It must admit that what it knows most about is the past and participate in debates about the future as equals, not as omnipotent judges. Impatient, results-oriented senior executives must be willing to come back again and again to issues that are complex and seemingly indeterminable. They must recognize that building industry foresight is, at least initially, as much about discovering as deciding.

Take an issue that begs for thoughtful speculation: the impact of virtual reality

(VR). Virtual reality is a technology with profound implications for almost every industry. VR is not about videogames or cybersex, but about a capacity to model and simulate just about anything. As far-reaching as virtual reality's impact may be, how many senior teams have given any thought to how VR might influence their business? We were particularly pleased when the executive committee of a company we work with allowed itself to be led, by a 20-something savant, through an intellectually challenging series of meetings where the implications of VR were debated in depth. Concluding that it needed to better understand virtual reality, the top team set up an internal monitoring function to keep it informed of VR's development and suggest novel ways of exploiting the emerging technology.

THE FUTURE is to be found in the intersection of changes in technology, lifestyles, regulation, demographics, and geopolitics. For example, the opportunity that CNN found for global, 24-hour television news grew out of changes in lifestyle (ever longer and more unpredictable work hours), changes in technology (handicams and suitcase-size satellite linkups), and changes in the regulatory environment (the licensing and growth of cable television companies).

Companies that create the future are rebels. They're subversives. They break the rules. They're filled with people who take the other side of an issue just to spark a debate. In fact, they're probably filled with folks who didn't mind being sent to the principal's office once in a while. Foresight often comes not from being a better forecaster, but from being less hidebound. Ted Turner was a contrarian -you don't need superstar news readers with their superstar salaries. Anita Roddick, founder of the Body Shop, was a contrarian. She believed, contrary to much of the cosmetics industry, that trying to seduce women into buying overpackaged, overhyped, and overpriced cosmetics was an insult to their intelligence.

It is much in vogue to be customer-led. From their bully pulpits, which today are likely to be worldwide satellite hookups, CEOs tell the troops that "everything begins with the customer." Companies claim to be reengineering their processes from the customer backward. Rewards and incentives are tied to measures of customer satisfaction. And it is almost impossible to check out of a hotel, pay for a restaurant meal, or hire a car without being asked to rate the vendor's customer service. While we are somewhat taken aback by the fact that some corporate leaders seem to find the idea of putting the customer first novel, we nonetheless applaud the sentiment and commend the ensuing effort. On the other hand, if the goal is getting to the future first, rather than merely preserving market share in existing businesses, a company must be much more than customer-led.

Customers are notoriously lacking in foresight. Ten or 15 years ago, how many of us were asking for cellular telephones, fax machines, and copiers at home, 24-hour discount brokerage accounts, multivalve automobile engines, compact disk players, cars with on-board navigation systems, handheld global satellite positioning receivers, automated teller machines, MTV, or the Home Shopping Network? As Akio Morita, Sony's visionary leader puts it: "Our plan is to lead the public with new products rather than ask them what kind of products they want. The public does not know what is possible, but we do. So instead of doing a lot of market research, we refine our thinking on a product and its use and try to create a market for it by educating and communicating with the public." The company's founder and honorary chairman, Masaru Ibuka, concurs: "Our emphasis has always been to make something out of nothing."

DETROIT automaker introduced in 1991 a new compact that had been five years in development. The car's design and specifications grew out of the most intensive customer research ever carried out by the company. Yet when the car was launched, it turned out to be the perfect car to compete with the three-year-old models of Japanese competitors. The U.S. company was following its customers all right, but its customers were following more imaginative competitors. By way of contrast, Honda introduced in the early 1990s its mid-engine NSX sports car, which nearly matched the performance of a Ferrari but at a fraction of the price. In the print ad for the car, Honda claimed that the NSX was "not a car buyer's dream-no car buyer could have dreamt of this car." Instead, crowed Honda, the NSX is a "carmaker's dream," which fulfilled the company's long-term ambition of producing a car that was both exotic and housebroken. Having achieved this goal, it is interesting to ask, who is Honda going to benchmark now? One gets the feeling that Honda is more interested in outpacing competitors than benchmarking them.

There are three kinds of companies: Companies that try to lead customers where they don't want to go (these find the idea of being customer-led an insight); companies that listen to customers and then respond to their articulated needs (needs that are probably already being satisfied by more foresightful competitors); and companies that lead customers where they want to go but don't know it yet. Companies that create the future do more than satisfy customers, they constantly amaze them.

ONE OF THIS is to argue that existing or potential customers can't play an important role in helping the firm stretch the boundaries of its opportunity horizon. But too often the questions asked of customers by market researchers-"Do you prefer a widget with a green strip or one with a red strip?"-provide little scope for fundamentally challenging traditional product concepts or creating real competitive differentiation. Although market research can be helpful in fine-tuning well-known product concepts to meet the

demands of a particular class of customers (such as trying to discover just what diet cola formulation will appeal to European customers, which was the goal of researchers testing PepsiCo's new Europe-targeted soft drink, Pepsi Max), it is seldom the spur for fundamentally new product concepts (such as IDV's Aqua-Libra, which created an entirely new category of sophisticated adult "health" drinks in Britain).

Listen to Hal Sperlich, father of the minivan, who took the concept from Ford to Chrysler when Ford balked at turning it into reality: "[Ford] lacked confidence that a market existed, because the product didn't exist. The auto industry places great value on historical studies of market segments. Well, we couldn't prove there was a market for the minivan because there was no historical segment to cite. In Detroit most product-development dollars are spent on modest improvements to existing products, and most market research money is spent on studying what customers like among available products. In ten years of developing the minivan we never once got a letter from a housewife asking us to invent one. To the skeptics, that proved there wasn't a market out there."

Insights into new product possibilities may be garnered in many ways, all of which go beyond traditional modes of market research. Toshiba has a Lifestyle Research Institute; Sony explores "human science" with the same passion it pursues the leading edge of audiovisual technology. The insights gained allow these firms to answer two crucial questions: What range of benefits will customers value in tomorrow's products, and how might we, through innovation, preempt competitors in delivering those benefits to the marketplace? Yamaha gained insights into the unarticulated needs of musicians when it established a "listening post" in London, chockfull of the latest gee-whiz music technology. The facility offered some of Europe's most talented musicians a chance to experiment with the future of music making. The feedback helped Yamaha continually push out the boundaries of the competitive space it had staked out in the music business. Yamaha's experience illustrates an important point: To push out the boundaries of current product concepts, it is necessary to put the most advanced technology possible directly into the

hands of the world's most sophisticated and demanding customers. Thus arose Yamaha's London market laboratory: Japan is still not the center of the world's pop music industry.

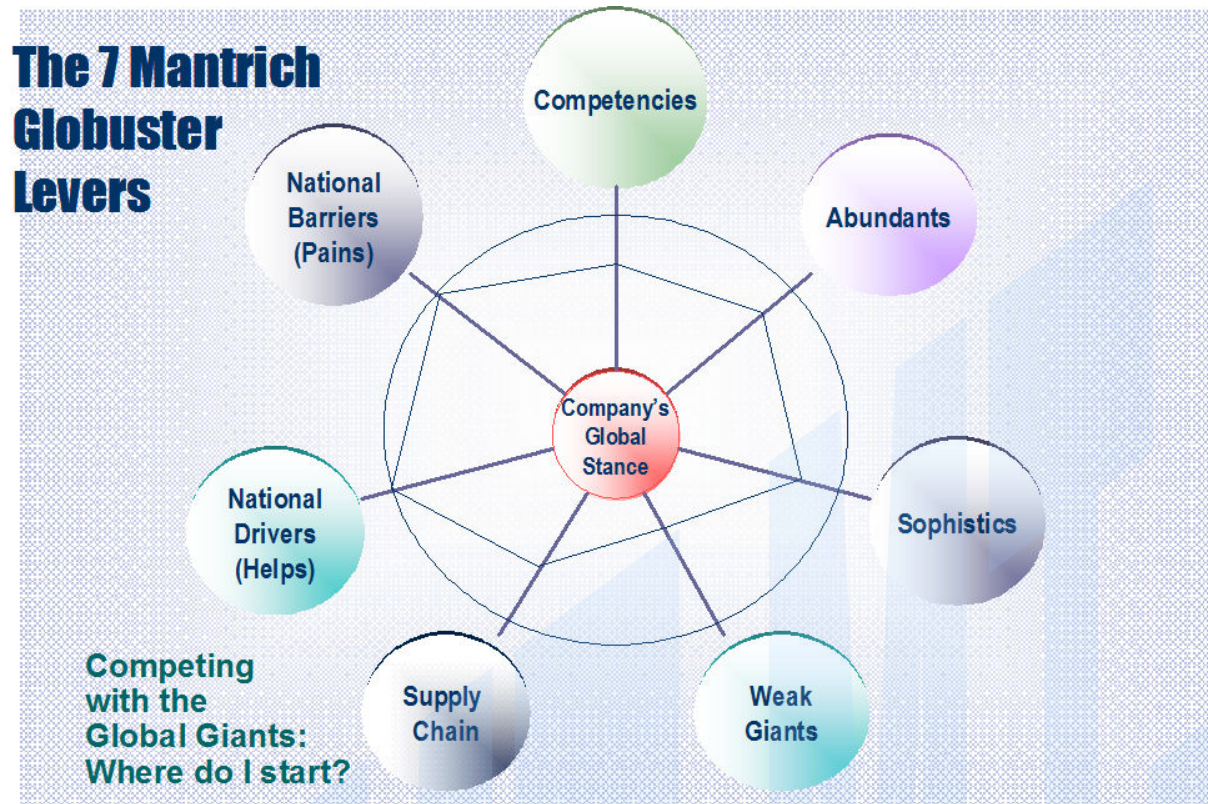
Being a perpetual follower is not the only risk from being customer-led. Being customer-led begs the whole question of who are my customers? As IBM, DEC, Xerox, and many other companies have learned, today's customers may not be tomorrow's. Folks buying Buick Roadmasters and Oldsmobile Ninety-Eights may be happy enough with GM service and quality, but if GM

can't make a car that appeals to 30-something Benz and Bimmer owners, it will surrender its future. Recognizing this, GM has launched many self-proclaimed import beaters, and its latest, the Oldsmobile Aurora, may finally prove a worthy contender. Although it is important to ask how satisfied my customers are, it is equally important to ask which customers are we not even serving.

Think of a simple two-by-two matrix (see diagram). On one axis are needs-those that customers are capable of articulating and those that they can't yet articulate. On the other axis are classes of customer-those classes the company currently serves and those it doesn't. However well a company meets the articulated needs of current customers, it runs a great risk if it doesn't have a view of the needs customers can't yet articulate but would love to have satisfied. And however content a company's existing customers may be, it may find its growth stymied if it can't reach out and appeal to fundamentally new customer groups. Any company that can do no more than respond to the articulated needs of existing customers will quickly become a laggard.

Many companies use an array of tools that make them think they're looking into the future: technology forecasting, market research, scenario planning, competitor analysis. Although potentially useful, none of these will necessarily yield industry foresight. The reason: None compels senior management to reconceive the corporation and the industries in which it competes. Until managers do that, they haven't begun competing for the future.

Case Examples of the Application of the 7 Mantrich Globuster Levers



1. Competencies:

In the case of Al-Kharafi Group, a large diversified business in Kuwait, competencies is how Al-Kharafi used its skills, resources, political connections & funds availability to extend its business in different directions mostly in the Middle East region. In the case of Huawei, the large Chinese global telecom equipment supplier, this included huge competencies in R&D, including investment in R&D centres globally. This also resulted in numerous patent applications and inroads into state-of-the-art telecom technology. Huawei also has strong Customer Relationship Management (CRM) competencies and strategies and a sound fusion of eastern and western management practices. These competencies coupled with other Globuster Levers described below led to Huawei achieving a unique global competitive positioning.

2. Abundants:

In the case of Brasil Foods, the largest poultry producer in the world, it is how this company used the abundant resources in Brazil to leverage its international expansion: Brazil is endowed with 1) abundant natural resources such as good climate, arable land and abundance of grain supplies, 2) Ample manpower and skills in addition to western European settlers from Germany, Italy and Portugal who have over more than a century applied their skills in agriculture and animal husbandry to the poultry sector in Brazil; 3) Substantial national drivers such as the availability of funds through

government bank loans; pension funds of state companies and the social and political network of the people involved in the poultry business over the years; 4) With a Brazilian population of 201 million, the 5th most populated country in the world, led to substantially large Brazilian market demand for meat products. This acted as a good foundations for Brasil Foods to strengthen its economies of scale for the international markets.

3. Sophistics:

In the case of Witanto, a diversified Indonesian conglomerate which is also in the restaurant chain business, the company created a restaurant theme from its country's cultural, religious and social heritage and expanded to similar regions internationally. As much as an emerging giant may introduce a product or service to cater for the special needs of a target population, it may also remove a particular product or service due to such a special needs. The target market for Witanto's franchise chains of restaurants in Indonesia is the "family as a whole". The positioning is clearly differentiated from other international restaurant chains which may target secular families, individuals, couples, the younger generation or the corporate market. Because of the predominantly Moslem population in Indonesia, Witanto Group refrained from serving alcoholic drinks in its restaurant chains, something which the competition was not willing to do. This increased not only the religious appeal of its restaurants but also the family

appeal as well. For this and other positioning strategies employed by Witanto Group, its chains of restaurants became well known for their wholesome family appeal and this clearly differentiated its brands from others in the market. This strategy worked well in other southeast Asian countries where sizable Moslem populations are present, including, Malaysia, Philippines, Thailand, China and Myanmar (Burma).

4. Weak Giants:

In the case of Al-Kharafi Group, the majority of Al-Kharafi investments are in the Middle East market whereby Al-Kharafi has strong political connections, and more familiar with consumers tastes, flavours, requirements and needs. For example, they worked as a subcontractor for an American company in Iraq for the implementation of the local activities to benefit from their familiarity with the local conditions in this country. These capabilities are not possessed by giant western companies. So in comparison to Al-Kharafi, giant western companies are weak in the areas where Al-Kharafi is mostly strong. Therefore, those weak giants cannot easily make inroads in sectors or regions where Al-Kharafi has unique strengths.

5. Supply Chain:

In the case of Brasil Foods, it is how the company used the strong supply chains and feeder industries in the agricultural and foods industry in Brazil to leverage its global expansion. In Brasil Foods has: 1) A strong relationship with a vast pool of integrated poultry outgrowers (farmer breeders)-including the supply of training, materials and technology; 2) High quality standards required from outgrowers including monitoring and control systems to ensure this. 3) Large economies of scale with Brasil Foods processing plants located close to outgrower communities; 4) environment sustainability in the use of energy and materials used for the breeding and processing of poultry.

6. National Barrier:

In the case of the Indian organisation, Aravind, the largest eye care facility in the world, the national barriers in India of poverty, weak public health care systems, lack of infrastructure in rural India, and lack of educational facilities for the training of ophthalmic professionals were the seeds for the creation and international success of Aravind. A cataract operation in the United States can cost anywhere between US\$2000 and US\$4000. Through Aravind, a paying patient would contribute an average of US\$75 per operation. The national barriers have triggered Aravind to find ways of reducing cost, maintaining quality levels while

performing hundreds of thousands of eye-surgeries every year. The founder of Aravind, Dr V. had the vision of creating a model of eye-care with the efficiency of an international fast food franchise. By standardising the processes for identifying patients, preparing them for surgery, performing the surgery and supplying post-operative care, each doctor can perform an average of 2000 surgeries per year. This is 10 times more than the national average for annual surgeries per doctor in India. This means that Aravind can get much more productivity from the few ophthalmic surgeons that are available in the country. For instance, to manage the lack of infrastructure in rural India, where significant unnecessary blindness exists, Aravind sets up makeshift “eye camps” in the rural community where potential patients are screened and selected. They are then provided transport to and from the distant Hospital. The eye camps are sponsored by business leaders who have a presence in the rural community.

7. National Driver:

In the case of Rusal of Russia, the largest aluminium producer in the world, the national driver that assisted Rusal was the Russian Government's support. This includes support provided initially to the founder Deripaska to start up Rusal and the sustained support till this very day in most of the elements that fuel Rusal's competitive advantage. For instance, since the location of the raw material is far away from Rusal's smelting facilities and the customers are also in different places, railway transportation has been an important element in Rusal's total cost structure. To mitigate these costs, Rusal has made special transportation contracts with the government controlled Russian railway company. Apart from favourable tariffs, if annual volume targets are met, Rusal also enjoys protection from tariff escalation spanning over several years. Rusal is also currently negotiating tariff reductions if the aluminium spot market price falls below specific levels. In another case, that of Huawei, the large Chinese global telecom equipment supplier, there were a number of National Drivers that assisted the company in its global expansion: For instance, it managed to get sizable orders for telecom equipment for the military as well as substantial loans from the Chinese Development Bank and the Export-Import Bank of China. With the strong backing from Chinese government banks, Huawei can arrange financing for its international customers to the detriment of its global competitors.

