THE STRATEGIC PLANNING PROCESS, PART 2

The second of two articles that focus on applying your knowledge of management and strategy to a scenario situation. Part 1 considered the complexities of strategic planning and how they can be broken down into three main areas. Part 2 adopts a similar simplification approach to the issues of strategic choice and strategic implementation

One of the main problems faced by students on Paper P3 is application of knowledge. Early on in their preparation most students feel comfortable with all that is discussed in Paper P3 and many develop a false sense of security preferring to concentrate on what seems to be an overwhelming amount of information for Papers P2, P4 or P6. It is only when students enter the revision phase do they realise that you need to do much more than just learn the notes in order to pass the exam. The main skill that a student needs to develop is an ability to apply the acquired knowledge in a scenario situation. The following provides an insight into how to apply your knowledge effectively.

In the previous article we established how the complexities of strategic planning could be broken down into three main areas:

1. Strategic analysis
2. Strategic choice
3. Strategic implementation

The previous article comprehensively explained strategic analysis by breaking it down into three questions:

- Where do we want to go? (Think stakeholder constraints)
- What constraints exist on our resources? (Think 6Ms)
- What are the key threats from the external environment? (Think PESTEL and five forces)

In this article we are going to try to adopt a similar simplification approach to the issues of strategic choice and strategic implementation.

Strategic choice

Johnson and Scholes break down the issue of strategic choice into three distinct subheadings, which are:

- On what basis do we decide to compete?
- Which direction should we choose?
- How are we going to achieve the chosen direction?

On what basis do we decide to compete?

A useful framework to use here is Porter's generic strategies. Michael Porter stated that a firm that is wishing to obtain competitive advantage over its rivals is faced with two choices:
Choice 1: Is the company seeking to compete by achieving lower costs than its rivals achieve and by charging similar prices for the products and services that it offers, thereby achieving advantage via superior profitability? Or…
Is the company wishing to differentiate itself and the customer is prepared to pay a premium price for the added value which the customer perceives in the product, and thereby enjoys greater margin than the undifferentiated product.

Choice 2: What is the scope of the area in which the company wishes to obtain competitive advantage? Is it industry-wide or is it restricted to a specific niche?
The answers to these two choices leave the organisation faced with three generic strategies, which are defined as:

1. cost leadership
2. differentiation
3. focus.

1. Cost leadership

Set out to be the lowest cost producer in an industry. By producing at the lowest possible cost the manufacturer can compete on price with every other producer in the industry and earn the highest unit profits.
In order to achieve cost leadership some of the following need to be in place:

- Seek to set up production facilities for mass production as these will facilitate the economies of scale advantages to be achieved.
- Invest in the latest technology – improved quality less labour needed.
- Seek to obtain favourable access to sources of raw materials.
- Look to develop product designs that facilitate automation.
- Minimise overhead costs by exploiting bargaining power.
- Concentrate on productivity objectives and constantly seek to improve efficiency and economy – for example, ZBB, value chain analysis.

One should also be aware of the drawbacks of such a strategy, such as the need to continually keep up to date with potential changes in technology or consumer tastes.

2. Differentiation

A firm differentiates itself from its competitors when it provides something unique that is valuable to buyers. Differentiation occurs when the differentiated product is able to obtain a price premium in the market that is above the cost incurred to create the differentiation.
As a consequence of differentiation being about uniqueness, it is not really possible to give an exhaustive list detailing how a firm may differentiate itself. To truly differentiate yourself we must understand the product or service offered and the customer to whom you are selling it.

Ways of achieving differentiation

Image differentiation

Marketing is used to feign differentiation where it otherwise does not exist – ie an image is created for the product. This can also include cosmetic differences to a product that does not enhance its performance in any serious way – for example, perfume – colour, size, packaging.

Support differentiation

More substantial, but still has no effect on the product itself, is to differentiate on the basis of something that goes alongside the product, some basis of support.
This may have to do with selling – for example, 0% finance, 24-hour delivery.

Quality differentiation

This means the features of the product that make it better – not fundamentally different, but just better. The product will perform with:

- greater initial reliability
- greater long-term durability
- superior performance.

Design differentiation

Differentiate on the basis of design and offer the customer something that is truly different as it breaks away from the dominant design if there is one – for example, Apple's iMac computer.

Reward of a differentiation strategy

Consumers are likely to pay a higher price for the goods because of the added value created by the differentiation.

