Organisational Strategy

BMA6104

Strategic Implementation (1):

Evaluating strategies

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Learning outcomes (1)

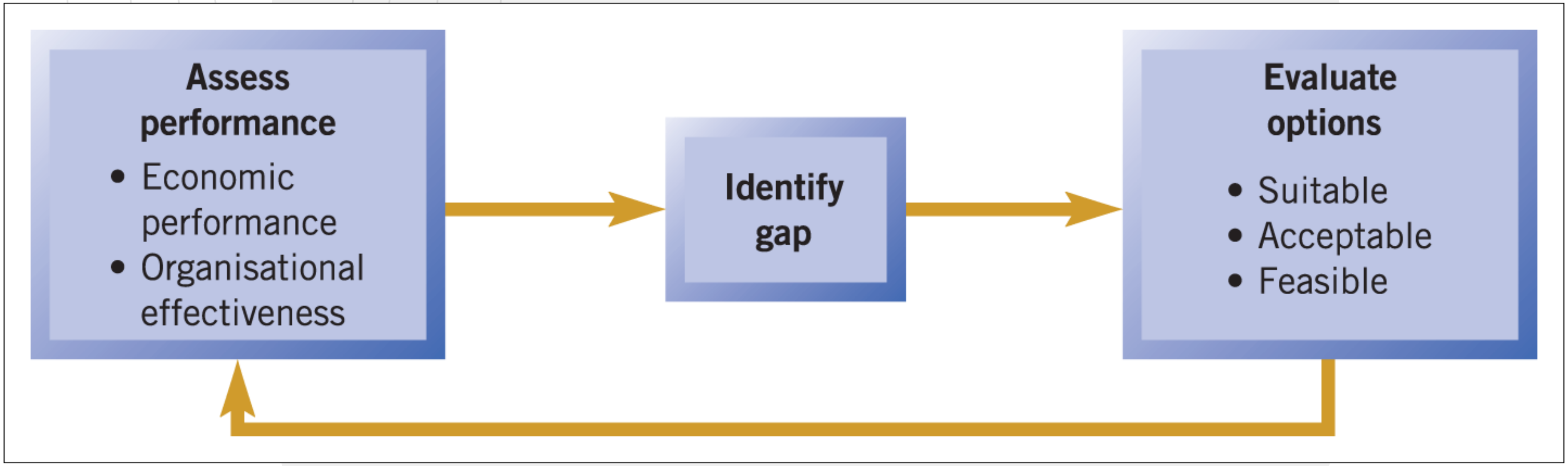
- **Assess the performance outcomes of different strategies in terms of direct *economic outcomes* and overall *organisational effectiveness*.**

- **Assess performance and the need for new strategies using *gap analysis*.**

Learning outcomes (2)

- Employ three ***success criteria*** for evaluating strategic options (the ***SAFe*** criteria):
  - ***Suitability***: whether a strategy addresses the key issues relating to the ***opportunities and constraints*** an organisation faces.
  - ***Acceptability***: whether a strategy meets the ***expectations*** of stakeholders.
  - ***Feasibility***: whether a strategy could ***work in practice***.
- Use for each of these a range of different ***techniques for evaluating strategic options***, both financial and non-financial.

Evaluating strategies



Performance measures: Economic performance

Economic performance refers to direct measures of success in terms of economic outcomes.

- There are three main dimensions:
  - Performance in ***product markets*** (e.g. sales growth or market share)
  - Accounting measures of ***profitability*** (e.g. profit margin or return on capital employed)
  - ***Financial market*** measures (e.g. share price).
- These measures may seem objective but need to be carefully interpreted.

Performance measures: Effectiveness

Effectiveness refers to a broader set of performance criteria reflecting internal operational efficiency or measures relevant to a wider range of stakeholders.

- A broad measure of effectiveness is provided by the ***balanced scorecard*** which considers four perspectives (i.e. the customer, internal business, innovation and learning and financial perspectives).
- The ***triple bottom line*** – has economic, social and environmental measures.

Performance comparisons

Performance is measured in relation to:

