RATIONALE

The syllabus for Paper P3, *Business Analysis*, is primarily concerned with two issues. The first is the external forces (the behaviour of customers, the initiatives of competitors, the emergence of new laws and regulations) that shape the environment of an organisation. The second is the internal

ambitions and concerns (desire for growth, the design of processes, the competences of employees, the financial resources) that exist within an organisation. This syllabus looks at both of these perspectives, from assessing strategic position and choice to identifying and formulating strategy and strategic action. It identifies opportunities for beneficial change that involve people, finance and information technology. It examines how these opportunities may be implemented through the appropriate management of programmes and projects.

The syllabus begins with the assessment of strategic position in the present and in the future using relevant forecasting techniques, and is primarily concerned with the impact of the external environment on the business, its internal capabilities and expectations and how the organisation positions itself under these constraints. It examines how factors such as culture, leadership and stakeholder expectations shape organisational purpose. Strategic choice is concerned with decisions which have to be made about an organisation's future and the way in which it can respond to the influences and pressures identified in the assessment of its current and future strategic position.

Strategic action concerns the implementation of strategic choices and the transformation of these choices into organisational action. This action takes place in day-to-day processes and organisational relationships and these processes and relationships need to be managed in line with the intended strategy, involving the effective coordination of information technology, people, finance and other business resources.

Companies that undertake successful business process redesign claim significant organisational improvements. This simply reflects the fact that many existing processes are less efficient than they could be and that new technology makes it possible to design more efficient processes. Strategic planning and strategy implementation has to be subject to financial benchmarks. Financial analysis explicitly recognises this, reminding candidates of the importance of focusing on the key management accounting techniques that help to determine strategic action and the financial ratios and measures that may be used to assess the viability of a strategy and to monitor and measure its success.

Throughout, the syllabus recognises that successful strategic planning and implementation requires the effective recruitment, leadership, organisation and training and development of people.

SUMMARY OF CHANGES TO P3

ACCA annually reviews its qualification so that they fully meet the needs of stakeholders including employers, students, regulatory and advisory bodies and learning providers. The following syllabus changes are effective from September 2015 and the next update will be September 2016.

The changes are introduced to the syllabus to reflect the latest business and educational developments affecting this paper. These are summarised in the table below.

Summary of changes to P3 (Table):

Section and subject area	Syllabus content
New C1e added	Discuss how big data can be used to inform and implement business strategy.
New G1b added	Discuss how the finance function has transformed to enabling an accountant to have a key role in the decision making process from strategy formulation and implementation to its impact on business performance
G1 heading amended	Finance
G2a and b clarified	Evaluate budgeting, standard costing and variance analysis in support of strategic planning and decision making
G2c clarified	Evaluate strategic and operational decisions taking into account risk and uncertainty. (Including using decision trees).

2.2 Business-level strategy

Key term

Business strategy is about how to compete successfully in particular markets. *JS&W*

Business-level strategy is about the particular and distinct combination of products and markets dealt with by one business unit. A business unit might be a small, independent organisation or part of a larger one. In the first case, business and corporate strategy merge with one another; in the second, SBU level strategies must be co-ordinated with corporate strategy and with each other.

2.3 Operational strategies

Key term

Operational strategies are concerned with how the component parts of an organisation deliver effectively the corporate- and business-level strategies in terms of resources, processes and people. *JS&W*

Much operational strategy is created by individual business functions and delivered by them.

Functional area	Comment
Marketing	Devising products and services, pricing, promoting and distributing them, in order to satisfy customer needs at a profit. Marketing and corporate strategies are interrelated.
Production	Factory location, manufacturing techniques, outsourcing and so on.
Finance	Ensuring that the firm has enough financial resources to fund its other strategies by identifying sources of finance and using them effectively.
Human resources management	Secure personnel of the right skills in the right quantity at the right time, and to ensure that they have the right skills and values to promote the firm's overall goals.
Information systems	A firm's information systems are becoming increasingly important, as an item of expenditure, as administrative support and as a tool for competitive strength. Not all information technology applications are strategic, and the strategic value of IT will vary from case to case.
R&D	New products and techniques.