THE 3 EMERGING GIANT STRATEGIES

1) Exploiting unique knowledge of domestic product markets - Unique tastes and needs

NOKIA

Given the peculiarities of its geography, and its lack of population density, it is easy to see why wireless telephony would find a natural constituency in the icy wilderness of Finland. But there was another historical reason why Nokia emerged as the world-leader from Finland, rather than an equivalent firm arising out of other equally inhospitable and depopulated terrains (e.g. deserts of the Middle East). This has to do with political risk. Finland, always wary of incursions by Tsarist Russia, eschewed a state-run telecommunications monopoly to avoid a situation where a hostile neighbor might bring it to its knees by seizing the entire infrastructure in one fell swoop. It thus relied on numerous telecom companies and seeded a commitment to competition in telecoms, unlike most, if not all, other countries which had a monopoly structure. The happy, if inadvertent, marriage of intrinsic demand and pressure-cooker competition created the local conditions within which Nokia was born.

JOLLIBEEES

Consider several seemingly different, but conceptually similar, examples from the fast-food restaurant industry, originating in different parts of the world. Jollibees in the Philippines emerged from the recognition that Filipinos liked their burgers to have a particular taste. Nandos started in South Africa by providing convenient cooked chicken that suited the local palate. Pollo Campero, originating in El Salvador, also provided locally palatable roast chicken to that country's populace. These companies have done battle with larger multinationals and, to varying extents, emerged victorious. Further, they have all used their mastery of the unique tastes of their domestic market customers to expand globally. Jollibees caters to the tastes of Filipinos communities worldwide, Nandos can be seen in the United Kingdom and Malaysia among other locations, and Pollo Campero is found in numerous Central American locations with plans to enter the United States.

HAIER

Another successful example of a company exploiting this type of business opportunity is the Haier Group in China. Haier is the world's No. 2 refrigerator maker, after Whirlpool, and has expanded into a wide range of household electrical appliances including washing machines, air conditioners, microwave ovens, small appliances, televisions, even computers and cell phones. Haier exports to over 160 countries and has global revenue just over \$7 billion.

Because China is so diverse, both geographically and culturally, a company must be able to cater to the wide range of consumers' tastes by adapting its product line for a multitude of possibilities. Haier dominates its home market (29% market share for refrigerators, 26% for washing machines) by developing a superior understanding of the wide variety of the Chinese consumers' needs and meeting those needs with quality products. Haier tries to use its design and manufacturing capabilities to meet special requirements with minimum waiting time, and is willing to go the extra mile to do so. In 1989, for instance, sales of one model of refrigerators were high in Beijing but under-performing in Shanghai. Through market research, Haier discovered that Shanghai residents had crowded living conditions, and that there was little space for a large refrigerator. As a result, Haier designed a smaller refrigerator only for the Shanghai market, and sales subsequently surged. This sensitivity to local conditions helped in Haier's worldwide expansion as well. In early 2001, based on information feedback from its Middle East branch, Haier developed an air conditioner exclusively for desert conditions. The technology contained in the air conditioner combined strong heat-resistance capability with unique exterior materials and allowed the unit to increase its anti-erosion ability. This product proved to be extremely popular with customers from Middle East and African countries. In addition, Haier has improved efficiency and cost effectiveness by developing logistics capabilities. With its own logistics, Haier can fill the void of China's fragmented distribution system and ensure that its products can be delivered to customers throughout China, especially to those living outside the major cities such as Beijing and Shanghai. The group has also set up its own logistics company to cater to internal needs. China's transportation and logistics infrastructure remains under-developed and plagued by bureaucracy. There's no single nationwide trucking firm. The average Chinese trucking company owns less than two vehicles. In addition, four separate government bodies regulate air, rail, road and river transport. This structural void in the Chinese market adds costs and inefficiencies to Haier's business. By adding logistics capabilities in house, Haier can keep the inventory levels as low as possible and ensure better distribution of its goods throughout China.

After establishing itself in its home market, Haier began to expand overseas. Its first overseas joint venture was launched in Indonesia, on December 6, 1996. This was followed by a few more investment projects in developing countries such as the Philippines, Malaysia and Yugoslavia before it moved to the USA in 1999. It established a design center in Boston, a marketing center in New York, and a manufacturing center in South Carolina, with a total investment of US\$30 million. Haier's initial foray into the US market involved focusing on price conscious niche segments in the white goods market. Currently, Haier has captured about half the U.S. market for compact refrigerators, the kind found in college dorms or hotel rooms. It also pioneered electric wine cellars-- the inexpensive stand-alone cabinets for storing bottles

of wine. By finding such niches, Haier generated U.S. sales of about \$200 million in 2001.

2 Exploiting unique knowledge of domestic factor markets

A second way to build an emerging giant has to do with superior ability to identify and manage local talent or the local supply chain to serve either local or global customers. The Indian software industry provides a case in point. Companies like TCS, Infosys, Wipro, and Satyam cater to the tremendous global demand for information technology services, as companies in well-developed markets are seeking to integrate IT into their operations. India is blessed with an abundance of software talent, which is significantly cheaper than similar talent in developed markets. However, given the institutional voids that pervade the Indian economy, it is very difficult and costly for companies in developed markets to access this talent. These difficulties include: sorting talent in a market where quality varies widely, and reputation of educational institutions is highly variable, and operating remote delivery services in an economy with very poor communications and travel infrastructure. Indian software companies have developed business models and organizational capabilities that allow them to match the talent in India with demand in developed markets. Multinational software service providers, such as Andersen Consulting or EDS, took years to acknowledge this potential business opportunity, given the Indian firms more than a decade's head-start in refining their business models and execution strategies. While these multinational companies are now attempting to replicate Indian firms' strategies, the institutional voids pose a serious barrier to entry to the former. At the same time, Indian software companies, in an attempt to compete with these multinationals, are able to access global managerial talent markets and global capital market, thus effectively nullifying some of the inherent advantages that multinational may have.

Another prominent example of this type of business model is Li & Fung, a Hong Kong based trading company that helps retailers in the US and Europe source merchandise from low cost emerging countries in Asia. Li & Fung has developed deep knowledge and sophisticated internal systems to identify and sort the quality of suppliers in many different emerging markets of Asia, help them design and manufacture products for Western customers, and to meet stringent delivery requirements despite the poor quality of local infrastructure. Multinational retail companies which are interested in sourcing low cost and high quality products from emerging markets find it very difficult to replicate Li & Fung's capabilities. As a result, trading houses such as Li & Fung have been able to create a very successful business with a sustainable competitive advantage.

As the Li & Fung example suggests, exploiting this type of business opportunity may allow an emerging market company

to collaborate, rather than compete, with multinationals to create a win-win situation. This is in fact the case with many contract manufacturing companies operating out of China. Take the case of Inventec, a Taiwanese company with significant operations in China. Inventec is the world's second largest manufacturer of note book computers, PCs, and servers. The company supplies its products primarily to HP and Toshiba who sell them under their own brands. Inventec allows HP and Toshiba to access the low cost and high quality manufacturing possibilities of China, without having to incur the cost of mastering all the complexities of setting up factories in China and operating them. Inventec also allows these companies to access very talented software and hardware professionals in China to design products in an industry fraught with extremely short product life cycles and rapid technological changes. Beyond serving the needs of HP and Toshiba, Inventec has recently began selling computers in Taiwan and China under its own brand name. These computers have Chinese language operating system and software, and hence do not directly compete with the products of its multinational clients.

3: Exploiting Local Institutional Voids as Business Opportunities

A third opportunity for building a world-class emerging market company is to create private sector businesses to fill local institutional voids in the market infrastructure. This approach is motivated by a simple observation that, since institutional voids impose costs on market participants, entrepreneurial ventures that seek to fill these voids can create significant value. While some of the market institutions are under the purview of the government, there are many that can be owned and operated by private sector. In general, these institutions can be classified into two categories. The first category of market institutions involves those that facilitate credible information flows in the market. One (sub)set of these enhances the credibility of claims made by producers of goods and services. Examples of such institutions in the U.S. markets include the public accounting firms in the financial markets, ISO and other quality certification agencies in the product markets, and AACSB and GMAC in the talent market. Another (sub)set analyzes information and provides recommendations to market participants. U.S. examples here include stock analysts and rating agencies in financial markets, the Consumers Union and JD Powers in product markets, and publications ranking universities and professional schools in the talent market. The second category of market institutions facilitate transactions either through aggregation and distribution of goods and services, or by creating forums where buyers and sellers can transact with each other directly. Distributors and aggregators provide low cost matching and other value added services for suppliers and customers through expertise and economies of scale. Examples include venture capital/private equity firms, and banks in financial markets, retailers of various types in product markets, labor unions and (at least to some extent) universities in talent market. Stock

exchanges, Ebay, and online job announcement sites are examples of transaction forums in financial, product, and labor markets respectively. Since many of these institutions are either missing or under developed in many emerging markets, they offer tremendous new business opportunities. Clearly, multinationals can exploit these opportunities as well. Multinationals can bring expertise and global credibility, two very critical assets for building many of the market institutions. Therefore, in exploiting the opportunities in building market institutions, domestic businesses need to focus on areas where they are likely to have advantages. Once again, there are several sources of potential advantage that emerging market businesses can exploit. First, many market institutions are human capital intensive, so running them requires familiarity with local talent, culture, and language. Second, many of these institutions are information intensive, so ability to access widely dispersed information of variable quality - and to analyze it reach reliable conclusions - requires local expertise. Third, governments often consider a number of these market institutions - for example, media, banking and financial services - to be of particular importance to national interests. As a result, multinationals are either prohibited from exploiting these opportunities, or they are required to collaborate with a local organization. There are two other observations that are important to consider here. First, while many of these opportunities are potentially available for a domestic company in an emerging market, by their very nature, ability to use domestic success as a launching pad for going global may be limited. Therefore, these opportunities may have limited potential in countries where the domestic market size is limited. However, in large emerging markets such as India, China, Russia, and Brazil, one can aspire to build sizable businesses even if the activity is limited to a domestic context. Second, in many areas of intermediation, the market often can be segmented into a "global piece" and a "local piece." The global segment may be best served by multinationals, where as the local segment is best served by a domestic company.¹⁴ Take the case of banking, for example.

¹⁴ 4 4 We conducted fieldwork on entrepreneurial ventures in Argentina, Brazil, Hong Kong, India and Mexico in 2002. Half our sample was comprised of ventures launched by incumbent business groups, the other half was comprised of de novo entrepreneurs. We expected that the greater prevalence of specialized intermediaries in some of these economies relative to others would make de novo entrepreneurship easier. No such correlation appeared. This is because most of the well-run intermediaries in these economies turned out to be branches of multinationals (e.g. banks and consulting firms and executive search firms); these did not have the cost structures to justify working with any indigenous enterprise other than the 'cream of the crop.' As such the mere existence of specialized intermediaries did not end up promoting de novo entry; it just cemented the status quo as represented by the incumbent business groups. See Tarun Khanna and Krishna Palepu, "Entrepreneurship in Emerging Markets: Field Evidence from Five Countries," mimeograph prepared for the Russell Sage Foundation, New York, 2002.

Multinational banks such as Citicorp are able to serve large blue chip companies in emerging markets because evaluating their credit worthiness is relatively straight forward - many of them produce high quality financial statements audited by globally reputed public accountants, and are listed abroad. However, evaluating the credit quality of small and medium enterprises is very hard for the multinational banks because of paucity of reliable information on them. Domestic banks, with local knowledge and informal connections, are in a much better position to cater to this segment. In Turkey, for example, the likes of Citibank skim the top end of the corporate market, whereas sizeable local businesses just below this tier (in size) are catered to by profitable and well-run local banks, like Finansbank. There are a number of successful examples of emerging market companies that play the role of market institutions. Consider Old Mutual, an insurance company in South Africa. South Africa traditionally lacked mutual funds and other long-term investment vehicles, as a result of poorly developed domestic financial markets. Old Mutual recognized that this presented a significant business opportunity. It responded by creating insurance policies that had significant savings account features, and marketed them to millions of South Africans. Through this process the company grew rapidly and became a large financial services firm that offered a variety of insurance and savings products to consumers. When the South African economy was integrated into the world markets, Old Mutual took advantage of its capabilities and began expanding into world markets - first in the African regional markets, and later in Europe and North America. Today, the company is listed on the Johannesburg and the London Stock Exchanges, and has operations all over the world.⁵ Agora of Poland is another interesting example. Agora is one of the most successful companies set up in Poland since the introduction of the free-market economy. It is the publisher of the biggest newspaper in Poland, Gazeta Wyborcza (GW). GW commands 42% of the national readership in Poland and has 62% market share in national newspaper advertising revenues. The strong position of GW is the result of its excellent content, wide geographic coverage and its unique national/regional structure, as well as a consistent marketing strategy.

The paper was first started in 1989 as a mouthpiece for Solidarity. After the elections, the founders of Agora decided to make the newspaper an independent media institution. By the end of 1993, the company had 17 regional offices, laying the foundations for today's most important competitive advantages of Agora, namely its unique countrywide/regional coverage and its extremely broad and high quality content. Agora filled the information void in Poland not only by providing strong news coverage but also by providing a format for advertising. Today's Gazeta readers come largely from Poland's emerging middle class, an educated, urban lot with plenty of disposable income. Gazeta advertisers -- the travel agencies, carmakers, cellular-phone companies and pension funds that fill its pages with ads. These advertisements, in a highly regarded newspaper, provided new consumers with much needed information. Agora's story also illustrates how

emerging market companies can exploit globalization to their advantage. The company's founder and president is Wanda Rapaczynski, a graduate of the Yale School of Management, and an ex-employee of Citibank. The company is listed not only on the Warsaw stock exchange, but also on the London Stock Exchange, enabling it to raise the necessary finances to fund its rapid growth. In addition, in 1993, the company sold 20.7% of its shares to Cox Enterprises, Inc., a US media company. This alliance enabled Angora to quickly gain a further competitive advantage based on the know-how and capital obtained from Cox. Agora, therefore, has been able to build a world-class media company by identifying an important institutional void in Poland, and by accessing the global markets for talent, know-how, and capital. Emerge Logistics of China provides a third example of a company seeking to exploit an institutional void in an emerging market. While China's economy has been growing by leaps and bounds, there is a significant institutional void in China's growing international trade: logistics and fulfillment--getting goods to the right places at the right time and outsourced bookkeeping and order management. Because China's distribution system is so fragmented, the nation spends about 15-20% of its GDP (which was \$1.2 trillion last year) on logistics, well above the U.S. rate. Getting goods across the country to potential buyers is not easy.

To address this need, Emerge Logistics was founded in 2000 to provide third party logistics (3PL) to importers trying to navigate the Chinese system. Operating from a warehouse an hour from central Shanghai, Emerge Logistics takes foreign companies from the filing of import applications before their goods enter the country all the way to collecting payments from customers after the wares are delivered. In between, the company helps coordinate and track movement of goods between different modes of transportation, such as trucks and airplanes, as well as taking orders from Chinese customers for companies' products and doing the billing. Emerge helps multinationals sell products into the Chinese market by capitalizing on its understanding of the disjointed transportation system and baffling bureaucracy. In addition, by providing effective third-party trade accounting to complement physical distribution, Emerge facilitates direct sales channels to Chinese manufacturing customers.

In summary, we have articulated three conceptually distinct generic strategies arising out of the institutional voids that pervade emerging markets. Many successful business models can be seen as combinations of these business models. Consider the Haier case, for example. The roots of its success lie in circumventing local institutional voids more efficiently than a multinational might be able to (in this case, leveraging its nuanced understanding – unavailable to the outsider in any neatly-packaged market research reports – of consumer tastes, and investing to overcome a fragmented and sometimes nonexistent country-wide distribution network). That is, it exploited unique understanding of product and factor markets. Other companies – e.g. Koc group in Turkey or Samsung in Korea – might be seen as combinations of all three generic

strategies. Not only do these companies understand local product and factor markets, but they also create specialist teaching institutions (company specific business schools, say) to fill a void in their respective markets for talent.

Sadafco Case – Fighting the Giants

Sadafco is a successful ice cream manufacturer located in Saudi Arabia. It has a wide distribution channel both in large supermarkets as well as small kiosks. Its strengths lie mostly in the small Kiosk market with a proliferation of freezers that it has located in several kiosk areas throughout Saudi. Sadafco has an extensive range of ice cream brands. Sadafco knows well the tastes of the Saudi ice cream consumer

Nestle Ice Cream came into Saudi to take over the lion's share of the ice cream market. It primarily focused on building its presence in large supermarkets in major cities with a large promotional and advertising budget. Nestle is well reputed for its international presence in the ice cream market and primarily sells the same range of ice cream brands in Saudi that it sells in other parts of the world.

The cultural barriers in the ice cream market in Saudi is that it is uncommon for consumers to eat ice cream in public, women do not normally drive and ice cream is still viewed as a children's product. The market is slowly changing and consumption of ice-cream is growing fast.

Question:

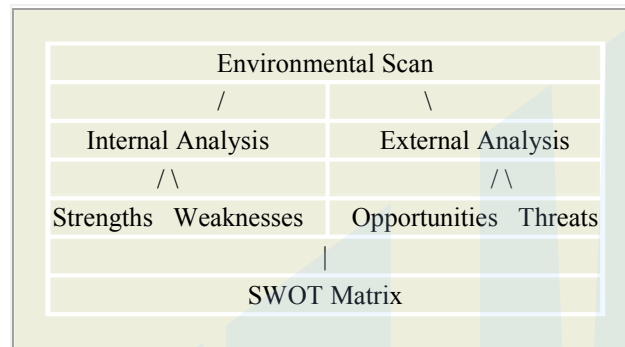
- 1) Which is your proposed strategy for Sadafco to deal with the competitive inroads of Nestlé? Why?
- 2) If you were on the Nestlé side, what competitive strategy would you adopt?
- 3) If you were a distributor of ice-cream products, where would you position yourself relative to these two ice-cream suppliers?