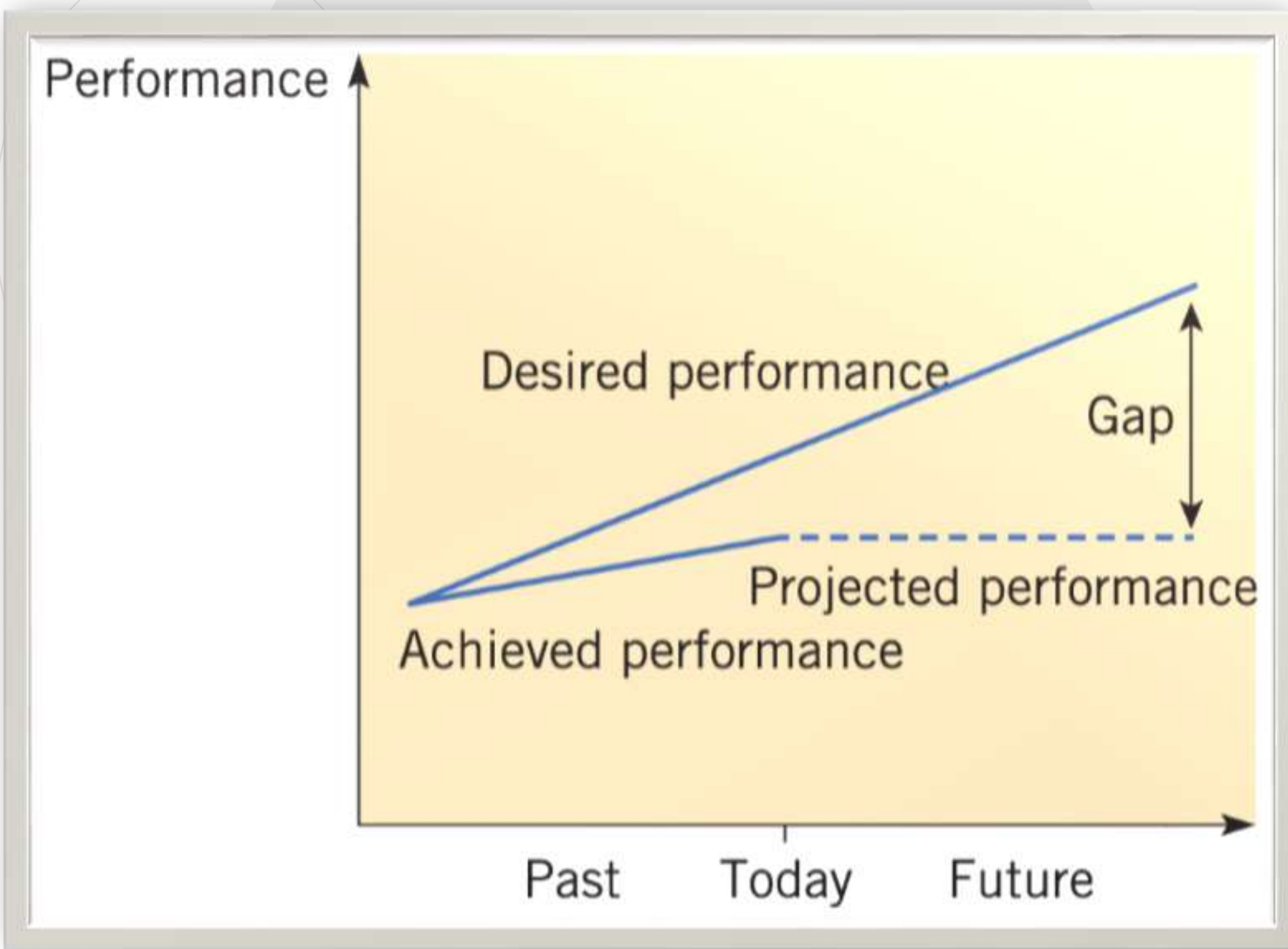
- ***Organisational targets.*** Management will typically set targets for sales growth or profitability.
- ***Trends over time.*** Is performance improving or declining over a significant period of time (but be aware of cycles)?
- ***Comparator organisations.*** Typically firms can benchmark themselves against key competitors (but beware of high risk rivals).

Gap analysis (1)

Gap analysis compares achieved or projected performance with desired performance.

- Helps to identify shortfalls in performance
- The size of the 'gap' provides a guide to the extent to which strategy needs to be changed – a very large gap may suggest transformational change is needed.

Gap analysis (2)



Complexities of performance analysis

- Performance measures can be ***contradictory***, e.g. sales growth can be achieved by cutting profit margins.
- Organisations can ***manipulate outcomes*** in order to meet key performance criteria.
- Organisations can legitimately manage performance ***perceptions and expectations***.
- The importance of particular measures can ***change over time***.

The SAFe criteria and techniques of evaluation

Suitability	• Does a proposed strategy address the *key opportunities and threats* an organisation faces?
Acceptability	• Does a proposed strategy meet the *expectations of stakeholders*? • Is the level of risk acceptable? • Is the likely return acceptable? • Will stakeholder reactions be positive?
Feasibility	• Would a proposed strategy *work in practice?* • Can the strategy be financed? • Do people and their skills exist or can they be obtained? • Can the required resources be obtained and integrated?

Suitability

Suitability is concerned with assessing which proposed strategies address the key ***opportunities*** and ***threats*** an organisation faces.

It is concerned with the overall ***rationale*** of the strategy:

- Does it exploit the ***opportunities*** in the environment and avoid the ***threats?***
- Does it capitalise on the organisation's ***strengths*** and avoid or remedy the ***weaknesses?***

Some examples of suitability

Strategic option	Why this option might be suitable in terms of:	
	Environment	Capability
Directions		
Retrenchment	Withdraw from declining markets Maintain market share	Identify and focus on established strengths
Market penetration	Gain market share for advantage	Exploit superior resources and capabilities
New products and services	Exploit knowledge of customer needs	Exploit R&D
Market development	Current markets saturated New opportunities for: geographical spread, entering new segments or new uses	Exploit current products and capabilities
Diversification	Current markets saturated or declining; new opportunities for expansion beyond core businesses	Exploit strategic capabilities in new arenas