Question — Levels of strategy

Ganymede Co is a company selling widgets. The finance director says: 'We plan to issue more shares to raise money for new plant capacity – we don't want loan finance – which will enable us to compete better in the vital and growing widget markets of Latin America. After all, we've promised the shareholders 5% profit growth this year, and trading is tough.'

Identify the **corporate**, **business** and **functional** strategies in the above statement.

Answer

The corporate objective is profit growth. The corporate strategy is the decision that this will be achieved by entering new markets, rather than producing new products. The business strategy suggests that those markets include Latin America. The operational or functional strategy involves the decision to invest in new plant (the production function) which is to be financed by shares rather than loans (the finance function).

Chapter Roundup

- **Strategy** is the direction and scope of an organisation over the long term, which achieves advantage in a changing environment through its configuration of resources and competences with the aim of fulfilling stakeholder expectations. Strategic decisions are made under conditions of complexity and uncertainty; they have wide impact on the organisation and often lead to major change.
- Strategies are developed in order to achieve desired outcomes. These are inherent in the organisation's mission or defining purpose. Mission guides strategic decisions and provides values and a sense of direction.
- A structure of goals and objectives derives from mission and supports it. All the parts of this structure should be mutually supportive.
- Strategy has its own vocabulary, though usage varies. JS&W provide a very useful list.
- There are many levels of strategy in an organisation.
  - **Corporate**: the general direction of the whole organisation
  - **Business**: how the organisation or its SBUs tackle particular markets
  - **Operational/functional**: specific strategies for different departments of the business
- JS&W suggest a three part structure for thinking about strategy.
  - Strategic position
  - Strategic choices
  - Strategy into action
- The **context of strategy** is the organisational setting in which it is developed. **Small businesses** tend to have limited resources and strong competition; **multinationals** are more concerned with problems of structure, resource allocation and logistics. **Public sector** and **not-for-profit** organisations are influenced by ideology, politics, and the influence of a range of stakeholders. Intangible aspects have become very important for companies dealing in physical products.
- The study of business strategy is fairly new and opinion as to its nature and content is only just beginning to settle. The breadth of opinion about it can be analysed into three different approaches or 'lenses' for looking at individual strategies. These lenses are **strategy as design**, **strategy as experience** and **strategy as ideas**.

Quick Quiz

1 What is strategy?

2 What are the four elements of the Ashridge model of mission?

3 What are the qualities of SMART objective?

4 What are the three elements of the JS&W model of strategy?

5 What are the three strategy lenses and what are the relationships between them?

Study guide

		Intellectual level
A2	**Environmental issues affecting the strategic position of, and future outlook for, an organisation**	
(a)	Assess the macro-environment of an organisation using PESTEL	3
(b)	Highlight the external key drivers of change likely to affect the structure of a sector or market	3
(c)	Explore, using Porter's Diamond, the influence of national competitiveness on the strategic position of an organisation	2
(d)	Prepare scenarios reflecting different assumptions about the future environment of an organisation	3
(e)	Evaluate methods of business forecasting used when quantitatively assessing the likely outcome of different business strategies	3
A3	**Competitive forces affecting an organisation**	
(a)	Discuss the significance of industry, sector and convergence	3
(b)	Evaluate the sources of competition in an industry or sector using Porter's five forces framework	3

Exam guide

This chapter, like the previous one, deals with wide topics that may be relevant to almost any exam question. However, it also covers some key models, such as **PESTEL** and **Porter's five forces**, that you must study in detail. Environmental analysis is a well established aspect of the theory of business strategy and the examining team find it an easy topic to introduce into questions. It will be unusual to come across a question that deals exclusively with the environment, but it is common in this field for the examining team to give a fair amount of environmental detail. Make sure you read question scenarios carefully and note the potential implications of the environmental background.