SWOT Analysis

A scan of the internal and external environment is an important part of the strategic planning process. Environmental factors internal to the firm usually can be classified as strengths (**S**) or weaknesses (**W**), and those external to the firm can be classified as opportunities (**O**) or threats (**T**). Such an analysis of the strategic environment is referred to as a **SWOT analysis**.

The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection. The following diagram shows how a SWOT analysis fits into an environmental scan:

SWOT Analysis Framework



Strengths

A firm's strengths are its resources and capabilities that can be used as a basis for developing a [competitive advantage](#). Examples of such strengths include:

- patents
- strong brand names
- good reputation among customers
- cost advantages from proprietary know-how
- exclusive access to high grade natural resources
- favorable access to distribution networks

Weaknesses

The absence of certain strengths may be viewed as a weakness. For example, each of the following may be considered weaknesses:

- lack of patent protection
- a weak brand name
- poor reputation among customers
- high cost structure
- lack of access to the best natural resources
- lack of access to key distribution channels

In some cases, a weakness may be the flip side of a strength. Take the case in which a firm has a large amount of manufacturing capacity. While this capacity may be considered a strength that competitors do not share, it also may be considered a weakness if the large investment in manufacturing capacity prevents the firm from reacting quickly to changes in the strategic environment.

Opportunities

The external environmental analysis may reveal certain new opportunities for profit and growth. Some examples of such opportunities include:

- an unfulfilled customer need
- arrival of new technologies
- loosening of regulations
- removal of international trade barriers

Threats

Changes in the external environmental also may present threats to the firm. Some examples of such threats include:

- shifts in consumer tastes away from the firm's products
- emergence of substitute products
- new regulations
- increased trade barriers

The SWOT Matrix

A firm should not necessarily pursue the more lucrative opportunities. Rather, it may have a better chance at developing a competitive advantage by identifying a fit between the firm's strengths and upcoming opportunities. In some cases, the firm can overcome a weakness in order to prepare itself to pursue a compelling opportunity.

To develop strategies that take into account the SWOT profile, a matrix of these factors can be constructed. The SWOT matrix (also known as a **TOWS Matrix**) is shown below:

SWOT / TOWS Matrix

	Strengths	Weaknesses
Opportunities	S-O strategies	W-O strategies
Threats	S-T strategies	W-T strategies

- **S-O strategies** pursue opportunities that are a good fit to the company's strengths.
- **W-O strategies** overcome weaknesses to pursue opportunities.
- **S-T strategies** identify ways that the firm can use its strengths to reduce its vulnerability to external threats.
- **W-T strategies** establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats.

Recommended Reading

Bradford, Robert W., Duncan, Peter J., Tarcy, Brian, [*Simplified Strategic Planning: A No-Nonsense Guide for Busy People Who Want Results Fast!*](#)

SWOT analysis method and examples, with SWOT template

The SWOT analysis is an extremely useful tool for understanding and decision-making for all sorts of situations in business and organizations. SWOT is an acronym for Strengths, Weaknesses, Opportunities, Threats. Information about the origins and inventors of SWOT analysis is below. The SWOT analysis headings provide a good framework for reviewing strategy, position and direction of a company or business proposition, or any idea. Completing a SWOT analysis is very simple, and is a good subject for workshop sessions. SWOT analysis also works well in brainstorming meetings. Use SWOT analysis for business planning, strategic planning, competitor evaluation, marketing, business and product development and research reports. You can also use SWOT analysis exercises for team building games. See also PEST analysis, which measures a business's market and potential according to external factors; Political, Economic, Social and Technological. It is often helpful to complete a PEST analysis prior to a SWOT analysis. See also Porter's Five Forces model, which is used to analyse competitive position.

A SWOT analysis measures a business unit, a proposition or idea; a PEST analysis measures a market.

A SWOT analysis is a subjective assessment of data which is organized by the SWOT format into a logical order that helps understanding, presentation, discussion and decision-making. The four dimensions are a useful extension of a basic two heading list of pro's and con's (free pro's and con's template here).

SWOT analysis can be used for all sorts of decision-making, and the SWOT template enables proactive thinking, rather than relying on habitual or instinctive reactions.

The SWOT analysis template is normally presented as a grid, comprising four sections, one for each of the SWOT headings: Strengths, Weaknesses, Opportunities, and Threats. The free SWOT template below includes sample questions, whose answers are inserted into the relevant section of the SWOT grid. The questions are examples, or discussion points, and obviously can be altered depending on the subject of the SWOT analysis. Note that many of the SWOT questions are also talking points for other headings - use them as you find most helpful, and make up your own to suit the issue being analysed. It is important to clearly identify the subject of a SWOT analysis, because a SWOT analysis is a perspective of one thing, be it a company, a product, a proposition, and idea, a method, or option, etc.

Here are some examples of what a SWOT analysis can be used to assess:

- a company (its position in the market, commercial viability, etc)
- a method of sales distribution
- a product or brand
- a business idea
- a strategic option, such as entering a new market or launching a new product
- a opportunity to make an acquisition
- a potential partnership
- changing a supplier
- outsourcing a service, activity or resource
- an investment opportunity

Be sure to describe the subject for the SWOT analysis clearly so that people contributing to the analysis, and those seeing the finished SWOT analysis, properly understand the purpose of the SWOT assessment and implications.

Subject of SWOT analysis: (define the subject of the analysis here)

strengths

- Advantages of proposition?
- Capabilities?
- Competitive advantages?
- USP's (unique selling points)?
- Resources, Assets, People?
- Experience, knowledge, data?
- Financial reserves, likely returns?
- Marketing - reach, distribution, awareness?
- Innovative aspects?
- Location and geographical?
- Price, value, quality?
- Accreditations, qualifications, certifications?
- Processes, systems, IT, communications?
- Cultural, attitudinal, behavioural?
- Management cover, succession?

weaknesses

- Disadvantages of proposition?
- Gaps in capabilities?
- Lack of competitive strength?
- Reputation, presence and reach?
- Financials?
- Own known vulnerabilities?
- Timescales, deadlines and pressures?
- Cashflow, start-up cash-drain?
- Continuity, supply chain robustness?
- Effects on core activities, distraction?
- Reliability of data, plan predictability?
- Morale, commitment, leadership?
- Accreditations, etc?
- Processes and systems, etc?
- Management cover, succession?

opportunities

- Market developments?
- Competitors' vulnerabilities?
- Industry or lifestyle trends?
- Technology development and innovation?
- Global influences?
- New markets, vertical, horizontal?
- Niche target markets?
- Geographical, export, import?
- New USP's?
- Tactics - surprise, major contracts, etc?
- Business and product development?
- Information and research?
- Partnerships, agencies, distribution?
- Volumes, production, economies?
- Seasonal, weather, fashion influences?

threats

- Political effects?
- Legislative effects?
- Environmental effects?
- IT developments?
- Competitor intentions - various?
- Market demand?
- New technologies, services, ideas?
- Vital contracts and partners?
- Sustaining internal capabilities?
- Obstacles faced?
- Insurmountable weaknesses?
- Loss of key staff?
- Sustainable financial backing?
- Economy - home, abroad?
- Seasonality, weather effects?

SWOT analysis example

This SWOT analysis example is based on an imaginary situation. The scenario is based on a business-to-business manufacturing company, who historically rely on distributors to take their products to the end user market. The opportunity, and therefore the subject for the SWOT analysis, is for the manufacturer to create a new company of its own to distribute its products direct to certain end-user sectors, which are not being covered or developed by its normal distributors.

Subject of SWOT analysis example: the creation of own distributor company to access new end-user sectors not currently being developed.

strengths

- End-user sales control and direction.
- Right products, quality and reliability.
- Superior product performance vs competitors.
- Better product life and durability.
- Spare manufacturing capacity.
- Some staff have experience of end-user sector.
- Have customer lists.
- Direct delivery capability.
- Product innovations ongoing.
- Can serve from existing sites.
- Products have required accreditations.
- Processes and IT should cope.
- Management is committed and confident.

weaknesses

- Customer lists not tested.
- Some gaps in range for certain sectors.
- We would be a small player.
- No direct marketing experience.
- We cannot supply end-users abroad.
- Need more sales people.
- Limited budget.
- No pilot or trial done yet.
- Don't have a detailed plan yet.
- Delivery-staff need training.
- Customer service staff need training.
- Processes and systems, etc
- Management cover insufficient.

opportunities

- Could develop new products.
- Local competitors have poor products.
- Profit margins will be good.
- End-users respond to new ideas.
- Could extend to overseas.
- New specialist applications.
- Can surprise competitors.
- Support core business economies.
- Could seek better supplier deals.

threats

- Legislation could impact.
- Environmental effects would favour larger competitors.
- Existing core business distribution risk.
- Market demand very seasonal.
- Retention of key staff critical.
- Could distract from core business.
- Possible negative publicity.
- Vulnerable to reactive attack by major competitors.

See also the [free PEST analysis template and method](#), which measures a business according to external factors; Political, Economic, Social and Economic. It is often helpful to complete a PEST analysis prior to competing a SWOT analysis.

See also [Porter's Five Forces model](#).

More on the difference and relationship between PEST and SWOT

PEST is useful before SWOT - not generally vice-versa - PEST definitely helps to identify SWOT factors. There is overlap between PEST and SWOT, in that similar factors would appear in each. That said, PEST and SWOT are certainly two different perspectives:

PEST assesses a market, including competitors, from the standpoint of a particular proposition or a business.

SWOT is an assessment of a business or a proposition, whether your own or a competitor's.

Strategic planning is not a precise science - no tool is mandatory - it's a matter of pragmatic choice as to what helps best to identify and explain the issues.

PEST becomes more useful and relevant the larger and more complex the business or proposition, but even for a very small local businesses a PEST analysis can still throw up one or two very significant issues that might otherwise be missed.

The four quadrants in PEST vary in significance depending on the type of business, eg., social factors are more obviously relevant to consumer businesses or a B2B business close to the consumer-end of the supply chain, whereas political factors are more obviously relevant to a global munitions supplier or aerosol propellant manufacturer.

All businesses benefit from a SWOT analysis, and all businesses benefit from completing a SWOT analysis of their main competitors, which interestingly can then provide some feed back into the economic aspects of the PEST analysis.

The origins of the SWOT analysis model

This remarkable piece of history as to the origins of SWOT analysis has been provided by Albert S Humphrey, one of the founding fathers of what we know today as SWOT analysis. I am indebted to him for sharing this fascinating contribution.

SWOT analysis came from the research conducted at Stanford Research Institute from 1960-1970. The background to SWOT stemmed from the need to find out why corporate planning failed. The research was funded by the fortune 500 companies to find out what could be done about this failure. The Research Team were Marion Doshier, Dr Otis Benepe, Albert Humphrey, Robert Stewart, Birger Lie.

It all began with the corporate planning trend, which seemed to appear first at Du Pont in 1949. By 1960 every Fortune 500 company had a 'corporate planning manager' (or equivalent) and 'associations of long range corporate planners' had sprung up in both the USA and the UK.

However a unanimous opinion developed in all of these companies that corporate planning in the shape of long range planning was not working, did not pay off, and was an expensive investment in futility.

It was widely held that managing change and setting realistic objectives which carry the conviction of those responsible was difficult and often resulted in questionable compromises.

The fact remained, despite the corporate and long range planners, that the one and only missing link was how to get the management team agreed and committed to a comprehensive set of action programmes.

To create this link, starting in 1960, Robert F Stewart at SRI in Menlo Park California lead a research team to discover what was going wrong with corporate planning, and then to find some sort of solution,

or to create a system for enabling management teams agreed and committed to development work, which today we call 'managing change'.

The research carried on from 1960 through 1969. 1100 companies and organizations were interviewed and a 250-item questionnaire was designed and completed by over 5,000 executives. Seven key findings lead to the conclusion that in corporations chief executive should be the chief planner and that his immediate functional directors should be the planning team. Dr Otis Benepe defined the 'Chain of Logic' which became the core of system designed to fix the link for obtaining agreement and commitment.

1. Values
2. Appraise
3. Motivation
4. Search
5. Select
6. Programme
7. Act
8. Monitor and repeat steps 1 2 and 3

We discovered that we could not change the values of the team nor set the objectives for the team so we started as the first step by asking the appraisal question ie what's good and bad about the operation. We began the system by asking what is good and bad about the present and the future. What is good in the present is Satisfactory, good in the future is an Opportunity; bad in the present is a Fault and bad in the future is a Threat. This was called the SOFT analysis.

When this was presented to Urick and Orr in 1964 at the Seminar in Long Range Planning at the Dolder Grand in Zurich Switzerland they changed the F to a W and called it SWOT Analysis.

SWOT was then promoted in Britain by Urick and Orr as an exercise in and of itself. As such it has no benefit. What was necessary was the sorting of the issues into the programme planning categories of:

1. **Product** (what are we selling?)
2. **Process** (how are we selling it?)
3. **Customer** (to whom are we selling it?)
4. **Distribution** (how does it reach them?)
5. **Finance** (what are the prices, costs and investments?)
6. **Administration** (and how do we manage all this?)

The second step then becomes 'what shall the team do' about the issues in each of these categories. The planning process was then designed through trial and error and resulted finally in a 17 step process beginning with SOFT/SWOT with each issue recorded separately on a single page called a planning issue.

The first prototype was tested and published in 1966 based on the work done at 'Erie Technological Corp' in Erie Pa. In 1970 the prototype was brought to the UK, under the sponsorship of W H Smith & Sons plc, and completed by 1973. The operational programme was used to merge the CWS milling and baking operations with those of J W French Ltd.

The process has been used successfully ever since. By 2004, now, this system has been fully developed, and proven to cope with today's problems of setting and agreeing realistic annual objectives without depending on outside consultants or expensive staff resources.

The seven key research findings

The key findings were never published because it was felt they were too controversial. This is what was found:

1) A business was divided into two parts. The base business plus the development business. This was re-discovered by Dr Peter Senge at MIT in 1998 and published in his book the 5th Dimension. The amount of development business which become operational is equal to or greater than that business on the books within a period of 5 to 7 years. This was a major surprise and urged the need for discovering a better method for planning and managing change.

2) Dr Hal Eyring published his findings on 'Distributive Justice' and pointed out that all people measure what they get from their work and divide it by what they give to the work and this ratio is compared to others. If it is not equal then the person first re-perceives and secondly slows down if added demands are not met. (See for interest [Adams Equity Theory](#) and the [Equity Theory Diagram pdf](#))

3) The introduction of a corporate planner upset the sense of fair play at senior level, making the job of the corporate planner impossible.

4) The gap between what could be done by the organisation and what was actually done was about 35%.

5) The senior man will over-supervise the area he comes from. Finance- Finance, Engineering- Engineering etc.

6) There are 3 factors which separate excellence from mediocrity:

a. Overt attention to purchasing

b. Short-term written down departmental plans for improvement

c. Continued education of the Senior Executive

7) Some form of formal documentation is required to obtain approval for development work. In short we could not solve the problem by stopping planning.

in conclusion

By sorting the SWOT issues into the 6 planning categories one can obtain a system which presents a practical way of assimilating the internal and external information about the business unit, delineating short and long term priorities, and allowing an easy way to build the management team which can achieve the objectives of profit growth.

This approach captures the collective agreement and commitment of those who will ultimately have to do the work of meeting or exceeding the objectives finally set. It permits the team leader to define and develop co-ordinated, goal-directed actions, which underpin the overall agreed objectives between levels of the business hierarchy.

Albert S Humphrey
August 2004

Translating SWOT issues into actions under the six categories

Albert Humphrey advocates that the six categories:

1. **Product** (what are we selling?)
2. **Process** (how are we selling it?)
3. **Customer** (to whom are we selling it?)
4. **Distribution** (how does it reach them?)
5. **Finance** (what are the prices, costs and investments?)
6. **Administration** (and how do we manage all this?)

provide a framework by which SWOT issues can be developed into actions and managed using teams.

This can be something of a 'leap', and so the stage warrants further explanation. Translating the SWOT issues into actions, are best sorted into (or if necessary broken down into) the six categories, because in the context of the way that business and organizations work, this makes them more quantifiable and measurable, responsible teams more accountable, and therefore the activities more manageable. The other pivotal part in the process is of course achieving the commitment from the team(s) involved, which is partly explained in the item summarising Humphrey's TAM® model and process.

As far as identifying actions from SWOT issues is concerned, it all very much depends on your reasons and aims for using SWOT, and also your authority/ability to manage others, whom by implication of SWOT's breadth and depth, are likely to be involved in the agreement and delivery of actions.

Depending on pretext and situation, a SWOT analysis can produce issues which very readily translate into (one of the six) category actions, or a SWOT analysis can produce issues which overlay a number of categories. Or a mixture. Whatever, SWOT essentially tells you what is good and bad about a business or a particular proposition. If it's a business, and the aim is to improve it, then work on translating:

strengths (maintain, build and leverage),
opportunities (prioritise and optimise),
weaknesses (remedy or exit),
threats (counter)

into actions (each within one of the six categories) that can be agreed and owned by a team or number of teams.