Suitability – screening techniques

There are several useful techniques:

- ***Ranking***
- ***Screening through scenarios***
- ***Screening for bases of competitive advantage*** – using the VRIO criteria
- ***Decision trees***
- ***Life-cycle analysis***

The industry life-cycle/portfolio matrix

Competitive position	Stages of industry life cycle				
	Development	Growth	Shake-out	Mature	Decline
Strong	Fast grow	Attain cost leadership Differentiate Broaden scope	Reinforce cost and differentiation advantages Drive out weaker competitors by innovation or price wars Acquire weaker competitors	Consolidate industry through acquisitions Harvest weaker activities Cut unnecessary costs (e.g. differentiation or innovation)	Drive out remaining competitors Exploit market power Cut unnecessary costs
Middling	Fast grow Differentiate Focus	Catch up Differentiate Focus Find niche	Harvest weaker activities Seek alliances or mergers	Retrench Turnaround Seek alliances or mergers Exit by sale	Seek alliances or mergers Exit by sale or closure
Weak	Find niche Catch up	Turnaround Retrench Seek alliances, mergers or acquirers	Seek alliances, mergers or acquirers Exit	Seek alliances, mergers or acquirers Exit	Seek alliances, mergers or acquirers Exit

Source: Adapted from Arthur D. Little.

The life cycle/portfolio matrix – competitive position

Competitive position within an industry can be:

- A ***strong*** position where organisations can follow aggressive strategies throughout the life cycle. Early on they can grow rapidly and later they can drive out weaker rivals by pricing, innovation or acquisition strategies.
- A ***middling*** position where organisations need to follow a more defensive strategy – to strengthen their position or find a relatively protected niche. Later on they may consider selling out to a stronger firm with parenting advantages.
- A ***weak*** position where competitors are too small to survive independently in the long run. They need a rapid improvement in their position or retreat to a niche quickly.

Acceptability

Acceptability is concerned with whether the expected performance outcomes of a proposed strategy meet the expectations of stakeholders.

There are three important aspects to acceptability:

- ***Risk***
- ***Return***
- ***Stakeholder reactions.***

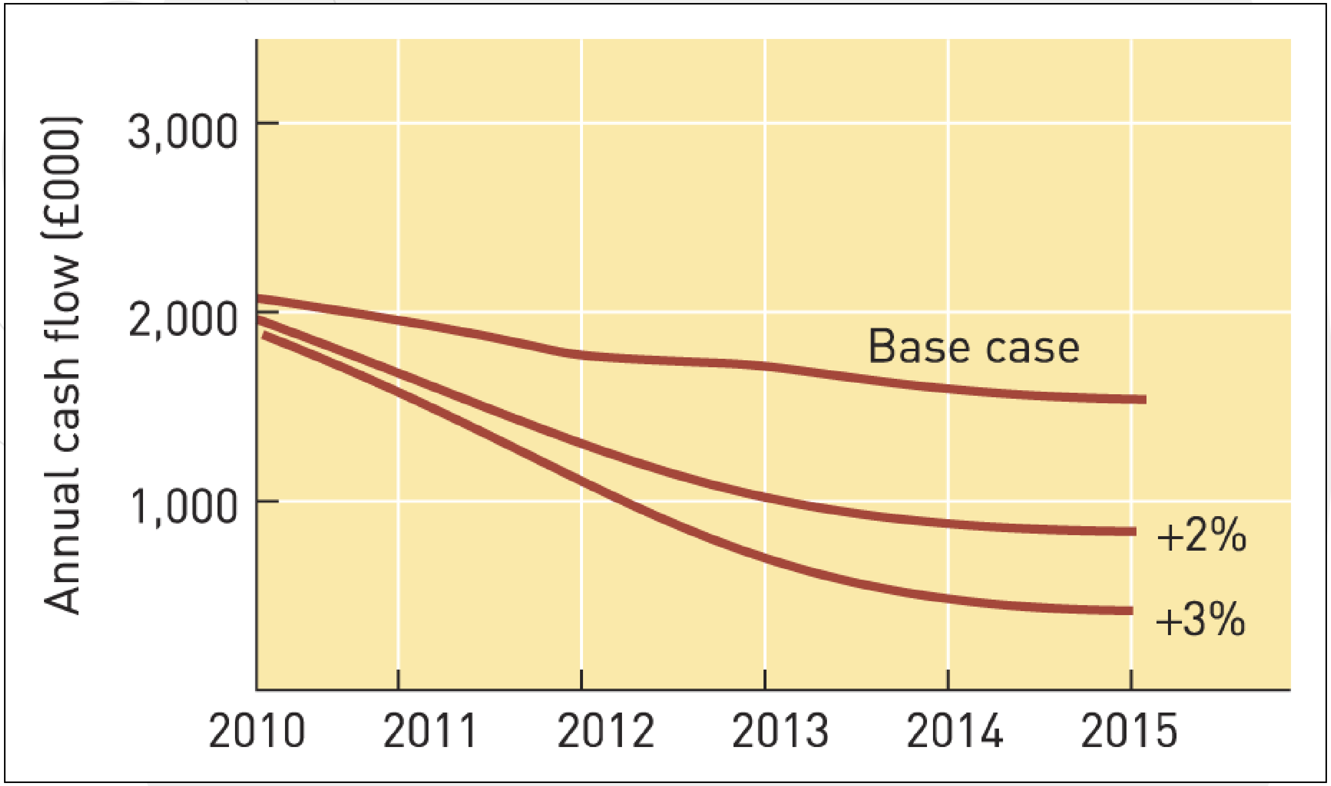
Risk

Risk concerns the extent to which strategic outcomes are unpredictable, especially with regard to negative outcomes.