Models

Three models covered in this chapter are explicitly referenced in the Study Guide and so could be specifically required in a question:

- PESTEL
- Porter's Diamond
- Porter's five forces framework

Exam focus point

A technical article in the P3 section of the ACCA website titled 'The adaptability of strategic models' (2007) written by Malcolm Eva explores the importance of understanding models such as those listed above and illustrates how they can be used to identify and analyse strategic issues. Eva highlights that often the key to using such models lies in the flexibility of their application to different scenarios. It would be worth taking the time to study this article.

Factor	Impact
Government spending	Suppliers to the government (eg construction firms) are affected by spending.
The business cycle	Economic activity is always punctuated by periods of growth followed by decline, simply because of the nature of trade. The UK economy has been characterised by periods of boom and bust. Government policy can cause, exacerbate or mitigate such trends, but cannot abolish the business cycle. (Industries which prosper when others are declining are called counter-cyclical industries.)

The **forecast state of the economy** will influence the planning process for organisations which operate within it. In times of boom and increased demand and consumption, the overall planning problem will be to **identify** the demand. Conversely, in times of recession, the emphasis will be on cost-effectiveness, continuing profitability, survival and competition.

Impact of **international factors** on the economic environment

Factor	Impact
Exchange rates	Cost of imports, selling prices and value of exports; cost of hedging against fluctuations
Characteristics of overseas markets	Desirable overseas markets (demand) or sources of supply (cheap imports)
International capital markets	Generally, advanced economies accept that supply and demand set the value of their currencies, using interest rates only to control inflation.
Large multinational companies (MNCs)	MNCs have huge turnovers and significant political influence because of governments' desire to attract capital investment.
Government policy on trade/protection	Cost of barriers to trade, effect on supplier interests of free trade, erection of regional barriers, possibility of dumping

Fairly obviously, there is constant and large scale interaction between government and economy through the various aspects of **government economic policy**.

2.3 The sociocultural environment

FAST FORWARD

The **social and cultural** environment features long-term social trends and people's beliefs and attitudes.

Key term

Demography is the study of human population and population trends.

Factors of importance to organisational planners

Factor	Comment
Growth	The rate of growth or decline in a national population and in regional populations.
Age	Changes in the age distribution of the population. In some countries, there may be an increasing proportion of the national population over retirement age. In others there are very large numbers of young people.
Geography	The concentration of population into certain geographical areas.
Ethnicity	A population might contain groups with different ethnic origins from the majority.
Household and family structure	A household is the basic social unit and its size might be determined by the number of children, whether elderly parents live at home and so on. In the UK, there has been an increase in single-person households and lone parent families.
Social structure	The population of a society can be broken down into a number of subgroups, with different attitudes and access to economic resources.

(c) Companies with poor environmental performance may face **increased cost of capital** because investors and lenders demand a higher risk premium.

(d) There are a growing number of **energy and environmental taxes**, such as landfill tax.

(e) Accidents and long-term environmental effects can result in **large financial liabilities**.

(f) **Pressure group campaigns** can cause damage to reputation and/or additional costs.

(g) **Environmental legislation** may cause some products to be phased out, but in doing so, can provide opportunities for new products to replace them.

(h) The cost of processing input which becomes **waste** is equivalent to 5–10% of some organisation's turnover.

They go on to suggest six main ways in which business and environmental benefits can be achieved.

(a) **Integrating the environment into capital expenditure decisions** (by considering environmental opposition to projects which could affect cash flows, for example).

(b) **Understanding and managing environmental costs.** Environmental costs are often 'hidden' in overheads, and environmental and energy costs are often not allocated to the relevant budgets.