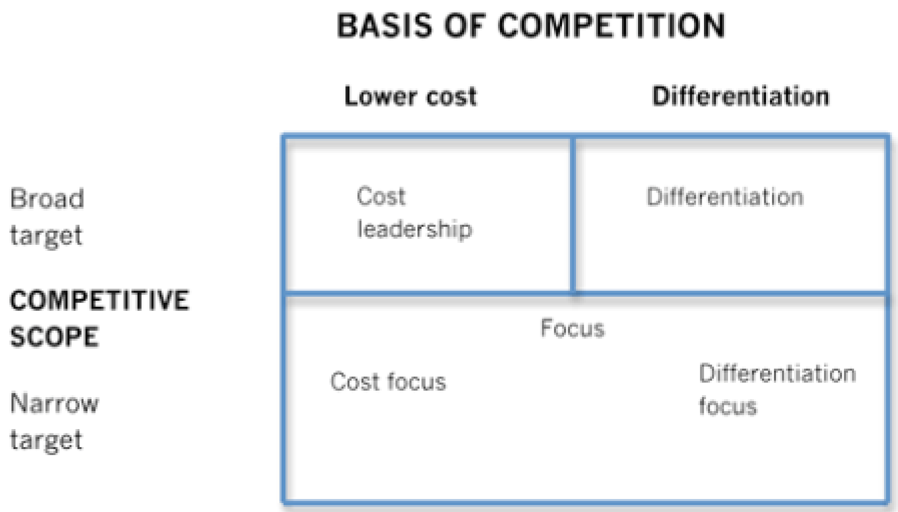
3. Focus

A focus strategy is based on fragmenting the market and focusing on particular market niche. The firm will not market its products industry-wide but will concentrate on a particular type of buyer or geographical area.

Cost focus: This involves selecting a particular niche in the market and focusing on providing products for that niche. By concentrating on a limited range of products or a small geographical area, the costs can be kept low.

Differentiation focus: Select a particular niche and concentrate on competing in that niche on the basis of differentiation – for example, luxury goods.

This can be summarised in the following diagram:



We stated that the alternative directions available to a business could be described in general terms as follows:

1. Do nothing
2. Withdrawal
3. Market penetration
4. Product development
5. Market development
6. Diversification

Do nothing

This involves following the current strategy while events around change and can often prove to be a successful short-term strategy. Basically, if an organisation is exposed to some form of competitive threat, its short-term objective is to not react and, hence, get involved in what could be an expensive decision.

Sell out/withdraw from the market

This may be followed so as to maximise the return on a business that may be at the top of its cycle and, hence, will be in line with the goal of maximisation of cash flows. Withdrawal from a business sector may be chosen to give the business more focus – for example, Richard Branson's decision to sell his original business Virgin Records to concentrate on the airlines business.

Market penetration

This involves increasing the market share in the current market with the current product. Market share can be enhanced by such techniques as improved quality, productivity or increased marketing activity.

Product development

This involves introducing a new product into the current market. The product change is often the result of changes and modifications to an existing successful product – for example, Mars ice cream. This is an alternative to the present product and builds on present knowledge and skills.

Market development

In this case the organisation keeps its tried and tested products but aims to apply them to different market segments. This strategy maintains the security of the present product while enabling extra revenue to be generated from new segments – for example, McDonald's and its geographic market development.

Diversification

This is the most risky of the product market strategies as it involves the introduction of a totally new product in a new market. Diversification can either be related or unrelated.

Related diversification

This involves development of the product and market but still remaining within the broad confines of the industry. There are three main types.

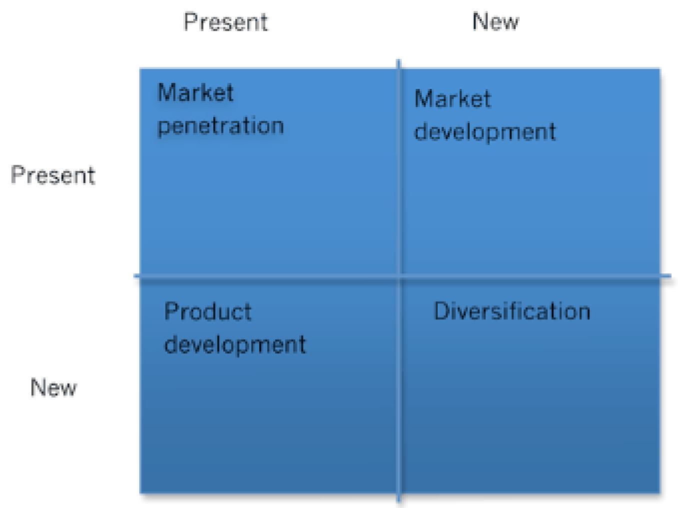
1. Backward. A development into the business that inputs into the present business – for example, move up the supply chain into raw material inputs.
2. Forward. A development into activities concerned with a company's outputs also called downstream integration – for example, move down the supply chain into distribution activities.
3. Horizontal. Movement into activities that are competitive with existing activities – for example, to benefit access to market or technology.