Risk can be assessed using:

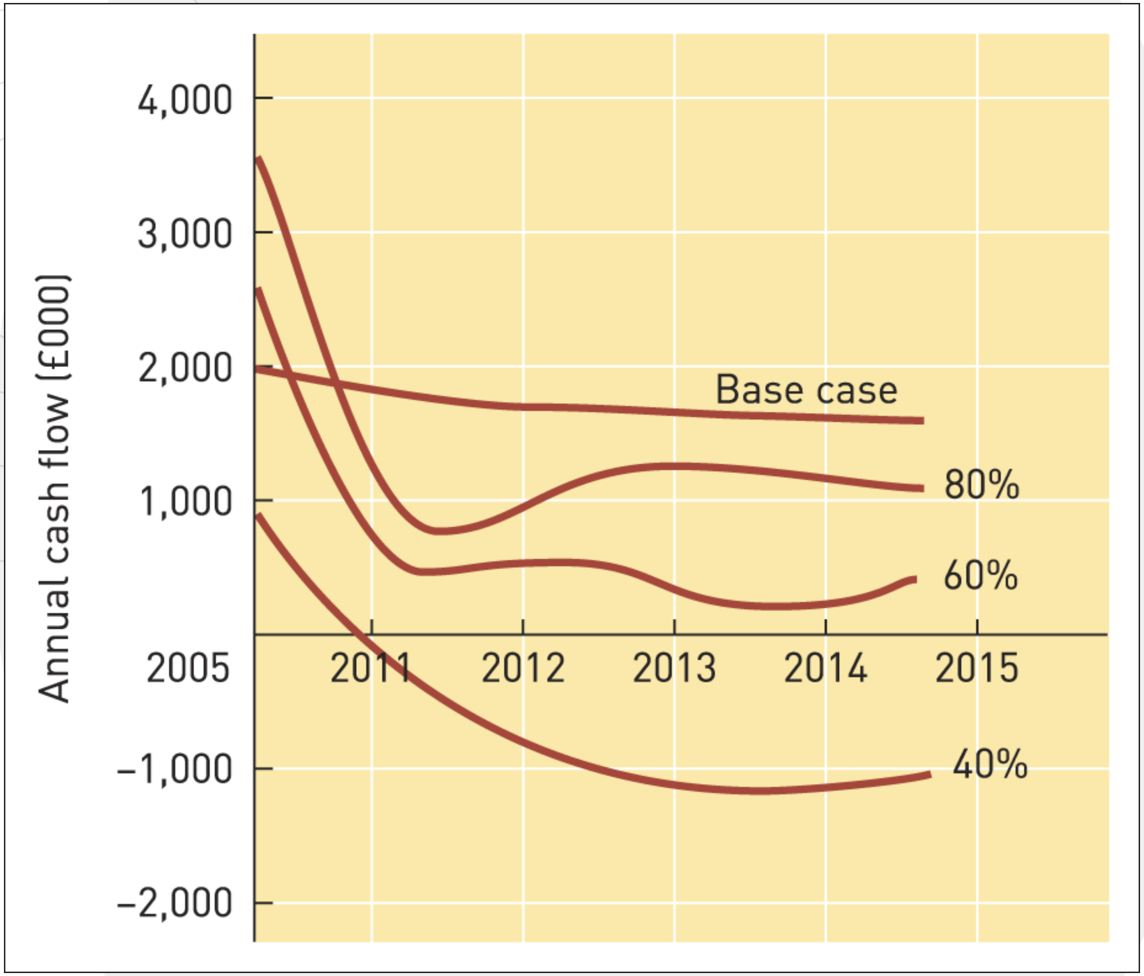
- ***Sensitivity analysis***
- ***Financial risk*** – use ratios e.g.
  - gearing (debt to capital)
  - liquidity (accessible cash to capital)
- ***Break-even analysis***

Sensitivity analysis (1)