(c) **Introducing waste minimisation schemes**

(d) **Understanding and managing life cycle costs.** For many products, the greatest environmental impact occurs upstream (such as mining raw materials) or downstream from production (such as energy to operate equipment). This has led to producers being made responsible for dealing with the disposal of products such as cars, and government and third party measures to influence raw material choices. Organisations therefore need to identify, control and make provision for environmental life cycle costs and work with suppliers and customers to identify environmental cost reduction opportunities.

(e) **Measuring environmental performance.** Business is under increasing pressure to measure all aspects of environmental performance, both for statutory disclosure reasons and due to demands for more environmental data from customers.

(f) **Involving management accountants** in a strategic approach to environment-related management accounting and performance evaluation.

Such analysis and action should help organisations to better understand present and future environmental costs and benefits.

2.5.3 Renewable and non-renewable resources

Key term

Sustainability involves developing strategies so that the company only uses resources at a rate that allows them to be replenished. At the same time, emissions of waste are confined to levels that do not exceed the capacity of the environment to absorb them.

Sustainability means that resources consumed are **replaced** in some way: for every tree cut down, another is planted. Some resources, however, are inherently non-renewable. For example, oil will eventually run out, even though governments and oil firms have consistently underestimated reserves.

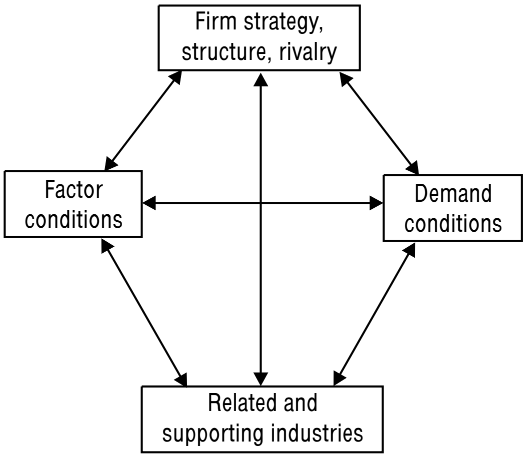
(a) Metals can be recycled. Some car manufacturers are building cars with recyclable components.

(b) An argument is that as the price of resources rise, market forces will operate to make more efficient use of them or to develop alternatives. When oil becomes too expensive, solar power will become economic.

John Elkington, chairman of the think-tank SustainAbility Ltd, has said that **sustainability** now embraces not only environmental and economic questions, but also social and ethical dimensions. He writes about the **triple bottom line**, which means that business people must increasingly recognise that the challenge now is to help deliver simultaneously:

- Economic prosperity
- Environmental quality
- Social equity

Porter identifies four principal factors, which are outlined in the diagram below. Porter refers to this as the **diamond**.



Porter's Diamond

4.1 Analysing the diamond

4.1.1 Factor conditions

Factor conditions are a country's endowment of inputs to production.

- Human resources (skills, price, motivation, industrial relations)
- Physical resources (land, minerals, climate, location relative to other nations)
- Knowledge (scientific and technical know-how, educational institutions)
- Capital (amounts available for investment, how it is deployed)
- Infrastructure (transport, communications, housing)

Porter distinguishes between **basic** and **advanced** factors.

(a) **Basic factors** are natural resources, climate, semiskilled and unskilled labour. They are inherent, or at best their creation involves little investment. They are **unsustainable** as a source of national competitive advantage, since they are widely available. For example, the wages of unskilled workers in industrial countries are undermined by even lower wages elsewhere.

(b) **Advanced factors** are associated with a well-developed scientific and technological infrastructure and include modern digital communications infrastructure, highly educated people (eg computer scientists), university research laboratories and so on. They are necessary to achieve high order competitive advantages such as differentiated products and proprietary production technology.

An abundance of factors is not enough. It is the efficiency with which they are deployed that matters. The former USSR had an abundance of natural resources and a fairly well educated workforce, but was an economic catastrophe.