If the SWOT analysis is being used to assess a proposition, then it could be that the analysis shows that the proposition is too weak (especially if compared with other SWOT's for alternative propositions) to warrant further investment, in which case further action planning, other than exit, is not required.

If the proposition is clearly strong (presumably you will have indicated this using other methods as well), then proceed as for a business, and translate issues into category actions with suitable ownership by team(s).

This is my understanding of Albert Humphrey's theory relating to developing SWOT issues into organizational change actions and accountabilities. (I'm pleased to say that Albert has kindly confirmed that this is indeed correct.)

There are other ways of applying SWOT of course, depending on your circumstances and aims, for instance if concentrating on a department rather than a whole business, then it could make sense to revise the six categories to reflect the functional parts of the department, or whatever will enable the issues to be translatable into manageable, accountable and owned aims.

You might also find it helpful to ask Albert Humphrey's views on this - I expect he will be able to add and clarify a great deal more than I can, and he is very approachable. Separately, his TAM model is a proven change and improvement process. Humphrey's contact details are on businessballs in the [TAM® article](#).

Albert Humphrey runs his own business-planning and development consultancy practice in London. Here is a [summary of Albert Humphrey's impressive TAM® \(Team Action Management\) model](#), developed and used to speed up the process of initiating and controlling organizational change.

See also:

[Porter's Five Forces Competitive Position Model](#)

[PEST and PESTELI Analysis](#)

[Marketing and Planning Templates](#)

SWOT analysis team building exercises (for team building, decision-making, change-management, strategy development, direction and motivation)

For a single team or any number of teams. For teams of three or four team members. Teams of five and over require a team leader. This is a really motivational and empowering activity that can deliver immediate organizational and business benefits. The exercise duration is from 30 minutes upwards, depending on the complexity of the SWOT subjects issued to or agreed with the teams. The SWOT exercise can take a whole day if the task is complex and big. First refer to the [SWOT analysis](#) notes and template examples on this site.

Ensure all delegates are issued with SWOT analysis instructions, and confirm their understanding of the process, which makes an ideal initial group exercise.

Identify before the session, or have the teams or team members do so at the start of the exercise, suitable subjects for SWOT analysis. Have the teams choose a subject each, and then work as a team to produce the SWOT analysis, which should then be presented back to the group for discussion and review. It's important that the teams want the particular subjects.

Prior to the exercise it's important for the facilitator to clarify what will happen after the exercise to the teams' SWOT analysis findings, so that team members have an appropriate expectation for where their efforts and recommendations will lead.

This SWOT exercise is very flexible - use it to suit the situation, the group, and what the organization needs. Examples of SWOT subject areas (have some specific propositions, opportunities or options handy in case you need them):

- organizational or departmental change options
- business development ideas
- team re-structuring
- problem-solving options
- customer service improvement ideas
- production/distribution/technical support efficiencies or improvements ideas

N.B.

1. The above headings are not SWOT subjects, they are areas within which you can identify SWOT subjects.
2. A SWOT analysis can only be used to assess a specific option, proposition, company, department or idea - a single SWOT analysis cannot be used to compare options or evaluate a number of options or propositions at once.

3. Avoid agreeing to SWOT subjects that are clearly beyond the remit of the teams (which creates expectations that cannot be met), unless the situation allows for the group to make recommendations.
4. A SWOT analysis measures a business unit, a proposition or idea; a PEST analysis measures a market.

Identifying Strengths, Weaknesses, Opportunities and Threats. Explanation of SWOT analysis.

What is a SWOT analysis? Description

A SWOT analysis is a tool, used in management and strategy formulation. It can help to identify the Strengths, Weaknesses, Opportunities and Threats of a particular company.

Strengths and weaknesses are internal factors that create value or destroy value. They can include assets, skills, or resources that a company has at its disposal, compared to its competitors. They can be measured using internal assessments or external benchmarking.

Opportunities and threats are external factors that create value or destroy value. A company cannot control them. But they emerge from either the competitive dynamics of the industry/market or from demographic, economic, political, technical, social, legal or cultural factors (PEST).

Typical examples of factors in a SWOT Analysis diagram:

<p style="text-align: center;">Strengths</p> <ul style="list-style-type: none"> • Specialist marketing expertise • Exclusive access to natural resources <ul style="list-style-type: none"> • Patents • New, innovative product or service <ul style="list-style-type: none"> • Location of your business • Cost advantage through proprietary know-how <ul style="list-style-type: none"> • Quality processes and procedures • Strong brand or reputation 	<p style="text-align: center;">Weaknesses</p> <ul style="list-style-type: none"> • Lack of marketing expertise • Undifferentiated products and service (i.e. in relation to your competitors) <ul style="list-style-type: none"> • Location of your company • Competitors have superior access to distribution channels • Poor quality of goods or services <ul style="list-style-type: none"> • Damaged reputation
<p style="text-align: center;">Opportunities</p> <ul style="list-style-type: none"> • Developing market (China, the Internet) • Mergers, joint ventures or strategic alliances • Moving into new attractive market segments <ul style="list-style-type: none"> • A new international market • Loosening of regulations • Removal of international trade barriers • A market that is led by a weak competitor 	<p style="text-align: center;">Threats</p> <ul style="list-style-type: none"> • A new competitor in your own home market <ul style="list-style-type: none"> • Price war • Competitor has a new, innovative substitute product or service <ul style="list-style-type: none"> • New regulations • Increased trade barriers • A potential new taxation on your product or service

Any organization must try to create a fit with its external environment. The SWOT diagram is a very good tool for analyzing the (internal) strengths and weaknesses of a corporation and the (external) opportunities and threats. However, this analysis is just the first step. To really create the fit with the external environment is often the most difficult work.

Confrontation Matrix

A tool to combine the internal factors with the external factors is the **Confrontation Matrix**.

	Opportunities	Threats
Strengths	Offensive make the most of these	Adjust restore strengths
Weaknesses	Defensive watch competition closely	Survive turn around

Often in reality the two columns of the SWOT diagram are pointing in opposite directions. Strategists must still deal with the paradox of creating alignment. This can be done via Outside-in strategy formulation (market-driven strategy) or Inside-out strategy formulation (resource-driven).

Note: you can also apply a SWOT analysis to competitors, often providing interesting new perspectives.

Porter's Generic Strategies

If the primary determinant of a firm's profitability is the attractiveness of the industry in which it operates, an important secondary determinant is its position within that industry. Even though an industry may have below-average profitability, a firm that is optimally positioned can generate superior returns.

A firm positions itself by leveraging its strengths. Michael Porter has argued that a firm's strengths ultimately fall into one of two headings: cost advantage and differentiation. By applying these strengths in either a broad or narrow scope, three generic strategies result: *cost leadership*, *differentiation*, and *focus*. These strategies are applied at the business unit level. They are called generic strategies because they are not firm or industry dependent. The following table illustrates Porter's generic strategies:

Porter's Generic Strategies

<i>Target Scope</i>	<i>Advantage</i>	
	Low Cost	Product Uniqueness
Broad (Industry Wide)	Cost Leadership Strategy	Differentiation Strategy
Narrow (Market Segment)	Focus Strategy (low cost)	Focus Strategy (differentiation)

Cost Leadership Strategy

This generic strategy calls for being the low cost producer in an industry for a given level of quality. The firm sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain [market share](#). In the event of a price war, the firm can maintain some profitability while the competition suffers losses. Even without a price war, as the industry matures and prices decline, the firms that can produce more cheaply will remain profitable for a longer period of time. The cost leadership strategy usually targets a broad market.

Some of the ways that firms acquire cost advantages are by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and [vertical integration](#) decisions, or avoiding some costs altogether. If competing firms are unable to lower their costs by a similar amount, the firm may be able to sustain a competitive advantage based on cost leadership.

Firms that succeed in cost leadership often have the following internal strengths:

- Access to the capital required to make a significant investment in production assets; this investment represents a barrier to entry that many firms may not overcome.
- Skill in designing products for efficient manufacturing, for example, having a small component count to shorten the assembly process.
- High level of expertise in manufacturing process engineering.
- Efficient distribution channels.

Each generic strategy has its risks, including the low-cost strategy. For example, other firms may be able to lower their costs as well. As technology improves, the competition may be able to leapfrog the production capabilities, thus eliminating the competitive advantage. Additionally, several firms following a focus strategy and targeting various narrow markets may be able to achieve an even lower cost within their segments and as a group gain significant market share.

Differentiation Strategy

A differentiation strategy calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition. The value added by the uniqueness of the product may allow the firm to charge a premium price for it. The firm hopes that the higher price will more than cover the extra costs incurred in offering the unique product. Because of the product's unique attributes, if suppliers increase their prices the firm may be able to pass along the costs to its customers who cannot find substitute products easily.

Firms that succeed in a differentiation strategy often have the following internal strengths:

- Access to leading scientific research.
- Highly skilled and creative product development team.
- Strong sales team with the ability to successfully communicate the perceived strengths of the product.
- Corporate reputation for quality and innovation.

The risks associated with a differentiation strategy include imitation by competitors and changes in customer tastes. Additionally, various firms pursuing focus strategies may be able to achieve even greater differentiation in their market segments.

Focus Strategy

The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation. The premise is that the needs of the group can be better serviced by focusing entirely on it. A firm using a focus strategy often enjoys a high degree of customer loyalty, and this entrenched loyalty discourages other firms from competing directly.

Because of their narrow market focus, firms pursuing a focus strategy have lower volumes and therefore less bargaining power with their suppliers. However, firms pursuing a differentiation-focused strategy may be able to pass higher costs on to customers since close substitute products do not exist.

Firms that succeed in a focus strategy are able to tailor a broad range of product development strengths to a relatively narrow market segment that they know very well.

Some risks of focus strategies include imitation and changes in the target segments. Furthermore, it may be fairly easy for a broad-market cost leader to adapt its product in order to compete directly. Finally, other focusers may be able to carve out sub-segments that they can serve even better.

A Combination of Generic Strategies - Stuck in the Middle?

These generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt it may achieve no advantage at all. For example, if a firm differentiates itself by supplying very high quality products, it risks undermining that quality if it seeks to become a cost leader. Even if the quality did not suffer, the firm would risk projecting a confusing image. For this reason, Michael Porter argued that to be successful over the long-term, a firm must select only one of these three generic strategies. Otherwise, with more than one single generic strategy the firm will be "stuck in the middle" and will not achieve a competitive advantage.

Porter argued that firms that are able to succeed at multiple strategies often do so by creating separate business units for each strategy. By separating the strategies into different units having different policies and even different cultures, a corporation is less likely to become "stuck in the middle."

However, there exists a viewpoint that a single generic strategy is not always best because within the same product customers often seek multi-dimensional satisfactions such as a combination of quality, style, convenience, and price. There have been cases in which high quality producers faithfully followed a single strategy and then suffered greatly when another firm entered the market with a lower-quality product that better met the overall needs of the customers.

Generic Strategies and Industry Forces

These generic strategies each have attributes that can serve to defend against competitive forces. The following table compares some characteristics of the generic strategies in the context of the Porter's five forces.

Generic Strategies and Industry Forces

<i>Industry Force</i>	<i>Generic Strategies</i>		
	Cost Leadership	Differentiation	Focus
Entry Barriers	Ability to cut price in retaliation deters potential entrants.	Customer loyalty can discourage potential entrants.	Focusing develops core competencies that can act as an entry barrier.
Buyer Power	Ability to offer lower price to powerful buyers.	Large buyers have less power to negotiate because of few close alternatives.	Large buyers have less power to negotiate because of few alternatives.
Supplier Power	Better insulated from powerful suppliers.	Better able to pass on supplier price increases to customers.	Suppliers have power because of low volumes, but a differentiation-focused firm is better able to pass on supplier price increases.
Threat of Substitutes	Can use low price to defend against substitutes.	Customer's become attached to differentiating attributes, reducing threat of substitutes.	Specialized products & core competency protect against substitutes.
Rivalry	Better able to compete on price.	Brand loyalty to keep customers from rivals.	Rivals cannot meet differentiation-focused customer needs.

Recommended Reading

Porter, Michael E., [*Competitive Strategy: Techniques for Analyzing Industries and Competitors*](#)

Competitive Strategy is the basis for much of modern business strategy. In this classic work, Michael Porter presents his five forces and generic strategies, then discusses how to recognize and act on market signals and how to forecast the evolution of industry structure. He then discusses competitive strategy for emerging, mature, declining, and fragmented industries. The last part of the book covers strategic decisions related to vertical integration, capacity expansion, and entry into an industry. The book concludes with an appendix on how to conduct an industry analysis.

Ansoff Matrix

To portray alternative corporate growth strategies, Igor Ansoff presented a matrix that focused on the firm's present and potential products and markets (customers). By considering ways to grow via existing products and new products, and in existing markets and new markets, there are four possible product-market combinations. Ansoff's matrix is shown below:

Ansoff Matrix		
	Existing Products	New Products
Existing Markets	Market Penetration	Product Development
New Markets	Market Development	Diversification

Ansoff's matrix provides four different growth strategies:

- **Market Penetration** - the firm seeks to achieve growth with existing products in their current market segments, aiming to increase its [market share](#).
- **Market Development** - the firm seeks growth by targeting its existing products to new market segments.
- **Product Development** - the firm develops new products targeted to its existing market segments.
- **Diversification** - the firm grows by diversifying into new businesses by developing new products for new markets.

Selecting a Product-Market Growth Strategy

The **market penetration** strategy is the least risky since it leverages many of the firm's existing resources and capabilities. In a growing market, simply maintaining market share will result in growth, and there may exist opportunities to increase market share if competitors reach capacity limits. However, market penetration has limits, and once the market approaches saturation another strategy must be pursued if the firm is to continue to grow.

Market development options include the pursuit of additional market segments or geographical regions. The development of new markets for the product may be a good strategy if the firm's [core competencies](#) are related more to the specific product than to its experience with a specific market segment. Because the firm is expanding into a new market, a market development strategy typically has more risk than a market penetration strategy.

A **product development** strategy may be appropriate if the firm's strengths are related to its specific customers rather than to the specific product itself. In this situation, it can leverage its strengths by developing a new product targeted to its existing customers. Similar to the case of new market development, new product development carries more risk than simply attempting to increase market share.

Diversification is the most risky of the four growth strategies since it requires both product and market development and may be outside the core competencies of the firm. In fact, this quadrant of the matrix has been referred to by some as the "suicide cell". However, diversification may be a reasonable choice if the high risk is compensated by the chance of a high rate of return. Other advantages of diversification include the potential to gain a foothold in an attractive industry and the reduction of overall business portfolio risk.

Recommended Reading

[Harvard Business Review on Strategies for Growth](#) (Harvard Business Review Series)

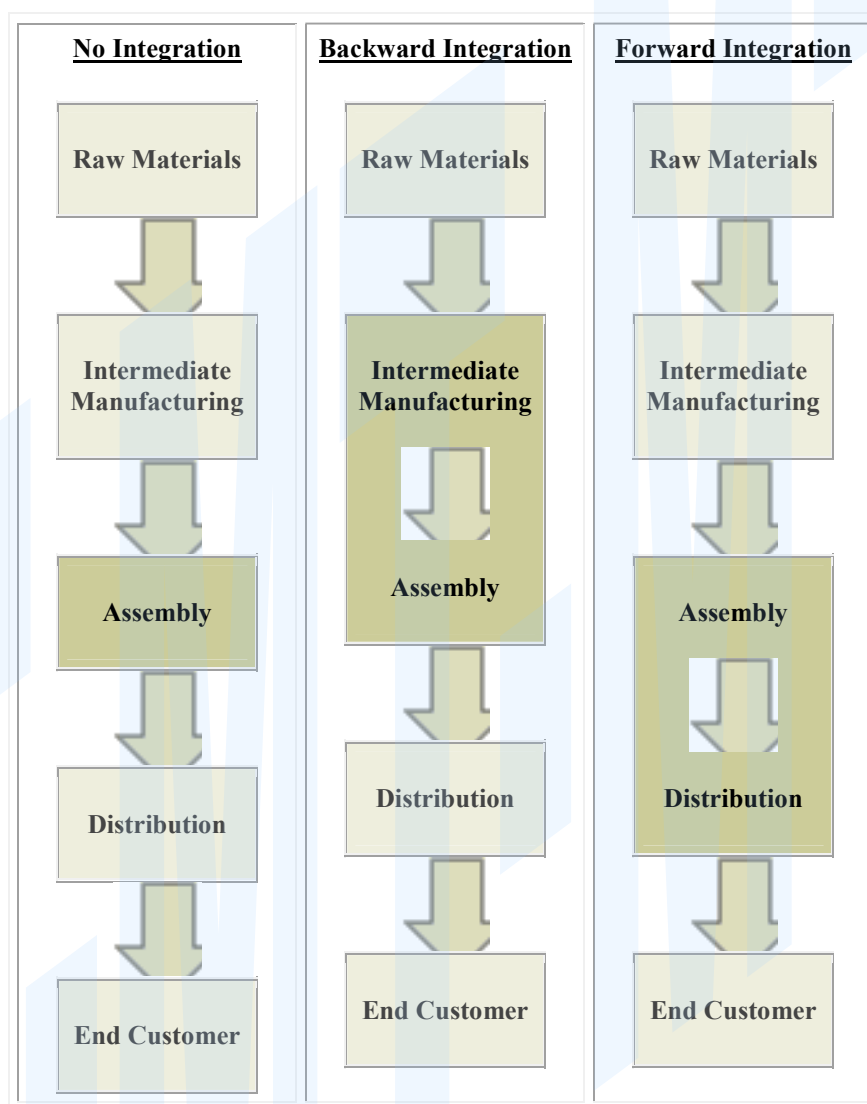
Vertical Integration

The degree to which a firm owns its upstream suppliers and its downstream buyers is referred to as **vertical integration**. Because it can have a significant impact on a business unit's position in its industry with respect to cost, differentiation, and other strategic issues, the vertical scope of the firm is an important consideration in corporate strategy.