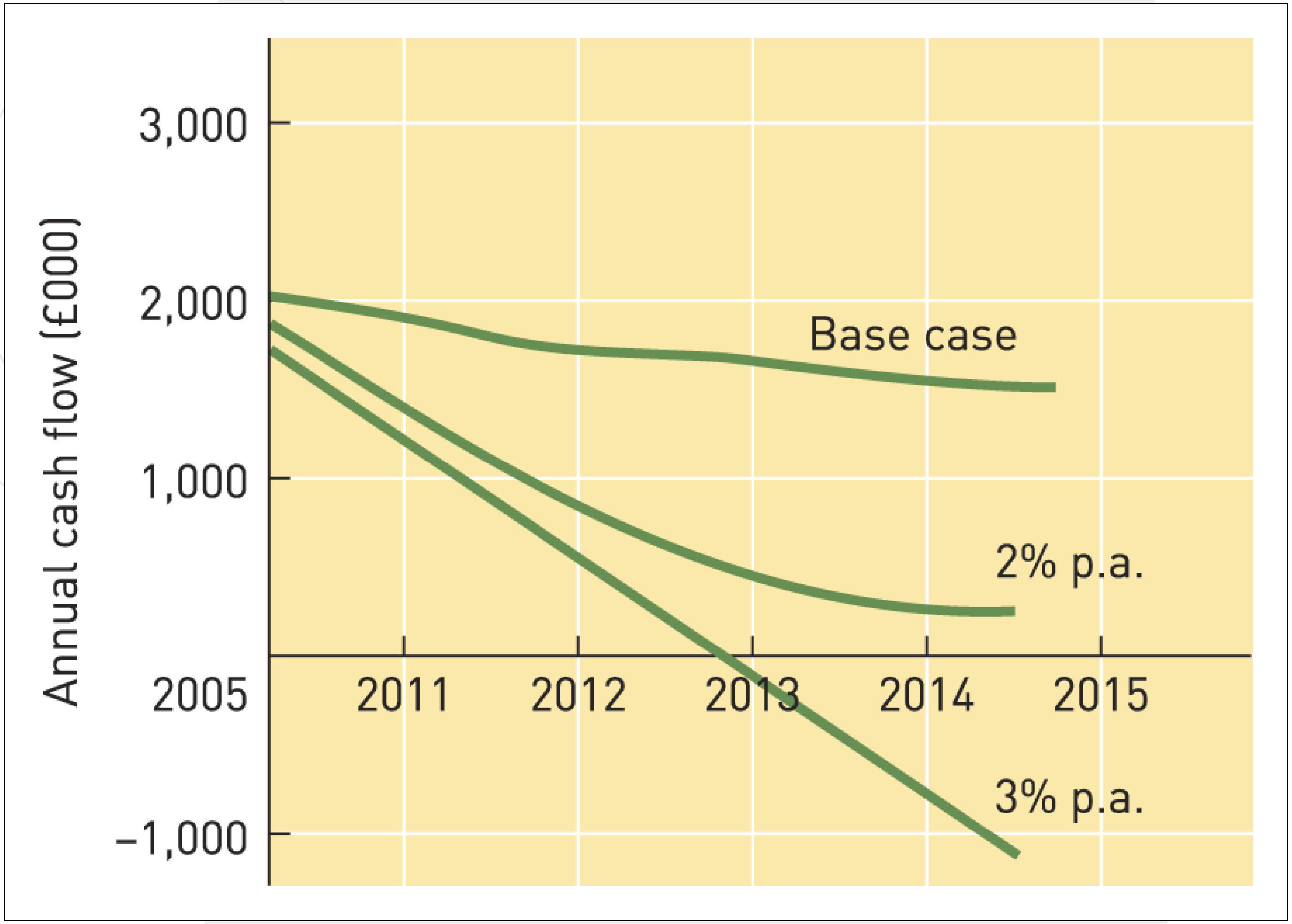
Sensitivity of cash flow to changes in real production costs

Sensitivity analysis (2)



Sensitivity of cash flow to changes in plant utilisation

Sensitivity analysis (3)