Porter also notes that **generalised factors**, such as transport infrastructure do not provide as decisive and sustainable bases for competitive advantage as **do specialised factors**. These are factors that are relevant to a limited range of industries, such as knowledge bases in particular fields and logistic systems developed for particular goods or raw materials. Such factors are integral to innovation and very difficult to move to other countries.

4.1.2 Demand conditions: the home market

The **home market determines how firms perceive, interpret and respond to buyer needs.** This information puts pressure on firms to innovate and provides a launch pad for global ambitions.

(a) There are **no cultural impediments** to communication.

(b) The **segmentation** of the home market shapes a firm's priorities: companies will be successful globally in segments which are similar to the home market.

(c) **Sophisticated and demanding buyers** set standards. If the home market sets high standards, achieving these high standards will put a firm in a strong position to be competitive on the international market.

(d) **Anticipation of buyer needs:** if consumer needs are expressed in the home market earlier than in the world market, the firm benefits from experience.

(e) The **rate of growth**. Slow growing home markets do not encourage the adoption of state of the art technology.

(f) **Early saturation** of the home market will encourage a firm to export.

4.1.3 Related and supporting industries

Competitive success in one industry is linked to success in related industries. Domestic suppliers are preferable to foreign suppliers, as they offer continuing close co-operation and co-ordination. The process of innovation is also enhanced when suppliers are of high quality, since information is transmitted rapidly and problems are solved by joint effort.

4.1.4 Firm strategy, structure and rivalry

Management style and industrial structure. Nations are likely to display competitive advantage in industries that are culturally suited to their normal management practices and industrial structures. For example, German managers tend to have a strong bias towards engineering and are best at products demanding careful development and complex manufacturing processes. They are less successful in industries based on intangibles such as fashion and entertainment.

Strategy. Industries in different countries have different **time horizons**, funding needs and so forth.

(a) **National capital markets** set different goals for performance. In Germany and Switzerland, banks are the main source of capital, not equity shareholders. Short-term fluctuations in share prices are not regarded as of great importance as funds are invested for the long term. In the US, most shares are held by financial institutions whose own performance indicators emphasise short-term earnings growth.

(b) **National attitudes to wealth** are important. The egalitarian Swedes are rarely successful in industries that have the potential to create individual fortunes but depend on new start-ups.

(c) **National culture** affects industrial priorities through the relative prestige it allots to various industries and their leaders. Italy values fashion and furnishings, for instance, while in Israel the most prestigious industries are agriculture and those related to defence.

Domestic rivalry is important for several reasons.

- There can be no special pleading about unfair foreign competition.
- With little domestic rivalry, firms are happy to rely on the home market.
- Tough domestic rivals teach a firm about competitive success.
- Domestic rivalry forces firms to compete on grounds other than basic factors.
- Each rival can try a different strategic approach.

The promotion by government of one or two **'national champions'** who can reap major economies of scale in the domestic market is undermined by the vigorous domestic competition among high-performing global companies. Examples are the Swiss pharmaceutical industry and the US IT industry.

4.2 Influencing the diamond

A nation's competitive industries tend to be **clustered**. Porter believes **clustering** to be a key to national competitive advantage. A cluster is a linking of industries through relationships that are either vertical (buyer-supplier) or horizontal (common customers, technology, skills). For example, the UK financial services industry is clustered in London, the US hi-tech electronics industry is clustered in Silicon Valley.

(b) The **coefficient of determination r^2** is the square of the coefficient of correlation. It measures the proportion of the total variation in the value of y that can be explained by variations in the value of x. For example, if r is –0.992, then r^2 is 0.984. This means that over 98% of variations in y can be explained by variations in x, and less than 2% of the variations would be explained by other variables.

In the previous example, it could be calculated that the coefficient of correlation between sales of Product Z and time is + 0.986, and r^2 is 0.972, indicating that over 97% of variations in annual sales of Product Z can be explained by the passage of time.