Unrelated diversification

This involves movement into industries that bear little relationship to the present one and is often the result of a profit motive.

Ansoff represented the last four choices in his product/market matrix.

Ansoff's product market matrix



How?

The final problem that must be overcome is to decide how the chosen strategic option should be undertaken.
The options available are:

- internal development
- external development/acquisition
- joint development.

Internal development

Reasons

Often undertaken to maintain the present equilibrium within the company as it is much less disruptive than an acquisition. Another reason may be that there is not sufficient finance available for an acquisition or that the government may prevent acquisition/merger through legislation.

Acquisitions

- If there is sufficient finance available an acquisition will provide a very quick way of providing access to new product/market areas and the new organisation will have economies of scale advantages.

Joint development

A formal agreement between two or more organisations to undertake a new venture together – for example, Airbus (spreading of cost).

Methods of joint development

- *Consortia*. Two or more firms working together to share the costs and benefits of a business opportunity.
- *Joint venture*. A separate business entity whose shares are owned by two or more business entities.
- *Strategic alliance*. A long-term agreement to share knowledge, technology or business opportunities.
- *Franchising*. The purchase of the right to exploit a business brand in return for a capital sum and a share of profits or turnover. The franchiser also usually provides marketing and technical support to the purchaser of the franchise.

- *Licensing*. The right to exploit an invention or resource in return for a share of proceeds. Differs from franchise because there will be little central support.

To summarise, we can use Figure 1. Once all the alternative options have been generated we need to evaluate their appropriateness before making a choice. A useful framework to apply when considering the appropriateness of an option is:

- suitability
- feasibility
- acceptability

Suitability

Suitability identifies the extent to which the proposed strategy enhances the situation identified in the strategic analysis. The following questions need to be addressed about the strategic options:

- Does it close the planning gap?
- Does it address threats and weaknesses?
- Does it build on identified strengths and exploit opportunities?
- Does it fit in with the organisation's mission?
- Will the portfolio remain balanced?

Feasibility

The issue of feasibility evaluates whether the chosen strategy can be implemented successfully. The resources the organisation has at its disposal will obviously determine this. To save time, simply think about the 6Ms.

Acceptability

The final issue to address is whether the selected strategy will meet the expectations of the key stakeholders in the firm and typical issues to be looked at would include the level of risk and return resulting from the option.

Remember that in the exam it is unlikely that you are going to get a question that asks you to regurgitate the information on strategic choice in the way in which I have just explained to you. Questions will normally touch on some part of the process we have described and if you have an in-depth understanding of everything that we have covered you will be able to construct much more comprehensive arguments in the exam. We will show this in a previous exam question later.

Strategic implementation

The area of strategic implementation covers many areas from project management to structure. However, as with strategic analysis and strategic choice, it is possible to simplify the issues in to a number of key sub-headings:

- Resource management.
- Organisational structure.
- Management of change.

Resource management

This will ensure that the 6Ms are working for you in the best way possible. Budgets and other performance management tools are likely to be used here.

Organisational structure

This will deal with issues regarding the levels of centralisation and decentralisation, together with structural form and style of management.

Management of change

The scope, speed and style of the changes need to be carefully reviewed in order to obtain full commitment to them. A useful model of change to remember is Kurt Lewins' three-step model, which involved:

- unfreeze
- change
- refreeze.

Unfreeze

For the change to take place the existing equilibrium must be broken down before a new one can be adopted.

Change

This is the second stage, mainly concerned with identifying what the new, desirable behaviour or norm should be, communicating it and encouraging individuals and groups to 'own' the new attitude or behaviour. To be successful, one should consider the adoption of the following management styles to improve the acceptance of the change:

- Participation with employees affected by the change, so that they feel more of a sense of ownership.
- Education and communication of the new ways, so that they fully understand what is going on and are not in a situation where they are afraid of the unknown and therefore show resistance.
- Negotiation may also be appropriate if there are large group stakeholders such as a trade union.

Refreeze

This is the final stage, implying consolidation or reinforcement of the new behaviour. Positive reinforcement (praise, reward, etc) or negative reinforcement (sanctions applied to those who deviate from the new behaviour) may be used. You should also look at the Change Kaleidoscope and Cultural Web

Therefore to summarise what we have just said:

Strategic choice

On what basis do we decide to compete? (Porter's generic strategies.)