Sensitivity of cash flow to reductions in real price

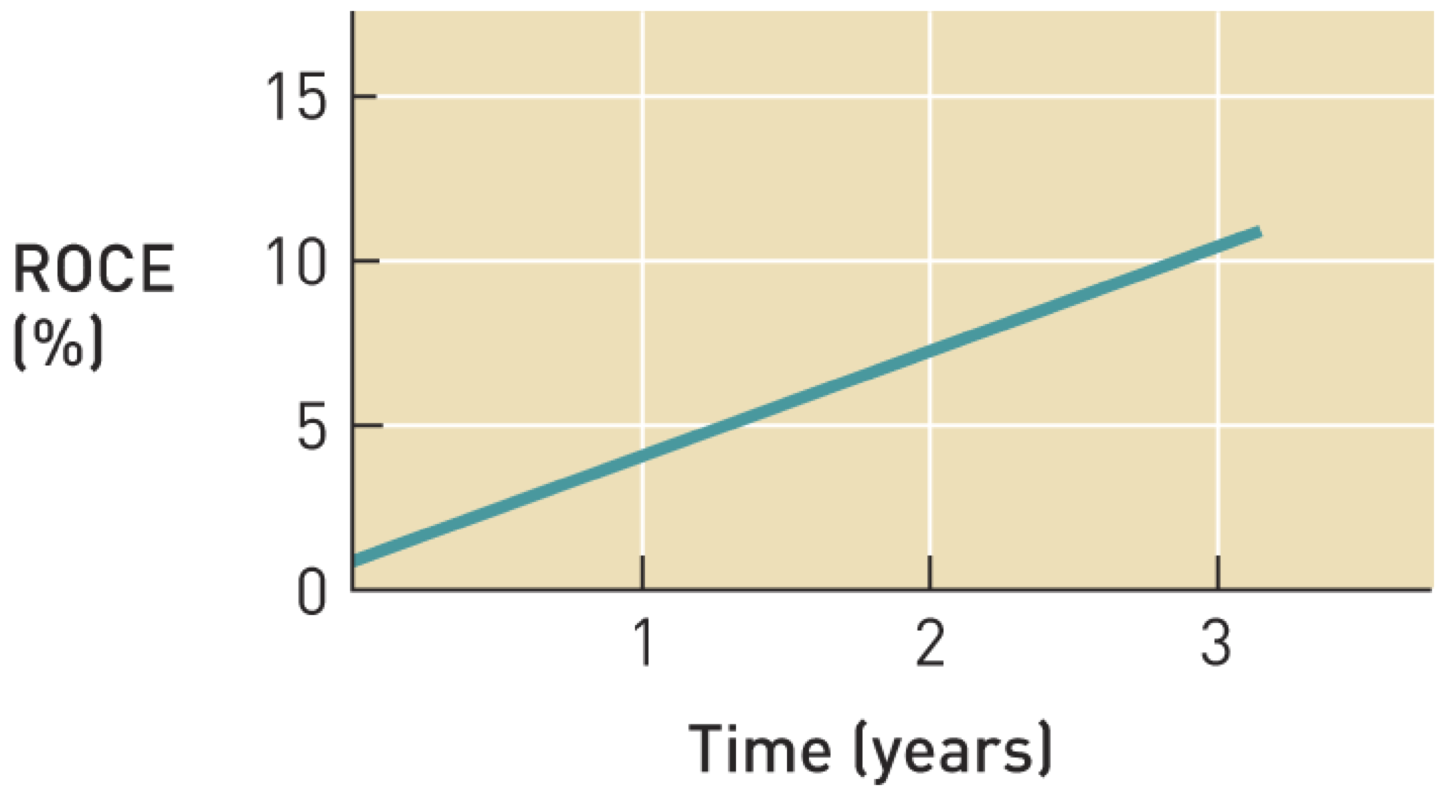
Return

These are a measure of the financial effectiveness of a strategy.

Different approaches to assessing return:

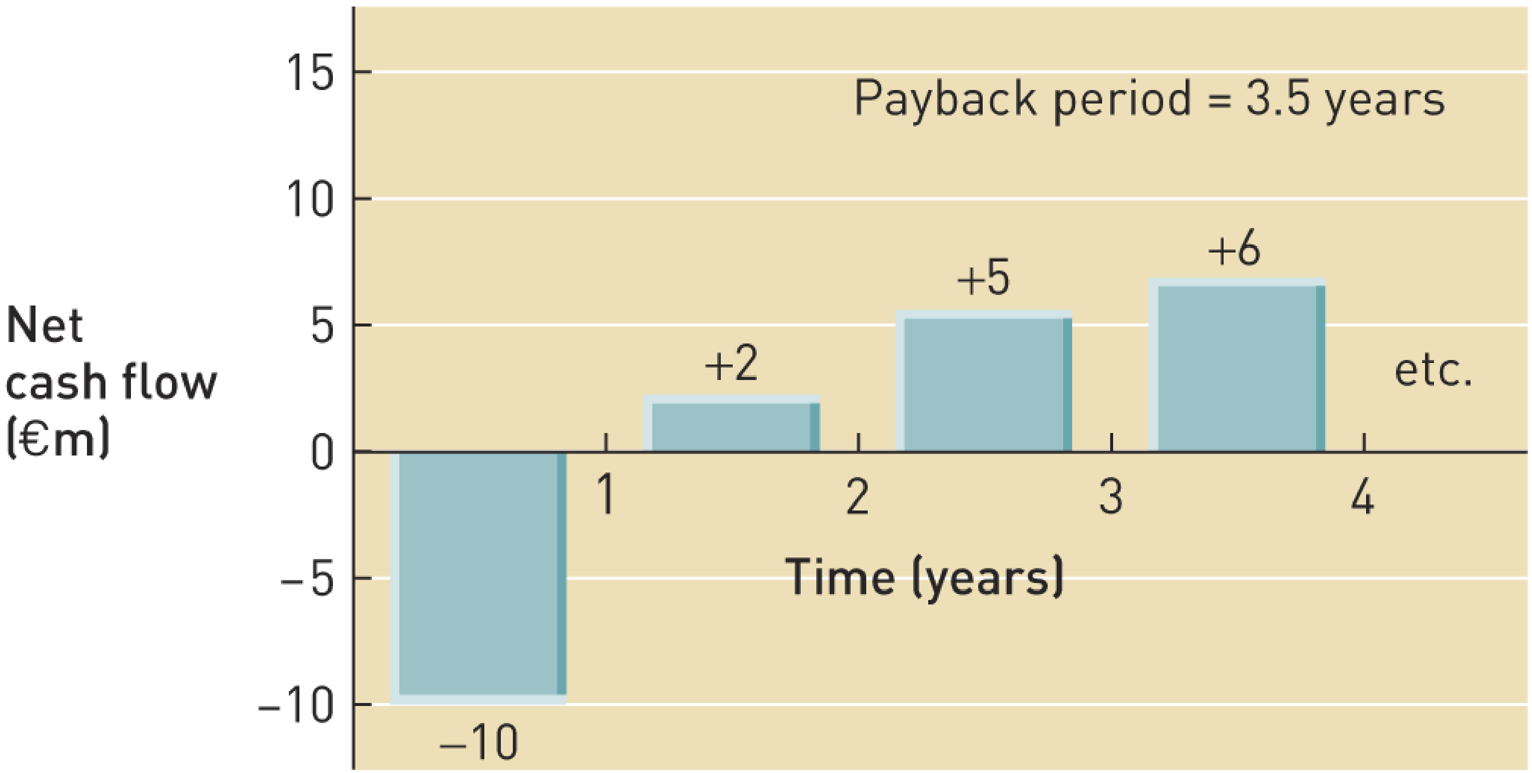
- ***Financial analysis***
- ***Shareholder value analysis***
- ***Cost–benefit analysis***
- ***Real options***