5.2.5 Problems with least squares regression analysis

There are several major problems with using linear regression analysis for forecasting:

(a) It assumes that historical data can be used to forecast what will happen in the future, which may not be appropriate. In the previous example, there was a fall in sales between Year 7 and Year 8, which might indicate that sales of Product Z may be going into decline and the historical growth pattern of the past may not continue into the future.

(b) It assumes a linear relationship between changes in the value of y and changes in the value of x, which may also be an incorrect assumption.

(c) When the value of r is low, the reliability of a line of best fit must be questionable. For example, if r = + 0.60, only 36% of variations in y could be explained by changes in the value of x, leaving 64% of variations in y to be attributable to other factors.

(d) It assumes that the value of one variable, y, can be predicted or estimated from the value of one other variable, x. In reality the value of y might depend on several other variables, or a common external factor, not just x.

(e) As with any forecasting process, the amount of data available is very important. Even if correlation is high, if the analysis is based on no more than about ten pairs of values, we must regard any forecast as being somewhat unreliable.

Exam focus point

The December 2011 exam included a Section B question which asked candidates to evaluate linear regression and correlation data for use in the pricing decision for an e-learning product, particularly highlighting any limitations in using such data. This question was an unpopular choice and a general lack of knowledge in this area was evident in many of those who did attempt it.

5.2.6 Least squares regression analysis for other dependent relationships

The example of least squares regression analysis for forecasting is an example of time series analysis, and forecasting future values of y from a trend line over time. The same technique may be used to predict a relationship between other independent and dependent variables.

For example, it may be possible to predict the amount of a household's monthly spending (dependent variable) from the amount of monthly income that members of the household earn. Historical data could be used to calculate a linear relationship between the two variables, and the coefficients of correlation and determination could be used to measure the strength of the connection between them.

The only requirements for estimating dependent relationships and values are that:

(a) An independent and a dependent variable should be identified

(b) Each of them should be measurable quantitatively, in pairs of data (values for x and corresponding values for y).

5.2.7 Time series analysis with seasonal or cyclical variations

Forecasting future values over time (time series analysis) from historical data can be complicated by the existence of seasonal variations or cyclical variations in the value of in the dependent variable y. For example, forecasting future sales in each month from historical sales data may be complicated by the fact that there are regular seasonal variations in monthly sales, with higher sales in some months and lower sales in others.

Moving averages can be used to:

(a) Calculate a historical trend line, from which it is possible to establish a trend line of best fit, using linear regression analysis (or another forecasting method), and measure the correlation between time and the dependent variable (using r or r^2)

(b) Estimate the amount of seasonal variation for each 'season' (day of the week, or month or quarter of the year)

(c) Combine forecasts using the line of best fit and the estimated seasonal variation to forecast future seasonal sales in the future.

5.2.8 Example: trend line and seasonal variations

Sales of Product x (in units) in each quarter for the years 2008 – 2011 were as follows.

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
2008	94	111	124	106
2009	102	117	135	118
2010	109	127	142	122
2011	110	135	152	128

Management are assuming that sales are on a linear rising trend, but with seasonal variations in sales in each quarter.

Required

(a) What is a suitable estimate of seasonal variations in sales each quarter?

(b) If the trend line estimate for sales in the four quarters of 2012 is 136, 138, 140 and 142 in quarters 1, 2, 3 and 4 respectively, what will the forecast of sales be in each quarter of 2012?

Solution

(a) The first step is to calculate a trend line and seasonal variations from the trend in each quarter. The trend line is calculated as a moving average. Since there are four quarters in each year, a moving average would be calculated as the average of sales over a cycle of four quarters. However, the average of quarters 1, 2, 3 and 4 is quarter 2.5, and the average of quarters 2, 3, 4 and 5 is quarter 3.5. To obtain a moving average for quarter 3, we must therefore calculate the moving average of quarters 1 – 4 and quarters 2 – 5, and then calculate the average of these.