Expansion of activities downstream is referred to as *forward integration*, and expansion upstream is referred to as *backward integration*.

The concept of vertical integration can be visualized using the value chain. Consider a firm whose products are made via an assembly process. Such a firm may consider backward integrating into intermediate manufacturing or forward integrating into distribution, as illustrated below:

Example of Backward and Forward Integration



Two issues that should be considered when deciding whether to vertically integrate is cost and control. The cost aspect depends on the cost of market transactions between firms versus the cost of administering the same activities internally within a single firm. The second issue is the impact of asset control, which can impact barriers to entry and which can assure cooperation of key value-adding players.

The following benefits and drawbacks consider these issues.

Benefits of Vertical Integration

Vertical integration potentially offers the following advantages:

- Reduce transportation costs if common ownership results in closer geographic proximity.
- Improve supply chain coordination.
- Provide more opportunities to differentiate by means of increased control over inputs.
- Capture upstream or downstream profit margins.
- Increase entry barriers to potential competitors, for example, if the firm can gain sole access to a scarce resource.
- Gain access to downstream distribution channels that otherwise would be inaccessible.
- Facilitate investment in highly specialized assets in which upstream or downstream players may be reluctant to invest.
- Lead to expansion of [core competencies](#).

Drawbacks of Vertical Integration

While some of the benefits of vertical integration can be quite attractive to the firm, the drawbacks may negate any potential gains. Vertical integration potentially has the following disadvantages:

- Capacity balancing issues. For example, the firm may need to build excess upstream capacity to ensure that its downstream operations have sufficient supply under all demand conditions.
- Potentially higher costs due to low efficiencies resulting from lack of supplier competition.
- Decreased flexibility due to previous upstream or downstream investments. (Note however, that flexibility to coordinate vertically-related activities may increase.)
- Decreased ability to increase product variety if significant in-house development is required.
- Developing new core competencies may compromise existing competencies.
- Increased bureaucratic costs.

Factors Favoring Vertical Integration

The following situational factors tend to favor vertical integration:

- Taxes and regulations on market transactions
- Obstacles to the formulation and monitoring of contracts.
- Strategic similarity between the vertically-related activities.
- Sufficiently large production quantities so that the firm can benefit from economies of scale.
- Reluctance of other firms to make investments specific to the transaction.

Factors Against Vertical Integration

The following situational factors tend to make vertical integration less attractive:

- The quantity required from a supplier is much less than the minimum efficient scale for producing the product.
- The product is a widely available commodity and its production cost decreases significantly as cumulative quantity increases.
- The core competencies between the activities are very different.
- The vertically adjacent activities are in very different types of industries. For example, manufacturing is very different from retailing.
- The addition of the new activity places the firm in competition with another player with which it needs to cooperate. The firm then may be viewed as a competitor rather than a partner

Alternatives to Vertical Integration

There are alternatives to vertical integration that may provide some of the same benefits with fewer drawbacks. The following are a few of these alternatives for relationships between vertically-related organizations:

- long-term explicit contracts
- franchise agreements
- joint ventures
- co-location of facilities
- implicit contracts (relying on firms' reputation)

Recommended Reading

Greaver, Maurice F., [*Strategic Outsourcing*](#) : A Structured Approach to Outsourcing Decisions and Initiatives

Horizontal Integration

The acquisition of additional business activities at the same level of the value chain is referred to as **horizontal integration**. This form of expansion contrasts with vertical integration by which the firm expands into upstream or downstream activities. Horizontal growth can be achieved by internal expansion or by external expansion through [mergers and acquisitions](#) of firms offering similar products and services. A firm may diversify by growing horizontally into unrelated businesses.

Some examples of horizontal integration include:

- The Standard Oil Company's acquisition of 40 refineries.
- An automobile manufacturer's acquisition of a sport utility vehicle manufacturer.
- A media company's ownership of radio, television, newspapers, books, and magazines.

Advantages of Horizontal Integration

The following are some benefits sought by firms that horizontally integrate:

- Economies of scale - achieved by selling more of the same product, for example, by geographic expansion.
- Economies of scope - achieved by sharing resources common to different products. Commonly referred to as "synergies."
- Increased market power (over suppliers and downstream channel members)
- Reduction in the cost of international trade by operating factories in foreign markets.

Sometimes benefits can be gained through customer perceptions of linkages between products. For example, in some cases synergy can be achieved by using the same brand name to promote multiple products. However, such extensions can have drawbacks, as pointed out by Al Ries and Jack Trout in their marketing classic, [Positioning](#).

Pitfalls of Horizontal Integration

Horizontal integration by acquisition of a competitor will increase a firm's market share. However, if the [industry concentration](#) increases significantly then anti-trust issues may arise.

Aside from legal issues, another concern is whether the anticipated economic gains will materialize. Before expanding the scope of the firm through horizontal integration, management should be sure that the imagined benefits are real. Many blunders have been made by firms that broadened their horizontal scope to achieve synergies that did not exist, for example, computer hardware manufacturers who entered the software business on the premise that there were synergies between hardware and software. However, a connection between two products does not necessarily imply realizable economies of scope.

Finally, even when the potential benefits of horizontal integration exist, they do not materialize spontaneously. There must be an explicit horizontal strategy in place. Such strategies generally do not arise from the bottom-up, but rather, must be formulated by corporate management.

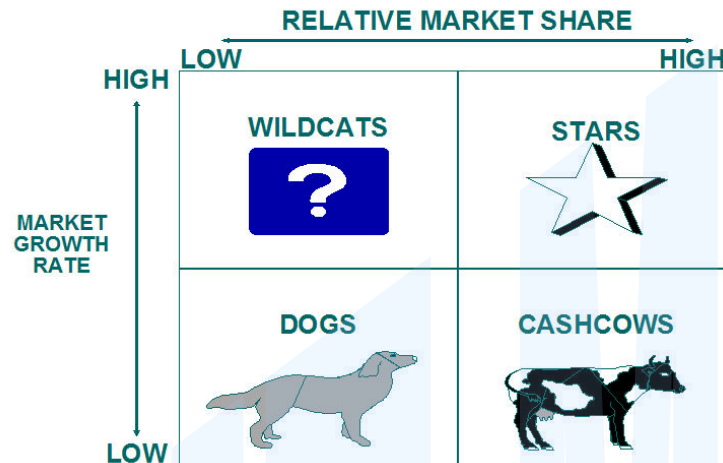
Recommended Reading

Mark N. Clemente and David S. Greenspan, [Winning at Mergers and Acquisitions](#) : *The Guide to Market Focused Planning and Integration*

Boston Matrix (BCG Growth-Share Matrix)

Companies that are large enough to be organized into strategic business units face the challenge of allocating resources among those units. In the early 1970's the Boston Consulting Group developed a model for managing a portfolio of different business units (or major product lines). The **BCG growth-share matrix** displays the various business units on a graph of the market growth rate vs. [market share](#) relative to competitors:

BOSTON MATRIX (Portfolio Matrix)



Resources are allocated to business units according to where they are situated on the grid as follows:

- **Cash Cow** - a business unit that has a large market share in a mature, slow growing industry. Cash cows require little investment and generate cash that can be used to invest in other business units.
- **Star** - a business unit that has a large market share in a fast growing industry. Stars may generate cash, but because the market is growing rapidly they require investment to maintain their lead. If successful, a star will become a cash cow when its industry matures.
- **Question Mark (or Wildcats)** - a business unit that has a small market share in a high growth market. These business units require resources to grow market share, but whether they will succeed and become stars is unknown.
- **Dog** - a business unit that has a small market share in a mature industry. A dog may not require substantial cash, but it ties up capital that could better be deployed elsewhere. Unless a dog has some other strategic purpose, it should be liquidated if there is little prospect for it to gain market share.

The BCG matrix provides a framework for allocating resources among different business units and allows one to compare many business units at a glance. However, the approach has received some negative criticism for the following reasons:

- The link between market share and profitability is questionable since increasing market share can be very expensive.
- The approach may overemphasize high growth, since it ignores the potential of declining markets.
- The model considers market growth rate to be a given. In practice the firm may be able to grow the market.

These issues are addressed by the [GE / McKinsey Matrix](#), which considers market growth rate to be only one of many factors that make an industry attractive, and which considers relative market share to be only one of many factors describing the competitive strength of the business unit.

Recommended Reading

The Boston Consulting Group, [Perspectives on Strategy](#)

CORPORATE PARENTING

Which businesses belong in a parent's portfolio?

Corporate Strategy: The Quest for



As they craft corporate-level strategy, most chief executives today fail to address two crucial questions: What businesses should this company, rather than rival companies, own and why? And what organizational structure, management processes, and philosophy will foster superior performance from its businesses?

We are not saying that chief executives intentionally avoid or ignore those questions. They simply lack the tools and processes for the job. Most planning processes focus on developing business-level, rather than corporate-level, strategies. Even more important, the planning frameworks that corporate-level strategists have commonly used have proven inappropriate or impractical.

The growth/share matrix, introduced in the 1970s and adopted by two-thirds of all U.S. corporations within a decade, encouraged companies to balance their business portfolios with a mix of

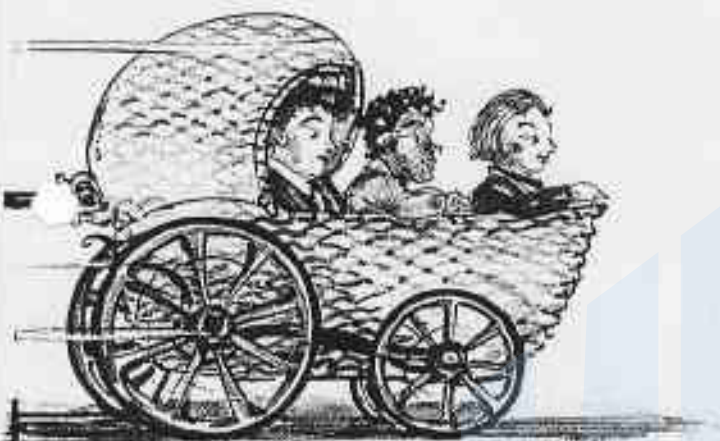
stars, cash cows, and question marks. But the poor performance of companies using the portfolio-management technique, and disillusionment with diversification, have discouraged all but a handful of companies from using it today.

For the past five to ten years, increasing numbers of companies have been trying to stick to their knitting, as Tom Peters and Bob Waterman first advised in their book *In Search of Excellence* in 1982. Companies have been shedding the businesses they acquired as diversifications in order to focus instead on core businesses, relying for guidance on the core competence concept. In introducing the concept ("The Core Competence of the Corporation," HBR May-June 1990), C.K. Hamel and Gary Prahalad proposed that companies should build portfolios of businesses around shared technical or operating competencies and should develop structures and processes to enhance their core competencies.

Despite its powerful appeal, the core competence concept has not provided practical guidelines for developing corporate-level strategy. Many companies have tried to define their core competencies, but, lacking reliable analytical tools, few have achieved the clarity they sought. Furthermore, the core competence model does not account for the

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for Parenting Advantage



by Andrew Campbell, Michael Goold,
and Marcus Alexander

success of companies such as ABB Asea Brown Boveri, BTR, Emerson Electric, General Electric, Hanson, and Kohlberg Kravis Roberts, whose businesses have limited technical or operating overlap.

The framework we propose—the parenting framework—fills in the deficiencies of the core competence concept. It provides a rigorous conceptual model as well as the tools needed for an effective corporate-level planning process.

Based on research with some of the world's most successful diversified companies, the parenting framework is grounded in the economics of competitive strategy. Multibusiness companies bring together under a parent organization businesses that could potentially be independent.

Such parent companies can justify themselves economically only if their influence creates value. For example, the parent organization can improve the businesses' plans and budgets, promote better linkages among them, provide especially competent central functions, or make wise choices in its own acquisitions, divestments, and new ventures.

Multibusiness companies create value by influencing—or parenting—the businesses they own. The

best parent companies create more value than any of their rivals would if they owned the same businesses. Those companies have what we call *parenting advantage*.

Previous strategic frameworks have focused on the businesses in the portfolio and searched for a logic by examining how they relate to one another. The underlying assumption has been that port-

The best parent companies create more value in their businesses than rivals would.

folios of related businesses perform better than portfolios of unrelated ones. The growth/share matrix implies that businesses are related if their cash, profit, and growth performance create a balance within the portfolio. The core competence concept says that businesses are related if they have common technical or operating know-how. The parenting framework, in contrast, focuses on the competencies of the parent organization and on the value

created from the relationship between the parent and its businesses.

The parent organization is an intermediary between investors and businesses. It competes not only with other parent organizations but also with other intermediaries, such as investment trusts and mutual funds. Corporate-level strategies, therefore, make sense to the extent that the parent creates sufficient value to compete with other intermediaries. That occurs when the parent's skills and re-

Fit between a parent and its businesses is a two-edged sword: a good fit can create value; a bad one can destroy it.

sources fit well with the needs and opportunities of the businesses. If there is a fit, the parent is likely to create value. If there is not a fit, the parent is likely to destroy value. The parent, we have found, is highly influential, and its impact is rarely neutral.

Demerger decisions, such as the one facing Imperial Chemical Industries (ICI) in 1992, dramatically illustrate the importance of fit between the parent and its businesses. To split a large and venerable organization that had been built up over decades demanded a powerful rationale. [See "Why ICI Chose to Demerge"]

Divestment decisions, such as the exit of oil companies from the minerals business, also illustrate the logic of the fit. Companies such as British Petroleum (BP), Exxon, and Shell entered minerals in order to diversify. They believed they had the appropriate skills for that business because, like oil, it involved exploration, extraction, government relations, and large, technically complex projects. Minerals and oil seemed to share competencies.

However, after more than ten years of experience, oil companies are getting out of the minerals business. BP sold its minerals businesses to the RTZ Corporation in 1989, and Shell recently sold its operations to Gencor in South Africa. Why? Because their minerals businesses have consistently underperformed those of minerals specialists. The minerals businesses of Atlantic Richfield, BP, Exxon, Shell, and Standard Oil had an average pretax return on sales of -17% during the mid-1980s, while independent metal companies achieved a 10% re-

turn. One reason for the disparity is the influence that managers in oil-company parents exercised over decisions made in their metals businesses. As a manager in BP's minerals businesses explains, "The problem was that the BP managing directors could not really come to grips with the minerals business or feel they understood it. There was always that vestige of suspicion that led to a temptation to say no to proposals from the business or, alternatively, if they said yes, to say yes for the wrong reasons." In other words, the influence of the parent managers on the minerals business was faulty because of insufficient understanding—an insufficient fit—between the parent and the business.

The oil companies' diversification into minerals failed because, despite similarities, some success factors in minerals are different from those in oil. Exploration, for instance, is not as critical. Finding new mineral deposits is not necessarily a passport to profit. More important is access to low-cost deposits because only those deposits make profits in cyclical downturns. For minerals businesses, forming joint ventures with companies that already have low-cost mines can be more profitable than searching for new deposits. Pressure from oil-company managers to spend more on exploration was therefore counter-productive. RTZ, the new parent of BP's minerals busi-

Whether a parent and its businesses fit is a tough question that few managers address.

nesses, has not had that problem, however. "It has been easy to add value," Robert Adams, RTZ's planning director, explains, "because we have some specialist expertise in mine planning and operations and a natural affinity for the investment and exploration decisions and trade-offs that you face in cyclical minerals businesses."

The oil-company examples show that fit between parent and businesses is a two-edged sword. A good fit can create additional value; a bad one can destroy value. Bad parenting causes business-unit managers to make worse decisions than they would otherwise. In one company, the managers in the minerals business had taken bad advice about exploration techniques from their oil-company

bosses. When asked why, they replied, "They had acquired us so we thought they must know something we didn't."

Our framework for developing corporate-level strategy is based on assessing the nature of the fit between the corporate parent and its businesses. Is there a match that will create value, or a mismatch that will destroy value? By answering that question, corporate strategists can consider which changes—either to the portfolio of businesses or to the parenting approach—will improve fit.

Assessing Fit

Few corporate-level managers find it easy to assess the fit between the corporate parent and its businesses. The reason, in part, is that they seldom openly address the question. But even if they do, it is a tough question to answer. It is like asking whether a particular manager fits a particular job. One must understand a great deal about the manager and the job to judge well.

To aid those judgments, we have developed a structured analytical approach. It begins with an assessment of the businesses. First, we examine the critical success factors of each business. We need to understand those factors in order to judge where the parent's influence is positive and where it is negative. Second, we document areas in the businesses in which performance can be improved. Those are areas in which the parent can add value. They represent the upside potential.