Assessing profitability: Return on capital employed



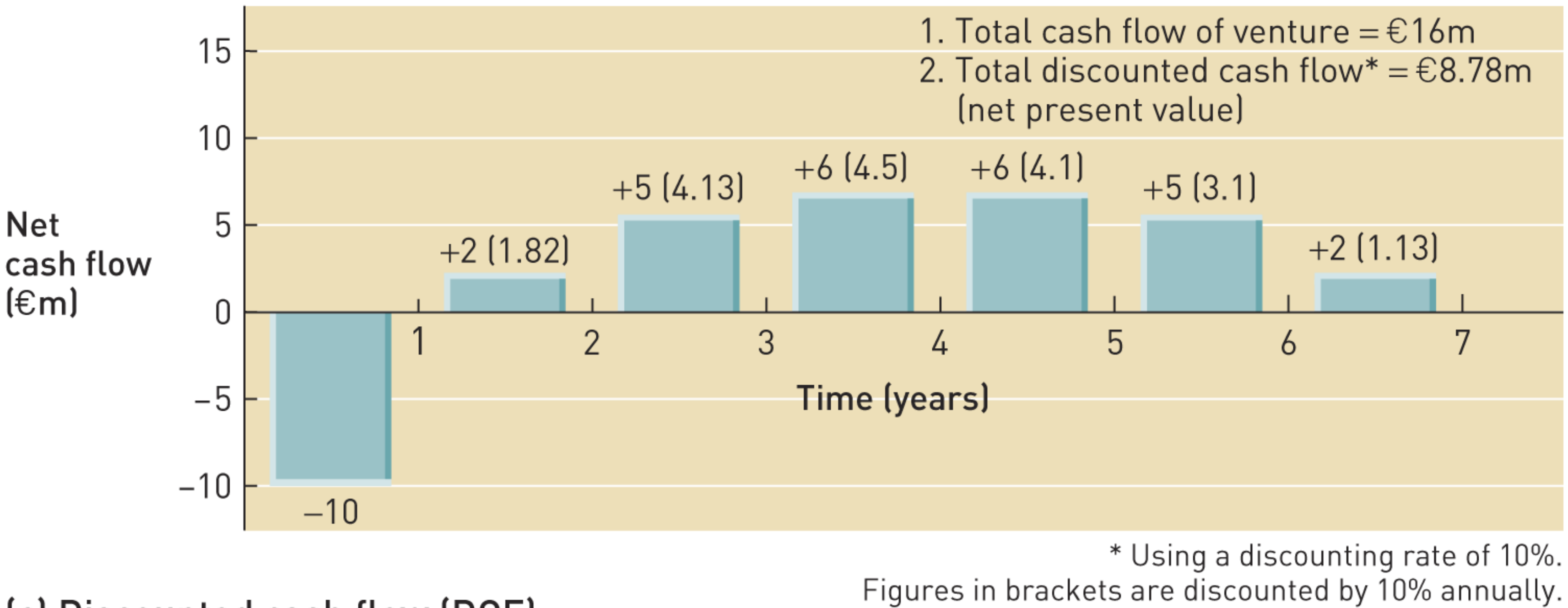
(a) Return on capital employed

Assessing profitability: Payback period



(b) Payback period

Assessing profitability: Discounted cash flow

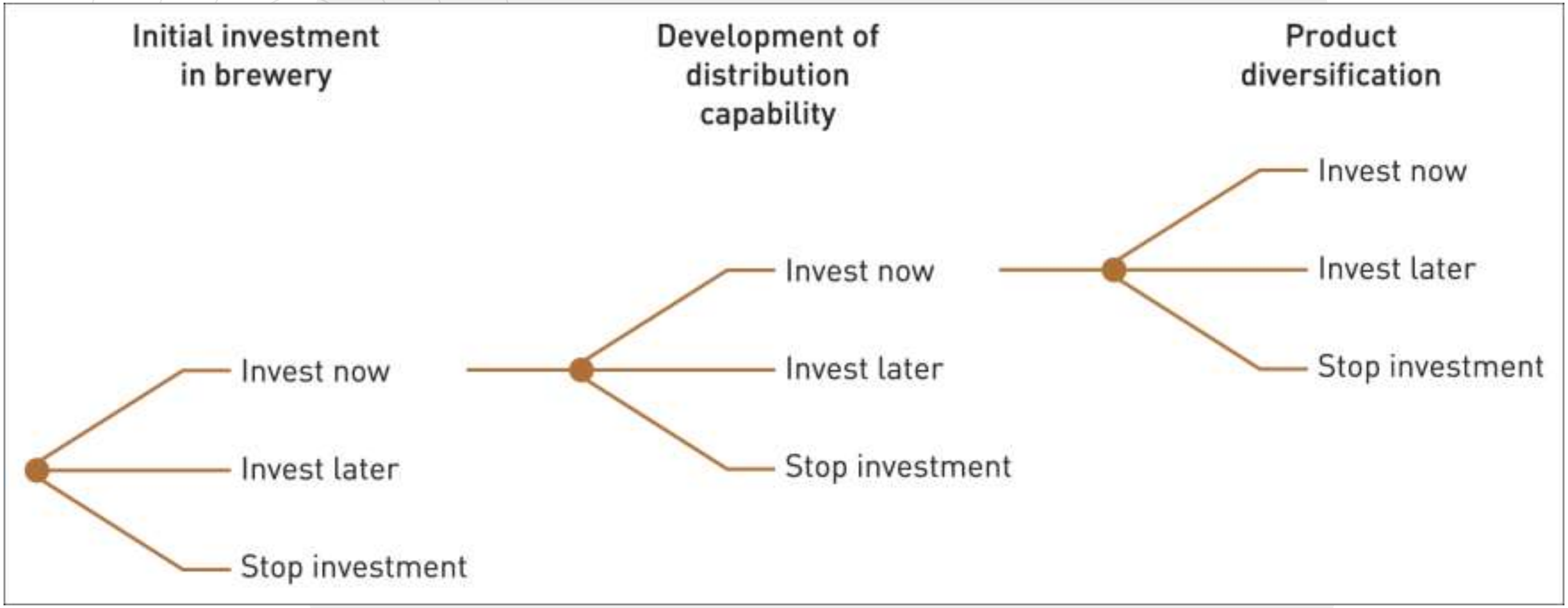


(c) Discounted cash flow (DCF)

Measures of shareholder value

(a) Total shareholder return (TSR)	(b) Economic profit or economic value added (EVA)
Given • Opening share price, £1 • Closing share price, £1.20 • Dividend per share received during financial year, 5p Then • Increase in share price (20p) plus dividend received (5p) = 25p TSR is • 25p divided by opening share price of £1 expressed as a percentage = 25%	Given • Operating profit after tax, £10m • Capital employed, £100m • Cost of capital, 8% Then • The capital or financing charge required to produce the operating profit after tax is the capital employed of £100m × the cost of capital of 8% = (£8m) EVA is • Operating profit (after tax) of £10m less the cost of the capital, £8m = £2m

Real options evaluation



A real options approach to a brewery development

Advantages of real options

There are four main benefits:

- ***Bringing strategic and financial evaluation closer together***
- ***Valuing emerging options***
- ***Coping with uncertainty***
- ***Offsetting conservatism.***

Reaction of stakeholders

Stakeholder mapping (power/interest matrix) can be used to:

- ***understand the political context of strategies***
- ***understand the political agenda***
- ***gauge the likely reaction of stakeholders to specific strategies.***

If key stakeholders find a strategy to be unacceptable then it is likely to fail.

Feasibility (1)