Which direction should we choose? (Ansoff's product market matrix, do nothing, withdraw.)

How are we going to achieve the chosen direction? (Internal external joint venture.)

Strategic implementation

Resource management (6Ms)

Organisational structure (centralisation, decentralisation, specific structural form)

Management of change (unfreeze, change, refreeze)

Let us see how we can expect to get questioned in this area in the exam.

Question 1

Sample ACCA exam

Jerome Gulsand is the owner and chief executive of a chain of 20 sports equipment shops, Sportak. These shops are clustered in the south of the country. The company is privately owned by the family and the freeholds of these shops, which the company owns and which are on prime retail sites, account for the majority of the assets of Sportak. The company sells a wide range of sports equipment such as golf clubs, tennis, skiing equipment, soccer and other sports equipment. Recently it has expanded its range to include certain types of designer sports clothing.
The company was founded by Jerome's father a quarter of a century earlier when he opened his first small shop. Over the next 25 years the company grew steadily. A major reason for this successful development lay with the philosophy of Jerome's father who delegated much of the decision-making to the individual shop managers. He believed that this gave the local managers a higher degree of motivation. It also allowed them to respond to local demand conditions as stock ordering was carried out by each shop and was not organised at the head office. The managers were also permitted to develop local marketing activities, using sales promotions and publicity as they felt appropriate.

These shop managers were remunerated partly by a basic salary and partly by a sales-related performance bonus, which could be up to 40% of their basic salary. These methods of operation were satisfactory while the company was operating in a steady growth environment. However, by late 2007 there was evidence that Sportak's overall position within the market was weakening. Sales had stabilised but, even more importantly, competition was growing from a number of discount traders who were prepared to operate on low profit margins but with larger volumes. It was at this time that Jerome took over the company from his father.

Jerome was impatient with the lack of growth. By nature he was an entrepreneur who sought growth. He was not sure that the steady organic growth was appropriate to these conditions. His father's policy had been to open a store each year, funding this growth out of current earnings. Jerome saw that the market was becoming so competitive that even small and specialist markets were proving to be vulnerable. He believed that only the big, nationwide retail chains would survive and that the smaller sized groups would be taken over by the larger chains of sports goods retailers who were more profitable and had greater capability to raise finance.

He decided that a 'dash for growth' was required if the company was to achieve the critical size to survive in the market place. It had been suggested to him that the franchising of the Sportak brand name would be a reasonable and relatively risk-free method of expansion. Growth, using other people's money, has its advantages, but it did not appeal to Jerome. He wanted a more 'hands-on' approach.

At about this time another chain of 15 sports shops became available for purchase. This group was in a distinctly separate area of the country – about 150 miles from

Sportak's current area of operations. As the overall sports equipment and sportswear market was still growing, the price being asked for this acquisition was rather high. However, Jerome was convinced that this was too good an opportunity to miss. He believed that Sportak needed this expansion so as to take advantage of the profitable sales still available in this sector. However, for an acquisition of this size, it was obvious that the growth could not be funded internally. Jerome assumed that he might use the freeholds of the properties Sportak owned as securities for the finance the company needed to borrow. Before approaching the bank Jerome discussed this issue with his accountant and offered the following ideas for his proposed expansion.

In anticipating this proposed expansion and the need to manage an enlarged group, Jerome believes that it is time for a strong and centralising leader. Recognising that the current system of product ordering is delegated to individual store managers, he proposes to provide a centralised purchasing function based upon a warehouse owned and controlled by Sportak. Individual shop managers will be permitted to decide upon their stock range, but they will have to order from the central warehouse set up by Sportak.

Jerome has also decided to tackle the problem of marketing and, in particular, promotion. The decentralised approach adopted by his father has not brought about the development of a well-known image and, therefore, the brand of Sportak needs to be strengthened. Under Jerome's plan it is proposed to allocate a substantial budget – 15% of sales – to spend on press advertising and on public relations, and this level of commitment will continue for the foreseeable future. Sports personalities will be paid to appear in all stores, which will have to be re-equipped. By a competent use of merchandising it is hoped that these stores will increasingly be recognised as centres for influencing the fashion of both sports equipment and clothing. The shop managers will also be encouraged to stock more expensive lines of products where the margins will be higher and, in addition, they will be expected to hold much more stock. A criticism of the stores when Jerome's father was in charge was that they were often short of stock. Most customers were unwilling to wait for the product to be ordered and they therefore bought from competitors' shops.