Armed with those analyses, we then review the characteristics of the parent, grouped in a number of categories. That analysis ensures that managers will consider all the main characteristics of the parent when they judge whether its influence is likely to fit the business's opportunities and needs. The final step is to test the judgments against the results that the businesses achieve under the influence of the parent.

Critical Success Factors: Understanding the Businesses. The concept of critical success factors is familiar to most managers. In every business, certain activities or issues are critical to performance and to the creation of competitive advantage. However, success factors differ among and even within industries. For example, those in bulk chemicals are not the same as those in specialty chemicals.

Most business-level plans define the critical success factors as part of the rationale for the actions proposed. A special analysis of critical success factors is not, therefore, usually necessary to develop corporate-level strategy. However, it is a good idea to summarize critical success factors, confirm their

Critical Success Factors for a Diversified Food Company

Success Factors	Food products	Property	Restaurant A	Restaurant B	Retail	Hotels
Product branding	★					★
Selling	★					★
Product mix management	★					
Scale and capacity utilization	★					
Business development skills		★				
Formula branding			★	★	★	
Positioning to match locality		★	★	★	★	
Site selection		★	★	★	★	★
Property development costs		★	★	★	★	★
Value engineering			★	★		★
Detailed operating controls			★	★	★	★
Management selection and training			★	★	★	★
Supply chain logistics	★		★	★	★	★
Low overheads	★	★	★	★	★	★

importance with business-level managers, and check whether circumstances in the business have changed—for example, whether its costs have risen. (See the table "Critical Success Factors for a Diversified Food Company.")

Critical-success-factor analysis is an important base for assessing fit. It is useful in judging whether friction is likely to develop between the business and the parent. A parent that does not understand the critical success factors in a business is likely to destroy value. It is also useful for judging how similar the parenting needs of different businesses are. In the food-company example, the restaurant and retail businesses are more similar than the hotel, property, and food-products businesses. Finally, critical-success-factor analysis is a prerequisite for a parenting-opportunity analysis.

Parenting Opportunities: Gauging the Upside. To add value, a parent must improve its businesses. For that to be possible, there must be room for improvement. We call the potential for improvement within a business a *parenting opportunity*.

Many kinds of parenting opportunities may present themselves. For example, a business may have excessive overhead costs that its managers are un-

aware of. For the right parent, the high overhead is an opportunity. Or two businesses might be able to gain economies of scale by combining their sales forces. The businesses' managers may find such consolidation difficult because of personal animosities or loyalties, or concerns about control. The combining of sales forces is, therefore, an opportunity for the right parent. In another example, a business may have good, but not world-class, manufacturing and logistics management skills. A parent company that has world-class expertise in those areas can help that business. (See the insert "Ten Places to Look for Parenting Opportunities" for a checklist of circumstances in which parenting opportunities can arise.)

Most businesses have parenting opportunities and could improve their performance if they had a parent organization with exactly the right skills and experience. The purpose of a parenting-opportunity analysis is to document those opportunities and estimate their significance. The analysis can be a major challenge, though, because the parent often needs a depth of expertise in the business to identify the opportunities. For example, a parent that is not expert in manufacturing might not know that a business lacked world-class manufacturing skills. Or a parent without detailed knowledge of a business's market may not be aware of the opportunity to combine sales forces.

Three types of analyses can help strategists identify parenting opportunities. First, strategists list the major challenges facing a business, which are normally recorded in the business plan. Then they examine each challenge to see whether it contains a parenting opportunity. For example, one business faced two major challenges: to expand capacity in order to meet the demands of a growing segment and to lower costs by improving purchasing. The first challenge did not contain a parenting opportunity, because the business-unit managers had already successfully expanded capacity many times and would likely be able to do so again without parenting influence. However, the second challenge did contain a parenting opportunity: the business-unit managers had weak purchasing skills and had never recruited a top-ranking purchasing manager. A parent with suitable skills would be able to coach the business managers, helping them avoid pitfalls, such as offering a salary too low to attract someone with the expertise they need.

In the second type of analysis, strategists document the most important influences the parent has on the business and then judge whether those influences are addressing parenting opportunities that were not identified in the first analysis. For example, at one parent company, the central engineering function develops the technical procedures and standards for all its chemical businesses. Con-

Understanding the Parent

To understand the parent organization, we recommend a systematic review of its characteristics in five categories:

- ☐ The parent's *mental maps* are the values, aspirations, rules of thumb, biases, and success formulas that guide parent managers as they deal with the businesses. Mental maps shape the parent's perception of opportunities to improve business performance. They embody its understanding of different types of businesses. They underlie the knee-jerk reactions and intuitive assumptions of the parent. Usually, they reflect deeply held attitudes and beliefs and are based on managers' personal experiences. A manager with 20 years of experience in commodity chemicals will have very different maps from one who has spent 20 years in fashion retailing.
- ☐ The parenting *structures, systems, and processes* are the mechanisms through which the parent creates value. The number of layers in the hierarchy, the existence of a matrix, the appointment processes, human resource systems, budgeting and planning processes,

capital-approval systems, decision-making structures, transfer-pricing systems, and other coordination or linkage mechanisms are all important aspects of parenting. The design of structures and processes is important, but more particular to each company is how managers interact within the structure or process.

- ☐ Corporate *staff departments* and *central resources* should support line management's efforts to create value. Some parents have large central functions, some as few as possible. Resources, such as patents held by the parent, the corporate brand, special government relationships, or access to scarce property or financial assets, can also be important characteristics. The potential for central staffs and resources to create value depends on the circumstances in each business: a large manufacturing-services staff may be helpful for one business but completely unnecessary or damaging for another.

- ☐ Parents often create value because they have *people* with unique *skills*. The parent's mental maps will likely overlap with the expertise in functions and ser-

versations with business-unit and central-engineering managers confirmed that having a central department develop standards addressed a parenting opportunity. The business-unit managers lacked the skills and time to become expert in technical and engineering standards. Moreover, the businesses were sufficiently similar so that technical lessons learned in one situation could be applied to others. Central engineering was able to create value by helping the businesses raise technical standards.

A third kind of analysis looks at the influence different parent companies have on similar businesses to see whether they have discovered still other parenting opportunities. This step requires that managers learn about rival parent companies through public documents, individuals in those companies, or consultants and industry observers. Frequently, rivals share information about their parenting activities, believing it to be of low commercial value.

Characteristics of the Parent: Assessing Fit. The next step in developing a corporate-level strategy is to decide how closely the parent organization fits with the businesses in the portfolio. That involves documenting the characteristics of the parent organization, then comparing them with the critical success factors and parenting opportunities in each of the businesses.

Parenting characteristics fall into five categories:

☐ the mental maps that guide parent managers;

☐ the corporate structure, management systems, and processes;

☐ the central functions, services, and resources;

☐ the nature, experience, and skills of managers in the parent organization; and

☐ the extent to which companies have decentralized by delegating responsibilities and authority to business-unit managers.

The five categories are lenses through which one can view the influences of the parent. Although the categories have obvious links and overlaps, analyzing each one separately ensures a comprehensive understanding of the parent. (See the insert "Understanding the Parent" for a fuller description of the categories.)

With a good grasp of a parent's characteristics and hence of the influence it exercises, strategists can then ask two key questions:

☐ Does the parent have characteristics—that is, the skills, resources, management processes, and so forth—that fit the parenting opportunities in the business? Can the parent exploit the upside potential of the relationship?

☐ Is there a misfit between the parent's characteristics and the business's critical success factors? What is the potential downside of the relationship?

The 1989 acquisition of Champion International Corporation, the spark-plug company, by Texas-based manufacturer Cooper Industries illustrates the importance of the two questions. Cooper uses a distinctive parenting approach designed to help its businesses raise their manufacturing performance. New acquisitions are "Cooperized"—Cooper audits their manufacturing operations; improves their cost accounting systems; makes their planning, budgeting, and human resource systems conform with its systems; and centralizes union negotiations. One business manager observes, "When you are acquired by Cooper, one of the first things that happens is a truckload of policy manuals arrives at your door." Such hands-on parenting has been effective in transforming the cost and quality of certain kinds of manufacturing businesses.

The issue facing Cooper was whether Champion would fit with that parenting approach. For example, would Cooper's manufacturing-services department be able to add value to Champion? Manufacturing at Champion fell short of best practice, offering a major opportunity for Cooper's parenting skills. But there were some worries. Spark plugs involve ceramic manufacturing, an area about which Cooper's manufacturing-services department knew little. Moreover, Champion's factories produced millions of spark plugs annually in high-volume processes, while Cooper's manufacturing staff was

vices. Yet neither of those characteristics sufficiently emphasizes the importance of key individuals in parent companies. Some corporate parents are dominated by managers, such as Jack Welch at General Electric or Allen Sheppard at Grand Metropolitan, whose personalities and skills make a critical difference. But a skilled division head or technical director can also be the parent's greatest source of value, provided his or her style, beliefs, and skills address parenting opportunities in the portfolio.

☐ The *decentralization contract* between parent and business defines which issues the parent normally influences and which it delegates to business managers. It contains the authorization limits, job descriptions, and formal statements of due process. However, it is typically embedded in the culture of the company rather than fully explicit. The decentralization contract should direct the parent's attention toward those business issues to which it has something to contribute and away from those for which its influence is likely to be damaging.

Ten Places to Look for Parenting Opportunities

Size and Age. Old, large, successful businesses often accumulate bureaucracies and overheads that are hard to eliminate from the inside. Small, young businesses may have insufficient functional skills, managerial-succession problems, and insufficient financial resources to ride out a recession. Are those factors relevant to the business?

Management. Does the business employ top-quality managers compared with its competitors? Are its managers focused on the right objectives? Is the business dependent on attracting and retaining people with hard-to-find skills?

Business Definition. The managers in the business may have an erroneous concept of what the business should be and may consequently target a market that is too narrow or broad, or they may employ too much or too little vertical integration. The trend of outsourcing and alliances is changing the definitions of many businesses, thus creating new parenting opportunities. Is each business in the portfolio defined to maximize its competitive advantage?

Predictable Errors. Does the nature of a business and its situation lead managers to make predictable mistakes? For example, attachment to previous decisions may prevent openness to new alternatives; business

maturity often leads to excessive diversification; long product cycles can encourage excessive reliance on old products; and cyclical markets can lead to overinvestment during the upswing.

Linkages. Could the business link more effectively with other businesses to improve efficiency or market position? Are linkages among units complex or difficult to establish without parental help?

Common Capabilities. Does the business have capabilities that could be shared among businesses?

Special Expertise. Could the business benefit from specialized or rare expertise that the parent possesses?

External Relations. Does the business have external stakeholders, such as shareholders, government, unions, and suppliers, that the parent company could manage better than it does?

Major Decisions. Does the business face difficult decisions in areas in which it lacks expertise—for example, entering China, making a big acquisition, or dramatically extending capacity? Would the business experience difficulty getting funding for major investments from external capital providers?

Major Changes. Does the business need to make major changes in areas with which its management has little experience?



most knowledgeable about slower, cell-based or batch-process operations. In addition, Champion had a number of operations outside the United States, while Cooper had less experience working in foreign countries.

To judge Champion's fit, Robert Cizik, Cooper's CEO, had to examine his company's parenting characteristics and assess the potential and risks for each one. What would be the impact of centralizing union negotiations, imposing Cooper's cost accounting processes, and so on? Cizik had to judge the net effect of all those influences.

In addition, he had to consider whether Cooper's parenting influence would be better for Champion than that of rivals. Dana Corporation, another manufacturing-oriented parent company, also spotted the opportunity at Champion. Would Cooper's impact on Champion be greater than Dana's and hence justify the premium Cooper had to pay to acquire the business in direct competition with Dana?

Impact on Results: Validating the Judgments. One can test a company's judgments about how well its parenting characteristics fit with its businesses by examining the company's track record with different sorts of businesses. A technique we call *success and failure analysis* is a useful way of summarizing a parent's track record. The analysis involves listing important decisions and classifying each as a success, a failure, or neutral. It is often useful to group decisions by type: for example, key appointments, major capital investments, new product launches, or acquisitions. By identifying the influences of the parent and by searching for patterns of success and failure, one can identify types of situations in which the parent's influence is positive or negative. (See the graph "Success and Failure Analysis.")

Performance analysis is yet another way of validating managers' judgments about fit. It involves reviewing the performance of each business in

comparison with its competitors. Businesses with comparatively poor results are probably not benefiting from, and may be hobbled by, the parent's influence. However, strategists must exercise care in reaching such conclusions. A business may be performing well or poorly without the parent having any significant influence on it. One must be sure that the performance is due to the parent's influence before using such evidence to assess fit. The real question is whether the business is performing better or worse than it would as a stand-alone, independent company. One way to make that judgment is to compare the performance of different businesses in a company's portfolio with their par return on investment, as predicted by the Profit Impact of Market Strategies (PIMS) methodology. PIMS is a research database of detailed information on thousands of business units, submitted by participating companies. One of the uses of the database is to provide par performance statistics for a business, based on responses to a questionnaire about its structural and strategic characteristics.

Profitability that is much higher or lower than par levels is a strong indication that the parent has had an impact. However, even then, strategists must understand to what extent the unusual performance is due to the influence of the parent.

The Fit Assessment at BTR

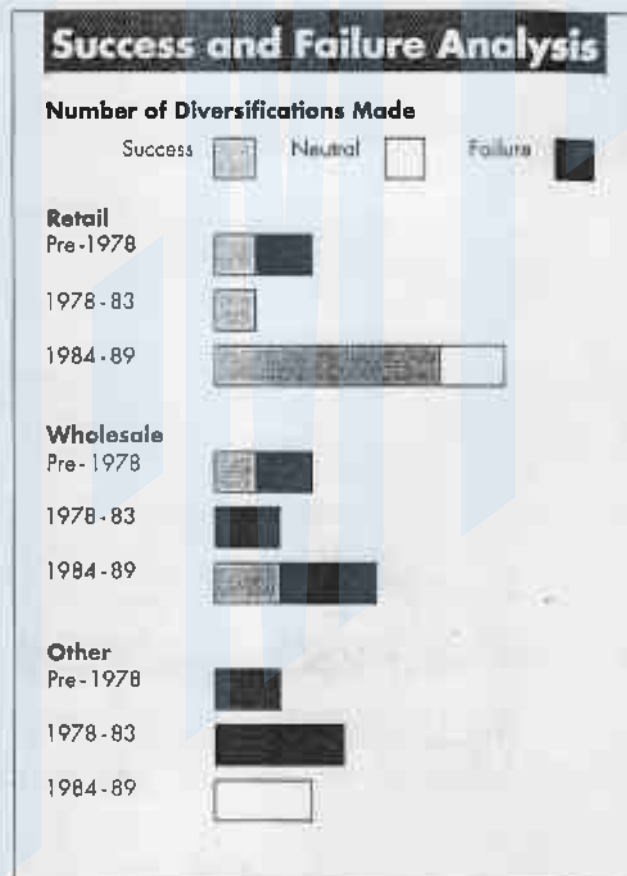
BTR, one of Great Britain's most successful companies, illustrates the importance of the fit between a parent and its businesses. In the industrial manufacturing businesses that make up the bulk of BTR's portfolio, the company's characteristics fit well both with the parenting opportunities that the company is targeting and with its businesses' critical success factors. BTR has gone from strength to strength, often achieving margins on sales in the 15% to 20% range, while competitors settle for 5% to 10%.

Sir Owen Green, managing director of BTR from 1967 to 1987, identified certain parenting opportunities in industrial manufacturing businesses. Particularly in mature niche areas, he found that businesses often underperform. Their financial information on product profitability may not tell them where they are making money and where they need to improve productivity. Their fear of losing customers may cause them to underprice, especially with larger customers. They may adopt a fill-the-factory mentality and pursue marginal sales, particularly in a recession. In an attempt to move away from mature product areas, they often diversify in a way that is wasteful.

Green learned from experience that BTR could improve those businesses' performance dramatically. For instance, by imposing a more rigorous budgeting and financial-reporting system, he encouraged business managers to pinpoint their richest profit sources, cut unnecessary costs, and achieve higher productivity. By pushing for price increases in line with or ahead of inflation, he showed managers how they could get higher prices from good customers. By focusing managers' attention on margins rather than sales, he helped managers shed the fill-the-factory mentality. By insisting on a tight business definition focused around the skills of the factory, he dissuaded managers from diversifying wastefully.

Over the years, BTR has developed parenting characteristics that fit its businesses, as described in the insert "Understanding the Parent." Green's insights, his commitment to giving managers responsibility for meeting profit targets, and his understanding of the critical success factors in industrial manufacturing businesses are now written into the *mental maps* that guide BTR's parenting.

BTR's structure comprises a large number of small, tightly defined, autonomous profit centers, each with its own management team. The company's renowned profit-planning process, which de-



mands detailed cost and profit information for every product line in every business, shapes its management systems. The process permits parent managers to challenge and stretch the profit targets of the businesses, to press for price increases and margin improvements, and to raise the standards of financial management throughout the company. The profit-planning process has become a powerful tool in the hands of the BTR parent managers, who have accumulated vast experience in interpreting the plans and comparing the performance of many similar profit centers.