Feasibility is concerned with whether a strategy could work in practice, i.e. whether an organisation has the capabilities to deliver a strategy.

Two key questions:

- Do the resources and competences currently exist to implement the strategy effectively?
- If not, can they be obtained?

Feasibility (2)

Need to consider:

- ***Financial feasibility*** – funding and cash flow
- ***People and skills*** – competences, systems, knowledge and experience
- ***Integrating resources*** – obtaining and integrating new resources.

Financial strategy and the business life cycle

Life-cycle phase	Funding requirement	Cost of capital	Business risk	Likely funding source(s)	Dividends
Start-up	High	High	High	Personal debt Equity (angel and venture capital)	Zero
Growth	High	Medium	High	Debentures and equity (growth investors)	Nominal
Maturity	Low/medium	Low	Low	Debt, equity and retained earnings	High
Exit/decline	Low	Medium/high	Medium	Debt, retained earnings	High

<u>People and skills</u>

Three questions arise:

- Do people in the organisation currently have the ***competences*** to deliver a proposed strategy?
- Are the ***systems*** to support those people fit for the strategy?
- If not, can the competences be ***obtained or developed?***

Summary

- Performance can be assessed in terms of both ***economic*** performance and overall organisation ***effectiveness***.
- ***Gap analysis*** indicates the extent to which achieved or projected performance diverges from desired performance and the scale of the strategic initiatives required to close the gap.
- Strategies can be evaluated according to the three SAFe criteria of ***suitability*** in view of organisational opportunities and threats, ***acceptability*** to key stakeholders and ***feasibility*** in terms of capacity for implementation.

Thanks!