Jerome recognised that during this period of change Sportak might lose a number of its key shop managers. These people have enjoyed substantial autonomy, and although they will still have some freedom on the stock range that they offer, they might increasingly see their freedom to act as managers being eroded. In appreciating that these shop managers provide much goodwill and their loss would be damaging to the company, Jerome is proposing to increase their sales-related bonuses as an inducement to stay.

Jerome fully understands that the costs incurred in the proposed acquisition involve more than the purchase of the new shops. Store modernisation programmes for all the shops, as well as upgrading stock with a wider and more sophisticated range of products, will also require funding. Forecasts of immediate future sales appear to be attractive. Jerome anticipates that sales per store will rise by about 8% over the next year. He believes that this growth in sales, accompanied by his more aggressive approach to retailing, will enable his bold expansion plans for Sportak to be achieved. Above all, Jerome wishes to see his company, Sportak, become a national company, no longer having to operate as a regional retailer does.

In Table 1 is a summary of the figures that have been prepared by Jerome’s accountant for discussion. Part of the data has been obtained from trade association statistics as well as government forecasts.

Requirements

(a) Jerome Gulsand’s father was a great believer in the decentralisation of both operations and decision making. To what extent has this process harmed or benefited Sportak? Provide examples to justify your arguments. (10 marks)
(b) Evaluate the key features that you consider to be important and would expect to see in the business plan that Jerome Gulsand would have to present to his bank to support his application for financial assistance. (15 marks)
(c) Acting in the position of Jerome Gulsand’s accountant, and using the financial data provided and the intentions developed by Jerome, assess the viability of the strategy that has been proposed by him. (15 marks)
(d) Discuss whether a franchise operation would have been a better option for expansion than an acquisition. (10 marks)

Table 1

	2007 Actual £m	2008 Budget £m	2009 Forecast £m	
Sales of revenue	30.00	29.50	58.80	57.96
Costs of sales	15.00	14.75	25.28	24.92
Gross margin	15.00	14.75	33.52	33.04
Expenses	12.00	12.50	29.50	29.75
Operating profit	3.00	2.25	4.02	3.29
Interest paid	0.00	0.00	2.50	2.50
Proft after interest	3.00	2.25	1.52	0.79
Fixed assets	15.00	15.00	34.00	34.00
Current assets	6.00	5.90	9.80	9.66

	2007 Actual £m	2008 Budget £m	2009 Forecast £m	
Current liabilities	3.75	3.69	7.35	7.25
Equity	24.75	24.59	26.15	25.91
Debt	0.00	0.00	25.00	25.00
Gross margin	50%	50%	57%	57%
Return of sales	10%	7.62%	6.83%	5.67%
Activity ratio	1.21	1.20	1.15	1.14
Return on net assets	12.2	9.15	7.85	6.46
ROE	12.2	9.15	5.80	3.04
Industry sales (2000 100)	125	135	140	138

Part (a) examines your knowledge of the implementation stage by asking a specific question on structure and whether you believe decentralisation has had any detrimental effect on Sportak. If you were to brainstorm the main issues regarding centralisation and decentralization, and then see which apply in the context of the case, a comprehensive answer would be able to be obtained.

Part (b) would be best answered by mixing common sense with the key issues from strategic analysis, strategic choice and strategic implementation. Common sense would tell you that the business plan should include an overview of Sportak’s business. More detailed information should be provided on the organisation’s resources (6Ms), together with an overview of the business environment in which it exists (use PESTEL and five forces for inspiration). A clear description of the basis on which Sportak intended to compete should also be included (use Porter’s generic strategies and Ansoff’s product market matrix for inspiration) together with the likely returns the business is to make from the chosen strategy.

Part (c) requires you to apply the financial skills you have learned throughout your ACCA studies to give an overview of how viable Jerome’s plans are.

Part (d) again would have been easily answered if you had approached your studies in the logical way suggested earlier and it specifically dealt with the how? Part of the strategic choice stage. (Use the internal, external or joint venture model for inspiration).

Summary

Hopefully you are now able to overview the strategic planning part of the syllabus in a more systematic and logical way. All you need to remember is the key steps of strategic analysis, choice and implementation. This should then set off another chain of words in your head, such as:

- strategic analysis (think 6Ms, think PESTEL and five forces and stakeholder constraints.)
- strategic choice (on what basis do we decide to compete? Which direction should we choose? How are we going to achieve the chosen direction?)
- strategic implementation (resource management, organisational structure, management of change.)

All that is necessary now is to use the framework in an applied way relevant to the question asked.

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