BTR does not believe in large *central staffs* or *functional resources*. As Alan Jackson, BTR's current CEO, explains, "It is very important to remember that each business remains separate. We certainly do not have any non-sense like central marketing or group marketing directors. We do not blunt the edges of clear business-unit focus. That would be criminal." Corporate headquarters is small and concentrates mainly on financial control, with only 60 employees in London and similarly small groups in the corporate offices in the United States and Australia. The headquarters building is modest, and its furnishings seem to have changed little since it was built in the 1960s. The inscription on the boardroom clock epitomizes the company's culture: "Think of rest and work on."

The primary *skills* of the people in the parent organization involve motivating and controlling profit center managers and using the profit-planning process to improve their performance. Nearly all the BTR senior managers have long personal experience with industrial manufacturing businesses.

Finally, the *decentralization contract* gives profit center managers the freedom to make their own decisions, as long as their profit-planning ratios and bottom line are satisfactory. The parent interferes in running its businesses only when it sees ways to enhance performance.

"Our game is really in industrial manufacturing," Jackson comments. "We know how to set up a plant. We know how to get productivity improvements. We know how to downsize and squeeze when volumes fall." In such businesses, BTR is good both at seeing the parenting opportunities and at understanding the critical success factors.

BTR's approach, however, fitted less well with some of the distribution businesses it obtained as

part of larger acquisitions. That is not because there are no parenting opportunities to be found in cost reduction, productivity improvement, or pricing, which are BTR's forte. Rather, distribution businesses have some critical success factors that do not fit BTR's approach. "We have found that it is much harder to downsize distribution businesses

The words on the boardroom clock epitomize BTR's culture: "Think of rest and work on."

when volumes fall," Jackson explains. The BTR approach seeks to maintain margins even when volumes decline, which is often possible in industrial manufacturing because true fixed costs are a small percentage of the total. In some distribution businesses, the approach does not work because of the relatively high fixed costs associated with maintaining a distribution network. "As volumes fall," Jackson says, "we press for cost reductions, and that can be achieved only by closing depots. But closing depots causes further volume losses and weakens the rest of the network."

The financial results also indicate a poor fit between the parent and its businesses. BTR's distribution businesses have not outperformed competitors in the same way that its manufacturing businesses typically do. In manufacturing, BTR's return on

A structured analysis cannot replace judgment. Managers must be honest about their own strengths and weaknesses.

sales is frequently double that of the average competitor, while margins in distribution are closer to industry norms. "We have been less successful away from industrial manufacturing," Jackson says. "Distribution businesses need a different sort of philosophy." So he decided to divest some of BTR's distribution businesses, such as National Tyre Service in Great Britain and Texas-based Summers Group. The parenting opportunities in distribution businesses were not great enough to warrant a change in BTR's parenting approach.

The BTR example shows that fit assessments require difficult judgments about the parent's positive and negative influences. A structured analytical approach to making those judgments can help by breaking the problem into smaller elements and ensuring that analysts take all relevant aspects of the parent and the businesses into account. But analysis cannot replace judgment. Parent managers must be honest with themselves about their own strengths and weaknesses. Most companies will find they have a good fit with some portfolio businesses and a poor one with others. The challenge for the corporate strategist is to decide which changes in parenting are appropriate.

Making Changes to Improve Fit

To pull the judgments about fit together and rank a company's businesses, it helps to summarize the assessments into a matrix. (See the graph "Parenting-Fit Matrix for a Diversified Food Company.")

The horizontal axis of the matrix records how well the parent's characteristics fit the business's parenting opportunities – the first set of judgments made in the fit assessment. The vertical axis records the extent of any misfit between the parent's characteristics and the business's critical success factors – the second set of judgments made in the fit assessment. A good fit reduces the danger of destroying value in a business.

Each portfolio business can be located on the matrix. The matrix in our illustration plots the businesses of the diversified food company described in the table of critical success factors. Each position on the matrix has implications for the company's corporate strategy.

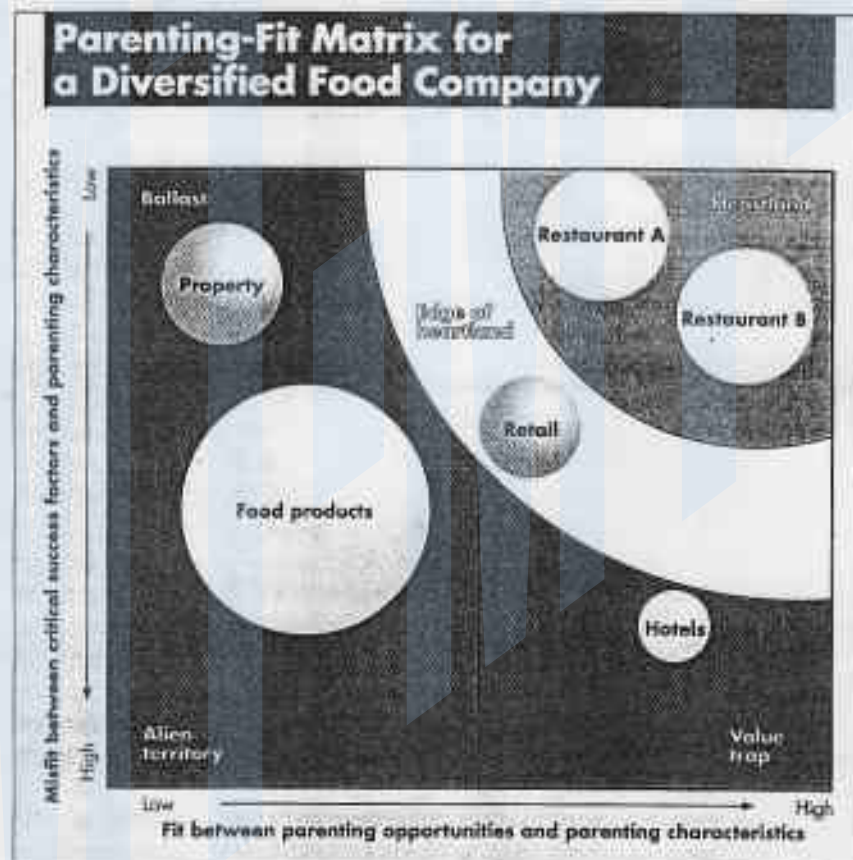
Heartland Businesses. Businesses that fall in the top right corner should be at the heart of the company's future. Heartland businesses have opportunities to improve that the parent knows how to address, and they have critical success factors the parent understands well.

In the case of the two restaurant businesses in the graph, the parent provides high-quality services in property development, food purchasing, menu management, and staff scheduling. The parent also has skills in formula brand-

ing, in setting performance targets that generate above-average restaurant margins, and in designing flat structures for chain operations that keep overheads per unit to a minimum. Furthermore, the parent does not have any characteristics that will destroy value; none of its characteristics conflict with the businesses' critical success factors.

Heartland businesses should have priority in the company's portfolio development, and the parenting characteristics that fit its heartland businesses should form the core of the parent organization.

Edge-of-Heartland Businesses. For some businesses, making clear judgments is difficult. Some parenting characteristics fit; others do not. We call those businesses, such as the retail business in the food-company example, *edge of heartland*. The parent's skills in staff scheduling, brand management, and lean organizational structures appear to add value to the business. However, the added value is partly offset by critical success factors that fit less well with the parent. For example, the retail business requires skills in site selection and property development that are different from those required for the restaurants. The parent's influence in those areas is probably negative. With edge-of-heartland businesses, the parent both creates and destroys value. The net contribution is not clear-cut. Such businesses are likely to consume much of the par-



ent's attention, as it tries to clarify its judgments about them and, if possible, transform them into heartland businesses.

Many edge-of-heartland businesses move into the heartland when the parent learns enough about the critical success factors to avoid destroying value. Sometimes that means changing the parent's behavior or the business's strategy, but often the solution is for the parent to learn when not to intervene and when to be sensitive to special pleas from the business.

When Unilever acquired Calvin Klein's perfume business, it adjusted its usual parenting approach to increase the potential for value creation. For instance, Unilever did not impose its famous human resource management processes on Calvin Klein, because it recognized that its managers and Calvin Klein's would not mix easily. Unilever also did not impose its marketing policies, which would have conflicted with Calvin Klein's. Calvin Klein, for instance, does not use market research to launch its upmarket perfumes in the same way Unilever does to launch mass-market products. Unilever treated Calvin Klein as a global business, while its own personal-products businesses are national or regional. To accommodate the differences between Calvin Klein and its other businesses, Unilever changed or neutralized many of its usual parenting influences and channeled most contact between the two companies through a single person.

Ballast Businesses. Most portfolios contain a number of *ballast businesses*, in which the potential for further value creation is low but the business fits comfortably with the parenting approach. That situation often occurs when the parent understands the business extremely well because it has owned it for many years or because some of the parent managers previously worked in it. The parent may have added value in the past but can find no further parenting opportunities. In the food-company example, the property business fits that category. The business owns a large number of sites that are leased to third parties. The company has little potential for adding value to the business operation because it has identified no parenting opportunities. It also has little potential for destroying value because the parent managers are so familiar with the property-business issues.

Most managers instinctively choose to hold on to familiar businesses. Sometimes that is the right decision, but it should always be examined. Ballast businesses can be important sources of stability, providing steady cash flow and reliable earnings. But ballast businesses can also be a drag on the company, slowing growth in value creation and dis-



While good parents are always fine-tuning their parenting, they r.

tracting parent managers from more productive activities. Moreover, there is a danger that changes in the business environment can turn ballast businesses into what we call *alien territory*.

Managers should search their ballast businesses for new parenting opportunities that might move them into heartland or edge-of-heartland territory. If that effort fails or if the parenting opportunities that are discovered fit better with a rival's characteristics, companies should divest the ballast business as soon as they can get a price that exceeds the expected value of future cash flows. Not surprisingly, that advice is difficult for most managers to take. Profitable businesses requiring little parent attention seem ideal. However, the risks of holding on to them may be substantial. Companies with too many ballast businesses can easily become targets for a takeover.

Alien-Territory Businesses. Most corporate portfolios contain at least a smattering of businesses in which the parent sees little potential for value creation and some possibility of value destruction. Those businesses are alien territory for that parent. Frequently, they are small and few in a portfolio—the remnants of past experiments with diversifications, pet projects of senior managers, businesses acquired as part of a larger purchase, or attempts to find new growth opportunities. But, in the food-company example, the largest business—food products—fits partly into alien territory, even though it is the company's original core business. The industry has become international, so the national business has become less competitive. The parent's managers have little international experience and have mostly come up through the restaurant side of



v rarely change in any fundamental ways.

the company. Their influence is more likely to destroy than to create value in the business.

Managers normally concede that alien-territory businesses do not fit with the company's parenting approach and would perform better with another parent. Nevertheless, parent managers often have reasons for not divesting them: the business is currently profitable or in the process of a turnaround; the business has growth potential, and the parent is learning how to improve the fit; there are few ready buyers; the parent has made commitments to the business's managers; the business is a special favorite of the chairman; and so forth. The reality, however, is that the relationship between such businesses and the parent organization is likely to be destroying value. They should be divested sooner rather than later. The company in our example should sell its food-products business to an international food company.

Companies need to be clear about their heartland before they can recognize alien territory. They also need to be clear about their alien territory in order to recognize their heartland. Hence, as companies describe their heartland businesses, they will give as many negative criteria—which are alien-territory criteria—as they do positive ones. For example, here is how managers at Cooper Industries describe their heartland: manufacturing businesses, metal-based manufacturing in particular rather than service or assembly; businesses with proprietary products and strong technology; cell-based manufacturing, not continuous process; businesses whose marketing

and distribution costs are less than manufacturing costs; businesses with strong market positions; businesses large enough to support Cooper's overhead; and businesses with no intractable environmental or union problems. The criteria help Cooper strategists sort among heartland, edge-of-heartland, and alien-territory businesses and improve their acquisition and divestment decisions. Cooper has exited a number of businesses that did not fit its criteria. Most recently, it proposed divesting its original business—oil tools.

Value-Trap Businesses. Parent managers make their biggest mistakes with *value-trap businesses*. They are businesses with a fit in parenting opportunities but a misfit in critical success factors. The

Managers make their biggest mistakes with businesses that fit in parenting opportunities but not in critical success factors.

potential for upside gain often blinds managers to the misfit—that is, downside risks.

In the food-company example, the hotel business is a value trap. The parent believed its restaurant and retail skills would bring success in the hotel business. Management initially saw it as an edge-of-heartland experiment, with parenting opportunities in food purchasing, property-development costs, and performance benchmarking. But value

was destroyed in other vital areas. Hotel businesses require selling skills, referrals from other businesses, and specialized site selection. The parent's influence in those areas proved highly negative, and, five years after its acquisition, the business is probably worth half the capital invested in it.

The logic of core competence can push parent managers into value traps as they strive for growth through diversification. In Europe, many privatized utility companies have created engineering consultancies and construction companies on the basis of their competence in engineering and managing large construction projects. But the parent organizations' bureaucratic policies, planning systems, and decision processes, which are geared to their capital-intensive base businesses, proved to be severe disadvantages for the new businesses. The parents burdened their businesses with unreasonable overheads, restrained them from paying appropriate salaries, encouraged them to overspend on balance-sheet items, and prevented them from grasping market opportunities in a timely manner. What sounded like a synergistic core competence has led the parents into a value trap.

Changing Parenting Characteristics

Faced with a spread of businesses across the parenting-fit matrix, as in the graph, managers might assume that they should change the skills and resources of the parent organization in order to move all their businesses into the top right corner. Our research suggests, however, that parenting characteristics are built on deeply held values and beliefs, making changes hard to implement. Good parents constantly modify and fine-tune their parenting, but fundamental changes in parenting seldom occur, usually only when the chief executive and senior-management team are replaced.

It is also difficult for parent organizations to behave in fundamentally different ways toward different businesses in their portfolios. The interlocking nature of parenting characteristics, pressures for fair and equal treatment of all businesses, and deeply held attitudes all mean that a parent tends to exert similar influences on all its businesses. Alan Jackson's recognition of the difficulties likely to arise from treating BTR's distribution and manufacturing businesses differently persuaded him to sell the distribution businesses rather than compromise the corporate philosophy.

Companies are coming to understand that it is often easier to change the portfolio to fit the parent organization than to change the parent organization to fit the businesses. That realization accounts

for the rise in demergers and corporate-level break-ups. ICI, for example, chose to divide into two portfolios rather than attempt to be a good parent to businesses with widely different parenting needs.

The process we have described is a structured means of creating corporate-level strategy. Critical-success-factor analysis identifies areas in which the parent's influence is inappropriate. Parenting-opportunity analysis focuses attention on the upside potential. The parenting-fit matrix ranks the businesses, exposing those with lower levels of fit.

The most immediate benefit that companies receive from such analyses is identifying misfits. With that knowledge, they start to reduce the impact of bad parenting techniques and exit alien-territory businesses. Additional value creation comes from focusing on the best parenting opportunities and developing the parenting skills to match. But it is a long-term challenge requiring the parent to learn new skills. Moreover, maintaining fit is a dynamic process. As the needs of the businesses change, the parent organization must continually review its behavior and its portfolio of businesses.

Companies without sound corporate-level strategies gradually lose strength and fall prey to hostile predators or become emaciated from periodic downsizing and cost cutting. Excessive overhead consumes profits, businesses that do not fit lose ground to competitors, and decisions are guided by the wrong criteria. Management fads, cash availability, or business-level performance—rather than parenting fit—influence acquisition decisions. Bureaucratic tidiness, arbitrary cost targets, or organizational politics—rather than value creation—influence changes in the parent.

Companies with sound corporate-level strategies create value from a close fit between the parent's skills and the businesses' needs. The best companies, however, do more. They strive to be the best parents for the businesses they own—to create more value than rivals would. They are on a quest for parenting advantage.

Just as the concept of competitive advantage has been one of the greatest contributors to clearer thinking about business-level strategy, we believe the concept of parenting advantage can achieve the same for corporate-level strategy. Parenting advantage not only drives planning; it also helps executives make decisions. Will an acquisition, divestment, corporate function, coordination committee, reporting relationship, or planning process enhance parenting advantage? If not, it should be reexamined and new ideas generated. □

Reprint 95202

Corporate Strategy and Parenting Theory

by

Michael Goold, Andrew Campbell and Marcus Alexander

The Ashridge Strategic Management Centre

In November 1987, the Ashridge Strategic Management Centre was established, with the mission of carrying out research focused on corporate-level strategy and the management of multi-business companies. In November 1997, we ran a major conference to review what we had learned during the last decade. Since Brief Case has reported piecemeal on a variety of the research initiatives that we have carried out during this time, we felt that it would be appropriate to publish the background paper that we prepared for the conference, which gives a brief overview of the main propositions that we believe we have established. We would very much welcome comments on these propositions: Which do you agree or disagree with? Which are most or least important? What areas merit further research and investigation?

This paper provides a brief summary of what we at the Ashridge Strategic Management Centre believe we have learned about corporate strategy over the last ten years. It lays out the basis for our ideas about corporate parenting and the implications of parenting theory for management decisions. It is structured around nine propositions, each of which attempts to convey both what we have learned and why it matters. The paper concludes with our views about where future research priorities should lie.

1. JUSTIFYING THE PARENT

What we have learned

In multibusiness companies, the existence of a corporate parent, by which we mean all those levels of management that are not part of customer-facing, profit-responsible business units, entails costs. These costs, which include not only corporate overheads but also knock-on costs of corporate reporting in the businesses, are not balanced by any direct revenues, since the corporate parent has no external customers for its services. Furthermore, the business units often feel that they could be independently viable and, indeed, could do better without a corporate parent. This belief is given credence by the success of so many management buy-outs and spin-off companies.

The parent can therefore only justify itself if its influence leads to better performance by the businesses than they would otherwise achieve as independent, stand-alone entities. It must either carry out functions that the businesses would be unable to perform as cost-effectively for themselves or it must influence the businesses to make better decisions than they would have made on their own. In other words, the parent must add more value than cost to the businesses in the portfolio. The logic of the need to add value is now becoming more widely accepted. However, there are still relatively few companies whose corporate strategies are based on powerful and convincing sources of value creation.

Why it matters

The challenge to corporate parents to justify themselves is important because it concentrates attention on whether and how the activities of the parent do add value. Rather than assuming the existence of a corporate parent, and then asking what the businesses can do for it, it places the onus in precisely the opposite direction. Now the key question is what the parent can do for the businesses, and whether it can positively demonstrate that its undoubted costs are more than offset by tangible benefits for the businesses. For many corporate parents, this

has been a new perspective, and has led to the elimination of worthless, bureaucratic routines and a sharper concentration on those things that genuinely add value.

PROPOSITION: Many of the business units in multibusiness companies could be viable as stand-alone entities: To justify its existence, the corporate parent must influence the businesses collectively to perform better than they would as stand-alone entities.

2. PARENTING ADVANTAGE

What we have learned

Since corporate parents exist in a competitive world, in which ownership of businesses is transferable, adding some value is not a sufficient justification for the corporate parent. Ideally, the parent must add more value than other rival parents would: otherwise all stakeholders could be made better off through a change in ownership of the businesses to a superior parent.

The force of this objective is evident when companies face the possibility of a hostile acquisition. But, even if there is no imminent threat of a take-over, the aspiration to add as much value as possible to all the businesses in the portfolio should remain the ultimate goal. Businesses whose competitors have parents that add more value are at a disadvantage, which will eventually be reflected in their results.

Why it matters

The objective of adding more value than other rival parents, which we refer to as achieving "parenting advantage", is important because it provides a sound and powerful guiding objective for corporate strategy. All too often other objectives, such as achieving a faster rate of growth, balancing the portfolio between sectors or geographies, spreading risk, or simply survival, take precedence over parenting advantage, and lead to poor decisions. These other objectives are not in themselves wrong, but can lead corporate parents to forget that parenting advantage should be in centre stage and, hence, to take decisions that have nothing to do with added value. Parenting advantage should be the guiding criterion for corporate-level strategy, rather as competitive advantage is for business level strategy.

PROPOSITION: Parent companies compete with each other for the ownership of businesses: The objective of corporate strategy should be to add more value to the businesses in the portfolio than other rival parent organisations would.

3. VALUE DESTRUCTION

What we have learned

Corporate hierarchies inevitably destroy some value. Apart from the obvious issue of corporate overheads, the main problems relate to ill-judged influence from senior managers and to information filters.

Since senior corporate managers must divide their time between a number of businesses in the portfolio, they will always be less close to the affairs of each business than its own management team. Inevitably, there is a danger that their influence will be less soundly-based than the views of the managers running the businesses.

Corporate hierarchies encourage business managers to compete with each other for investment funds and for personal promotion. Business managers therefore tend to filter the information they provide to divisional and corporate management, in order to present their businesses in the most favourable light. The information on which corporate managers must base their influence and decisions tends to be systematically biased.

The corporate centre also tends to be insulated from the sort of critical examination of cost effectiveness that other parts of a company routinely receive. Processes to assess net corporate value added are seldom well-developed, and power relationships in the corporate hierarchy mean that it is hard for the businesses to express their views openly. Central costs have a tendency to creep upwards and unproductive central interference goes unchecked.

Extra costs and negative influence are therefore pervasive features in all multibusiness organisational hierarchies and can only be offset by substantial value creation in targeted areas (see proposition 5). Research with a wide cross-section of companies in the US, Europe and Asia-Pacific has provided many specific examples of the phenomenon.

Why it matters

This observation is important because it should lead corporate parents to be more disciplined. They should avoid intervening in businesses unless they have specific reasons for believing that their influence will be positive. They should avoid extending their portfolios into new businesses unless they have good grounds for believing that they will be able to add value to them. They should seriously consider demerging or spinning off businesses that do not fit well with their skills. And they should be willing to downsize or eliminate corporate functions unless they have a clear added-value role.

This perspective provides a counterweight to ill-focused and over-ambitious corporate strategies. Previously, it was too easy for corporate parents to feel that simply going through the budget or capital expenditure review process "must be good for the businesses" or that diversifying into more glamorous or more rapidly growing sectors "must be good for investors". Now we know better, since we can see that good corporate strategy is as much about avoiding value destruction as it is about maximising value creation.

PROPOSITION: All multibusiness organisations have inherent and pervasive tendencies to destroy value: Corporate strategies should recognise these tendencies and be designed to minimise value destruction as much as to maximise value creation.

4. LATERAL SYNERGIES

What we have learned

Since Ansoff's pioneering work on synergy, most businessmen and management thinkers have justified multibusiness companies because of the existence or potential for lateral linkages between their businesses. Managers at the centre have believed that their main role is the creation of synergy.

Our research, in contrast, has shown that parent managers are often pursuing mirages rather than real synergy opportunities, and that their interventions in the lateral relationships between businesses are often net negative rather than net positive. Furthermore, most "synergies" are available between independent businesses. A common parent is not necessary for two or more businesses to trade with each other, form alliances or joint ventures, licence technology, share benchmarks and best practice, pool negotiating power, share services, coordinate strategies or combine to create new businesses. Only a few synergies require a common parent to be effectively implemented. We have also observed that, for many multibusiness companies, the main source of added value stems from the relationship between the centre and each business as a stand-alone entity. We have, therefore, concluded that the value potential of synergies has been systematically over-rated by managers, academics and consultants.

Why it matters

This observation is important because it should change the mindset of corporate centre managers. Instead of "desperately seeking synergies", centre managers should be focusing their efforts only on those synergies that need central intervention. Instead of actively fostering a "one enterprise" or "one family" philosophy, centre managers should usually be encouraging "market place" relationships between business units. Instead of supporting "corporate centre creep", in which activities graduate to the centre in the name of synergy, centre managers should be vigilant in avoiding interventions unless they are clearly beneficial. This change in mindset will focus central management time on those synergies where the parent has a real role to play. It may also free time for value creating influence on businesses as stand-alone entities.

The change in mindset will also reduce the amount of value destroyed from "contamination". Contamination occurs when two businesses with different critical success factors are encouraged to work closely together in the name of synergy, and pollute each other's thinking and strategies. The loss of focus and muddled thinking that results can end up hurting both businesses.

PROPOSITION: The importance of lateral synergies in creating value in multibusiness companies has been systematically overrated: Corporate parents should pay relatively more attention to other sources of value creation, in particular their ability to improve performance in each individual business as a stand-alone entity.

5. VALUE CREATION

What we have learned

Value creation only occurs under three conditions:

- the parent sees an opportunity for a business to improve performance and a role for the parent in helping to grasp the opportunity
- the parent has the skills, resources and other characteristics needed to fulfil the required role
- the parent has sufficient understanding of the business and sufficient discipline to avoid other value-destroying interventions.

The most successful parents concentrate their attention on a few large areas of opportunity rather than attempting to intervene more broadly: in this way they can both develop distinctive skills that are specially suitable for the opportunities they are targeting and avoid dissipating their energies on issues where their contribution will have low or negative value.

Although competitive pressures should weed out businesses that persistently underperform, opportunities for a corporate parent to add value are not uncommon. They arise when

- weaknesses in business managers are causing underperformance
- the business managers face opportunities that even a competent management team will find difficult to seize without help from the parent
- the parent possesses some special resources that open up new opportunities for the businesses.

Our emphasis is on the skills or competences of the parent and the extent to which they fit with the opportunities in the businesses. It is parenting competences or resources, what the parent can do to make a difference, that explain successful corporate strategies. The broader notion of core competences, though useful, fails to highlight the role to be played by the parent.

Why it matters

The conditions for value creation are important, because they force corporate parents to think through what major opportunities for added value lie behind the corporate strategy. If no such opportunities have been identified, the strategy is bound to be fatally flawed.

They also help corporate parents to focus their activities. By giving prominence to a few major opportunities, corporate priorities can be clarified, irrelevant or value destroying activities can be eliminated, and time and attention can be devoted to building up the competences that the parent needs most. By not trying to do everything, the parent can become specially good at doing the things that really matter.

The objective of building parenting competences that fit well with particular opportunities also gives a sharper and more practical basis for competence development at the parent level. The often fruitless quest for nebulous core competences can be replaced with a much more targeted agenda for the skills, resources and processes that the corporate parent needs most.

Lastly, an emphasis on the distinctive insights and skills possessed by the parent is valuable because it underlines how much the success of any corporate strategy depends on the experience, capabilities and attitudes of the CEO and his team. The personal views and qualities of the CEO need to be a primary criterion in selecting the corporate strategy.

PROPOSITION: Value creation seldom occurs unless the corporate parent perceives a few large opportunities for business performance enhancement, and develops distinctive skills, resources and influencing processes that address these opportunities: Corporate parents should focus their efforts on building special competences that fit the particular opportunities they are targeting.

Guidelines to Corporate Governance and the Board of Directors

First of all big board with many board members and with many cousins on the board tend to turn the Board into a highly political playing field. Cousins coming from cousin consortium also tend to act politically on the Board by represent their cousin branch on the board in a very "constituent" way thus undermining Board Agenda with hidden agenda.

It is best that these cousin branches are represented in the Family Council and not the BoD. Nevertheless, a few key family representatives should be appointed by the Family Council to the BoD so as to represent the family interest in general.

External Board Members: Family shareholders should be able to recognise the value in having the objective, professional experience of external board members. The addition to the board of "non-aligned" external members to help change the dynamics of board discussions to be more objective and constructive. By "non-aligned" we mean external independent Directors who are not loyal to any particular branch of the family or to any particular management alliance or to any particular supplier, service provider or financiers to company.

Smaller boards, not dominated by family members, tend to work better. As a principle, one has to aim to the ideal that all board members get focused on the best interest of the company, not on the interests of any particular individual or branch of the family.

A large family company board should have a maximum of 8 and a minimum of 5 members. Definitely not more than 8. The larger number permits more diversity of opinion. Beyond this number risks reducing the impact of individual board members and this reducing their sense of responsibility for board decisions.

The board should include the CEO of the company, a majority of external board members (meaning not family members or company managers), and a small number of family representatives. Family representatives are not necessarily family owners and may or may not

be family managers. Family board representatives may be chosen by the shareholders, the family assembly or the family council. **It is complicated to put on the board family managers who are working their way up the organisation ladder.** Their supervisors too often complain that it is not clear if these family managers report to them or vice versa. **I advise against putting family managers on the board until they are in very senior positions or are the official designated successor and close to assuming the top leadership role.**

The board should not include the company's service providers, suppliers, etc (eg, banker, lawyer, accountant). The Leader, Chairman or CEO should also resist enrolling on the board the board friends of the CEO, or the board friends of other family members, or the board friends of other company managers. **Company managers tend to steer discussion to operations issues and make it difficult for the other board members to openly evaluate the quality of company management.**

Because company managers can be present for as much of the board discussion as the board feels is valuable, there are no clear advantages to having company managers serve as board members. Some exceptions may exist to the above, but I need to be convinced about it with factual evidence.

The board meeting can best fulfill its duty by meeting once each quarter for one or more days.

Short more frequent board meetings rarely accomplish the objectives of the Board.

One board meeting each years should be a joint board-management retreat (mid-way in the company's planning cycle) to plan the next year's activities. Only family members or in-laws should be on the Family Council.

I have to clarify why I have suggested that outsider directors or external directors or what are called independent non-executive directors be appointed on the Board.

External directors have the sole purpose of enhancing the business' success. When external independent members are on the board, their strategically relevant experience will enable the Board to engage more in constructive conflict by offering informed but

differing points of view. It is also more likely to improve decision comprehensiveness by adding richness to discussions. Having a good balance of outside directors and family members on the board can provide the organization with the constructive conflict and richness in discussions necessary for considering issues faced by the family business. The company can get access to managerial competence, valuable input such as new ideas and perspectives, and extend its informal strategic networks. Such outside directors will also enable the Board to think outside the box. It will also help the Board see the business from a neutral unbiased and balanced perspective which does not give advantage to any particular executive board member who has an intrinsic interest in the company.

To be truly outside members, these directors must not be the legal, accounting, auditing, etc. counterparts hired by the business to perform various functions. These individuals have a personal stake in the company, which may create a conflict of interest and may not allow them to perform their job as a director very objectively. In general, it is useful to exclude from consideration the following types of individuals: anyone who has a conflict of interest in being an advisor to the company; suppliers or vendors to the company; friends of the owners who have no relevant experience to offer; anyone who will be a "yes-man;" anyone who is already overcommitted and would not be able to devote attention to this role; and existing providers of service to the company (since their advice is available in other forms).

The composition of the external directors should reflect the mix of skills or experience needed to balance competences required on the Board. The key factor for an external member on the board is the willingness and ability to provide objective expertise to guide the business.

For example, external directors of the company might consist of the CEO of a successful hotel chain, a former engineering company executive with experience in expanding his company's products and a finance expert not affiliated with the business, if those individuals have valuable expertise and advice to offer.

All board members should be able to be assessed by the Audit Committee whether they are internal or external directors (non-executive directors)

External directors (non executive directors) should be evaluated on the following criteria:

- ☐ How well prepared and informed are the non-executive directors for board meetings? Is their meeting attendance satisfactory?
- ☐ Do they demonstrate a willingness to devote time and effort to understand the company and its business? Do they have a readiness to participate in events outside of the boardroom such as site visits?
- ☐ What has been the quality and value of their contributions at board meetings?
- ☐ How successfully have they contributed to strategy development and risk management?
- ☐ How effectively have they tested the information and assumptions with which they are provided? How resolute are they in maintaining their own views and resisting pressure from others?
- ☐ How effectively and proactively have they followed up on any areas of concern?
- ☐ Does their performance and behaviour engender mutual trust and respect within the board?
- ☐ How actively and successfully do they refresh their knowledge and skills? Are they up to date with market and regulatory developments?
- ☐ Are they able to present their views convincingly yet diplomatically? Do they listen and take on board the views of others?

To be able to know if non-exec directors are REALLY independent the following questions have to be asked about each of these directors:

- ☐ Has he been an employee of the group within the last five years
- ☐ Has he had a material business relationship with the company within the last three years
- ☐ Does he receive additional remuneration apart from director's fee; is in company share option or performance-related pay scheme; or a member of the company's pension scheme
- ☐ Has he close family ties with any of the directors, senior employees or advisers
- ☐ Does he hold cross-directorships/has significant links with other directors
- ☐ Does he represents a significant shareholder
- ☐ Has he served on the board for more than nine years
- ☐ Has he got interests in other organisations competing with the company or with suppliers or subcontractors

At a general level, I believe that assessment of the Board by Shareholders and the Audit Committee should be based on:

- ☐ Clear strategy aligned to capabilities
- ☐ Vigorous implementation of strategy
- ☐ Key performance drivers monitored
- ☐ Effective risk management
- ☐ Sharp focus on views of City and other key stakeholders
- ☐ Regular evaluation of board performance

Also any director can be assessed by the company Audit Committee in terms of his behavioural characteristics eg:

- ☐ Asks the difficult questions
- ☐ Works well with others
- ☐ Has industry awareness
- ☐ Provides valuable input
- ☐ Is available when needed
- ☐ Is alert and inquisitive
- ☐ Has business knowledge
- ☐ Contributes to committee work
- ☐ Attends meetings
- ☐ Speaks out appropriately at board meetings
- ☐ Prepares for meetings
- ☐ Makes long-range planning contribution
- ☐ Provides overall contribution

So shareholders can know that all directors are doing what is right for them by evaluating directors on the above checklists.

QUESTION: What are the authorities for the BOD if there are many outsiders, their real authorities, I mean they don't own shares so how do they get their power, and how come

shareholders especially a family leaves everything in the hand of majority outsiders?

ANSWER: I know that this might sound a bit crazy for the company to have a majority of outsiders on the Board. But it does not mean that because these directors are outsiders they will all block vote together in favour of anything in the interest of any of them. Outsiders are there to give a balanced dialogue and decision making process. Mechanisms can still be established to ensure that the final say still lies in the hands of family executive directors. Veto power is one of them. Also an arrangement can be made where the outsider directors would not have a voting right on certain types of decisions. However, what is important for the company at this stage is to start rolling out this initiative. Even if it has a minority number of external independent directors eg. 2 external directors, it will start giving a different perspective to the Board. The Chairman can then take it from there according to his experience of the initial success of the experiment, whether to increase the number of outside directors or not.

Another alternative is to have a Council of Advisors who will play the same role of the executive directors but without the powers. The Advisors can give advice to the Chairman and CEO and meet independently. However, sometimes this option may not be feasible to the company because it may complicate the company structure especially if the organisation is still relatively small.

Martin Testa