In the table below, the column for the moving total for 2008 Quarter 3 is the sum of sales in time periods (1 – 4) + (2 – 5). Similarly the moving total for 2008 Quarter 4 is the sum of sales in time periods (2 – 5) + (3 – 6) , and so on. The trend line is calculated by dividing the moving total by 8 (8 quarters in the total) and the total variation for the quarter is the difference between actual sales and trend line sales in the quarter.

Year	Qtr	Time period	Sales	Moving total	Trend	Variation	Seasonal variation	Residual
2008	1	1	94					
	2	2	111					
	3	3	124	878	109.75	+ 14.25	+ 15.9	– 1.65
	4	4	106	892	111.50	–5.50	– 4.0	– 1.50
2009	1	5	102	909	113.63	– 11.63	– 14.6	+ 2.97
	2	6	117	932	116.50	+ 0.50	+ 2.7	– 2.2
	3	7	135	951	118.88	+ 16.12	+ 15.9	+ 0.22
	4	8	118	968	121.00	– 3.00	– 4.0	+ 1.0
2010	1	9	109	985	123.13	– 14.13	– 14.6	+ 0.47
	2	10	127	996	124.50	+ 2.50	+ 2.7	– 0.20
	3	11	142	1,001	125.13	+ 16.87	+ 15.9	+ 0.97
	4	12	122	1,010	126.25	– 4.25	– 4.0	– 0.25
2011	1	13	110	1,028	128.50	– 18.50	– 14.6	– 3.90
	2	14	135	1,044	130.50	+ 4.50	+ 2.7	+ 1.80
	3	15	152					
	4	16	128					

The seasonal variation for each quarter is calculated as the average of the variations for the quarter, as shown below. Adjustments are made so that the total of seasonal variations from the trend line each year add up to 0, and there is some rounding of the figures to eliminate the seasonal variations to one decimal place.

	Q1	Q2	Q3	Q4	Total
2008			+ 14.25	– 5.50	
2009	– 11.63	+ 0.50	+16.12	– 3.00	
2010	– 14.13	+ 2.50	+ 16.87	– 4.25	
2011	– 18.50	+ 4.50			
Total	– 44.26	+ 7.50	+ 47.24	– 12.75	
Average	– 14.75	+ 2.50	+ 15.75	– 4.25	– 0.75
Reduce to 0	+ 0.19	+ 0.19	+0.19	+ 0.19	+ 0.75
Adjusted	– 14.56	+ 2.69	+ 15.94	– 4.06	
Round	– 14.6	+ 2.7	+ 15.9	– 4.0	0

The seasonal variations are shown in the large table, and the residual is the difference between the actual variation in each quarter (difference between actual sales and the trend line) and the estimated seasonal variation.

When the residual is large, the accuracy of either the trend line or the seasonal variation estimates would be called into question.

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7.2 The threat from substitute products

A **substitute product** is a goods or service produced by **another industry** which satisfies the same customer needs. Substitutes are always present, but they can be easy to overlook because they may be very different from the industry's product. For example, video conferencing could be a substitute for business travel.

Exam focus point

It is very easy to misunderstand the nature of substitute products in Porter's model: while they provide competition, they are **not** goods or services produced by competitors in the same industry.

Case Study — **The Channel Tunnel**

Passengers have several ways of getting from London to Paris, and the pricing policies of the various industries transporting them there reflects this.

(a) 'Le Shuttle' carries cars in the Channel Tunnel. Its main competitors come from the ferry companies, offering a substitute service. Therefore, you will find that Le Shuttle sets its prices with reference to ferry company prices, and vice versa.

(b) Eurostar is the rail service from London to Paris/Brussels. Its main competitors are not the ferry companies but the airlines. Prices on the London-Paris air routes fell with the commencement of Eurostar services, and some airlines have curtailed the number of flights they offer.

When the threat of substitutes is high, industry profitability suffers. Substitute products or services limit an industry's profit potential by placing a ceiling on prices (because buyers will switch to the substitute if it offers a better value alternative).

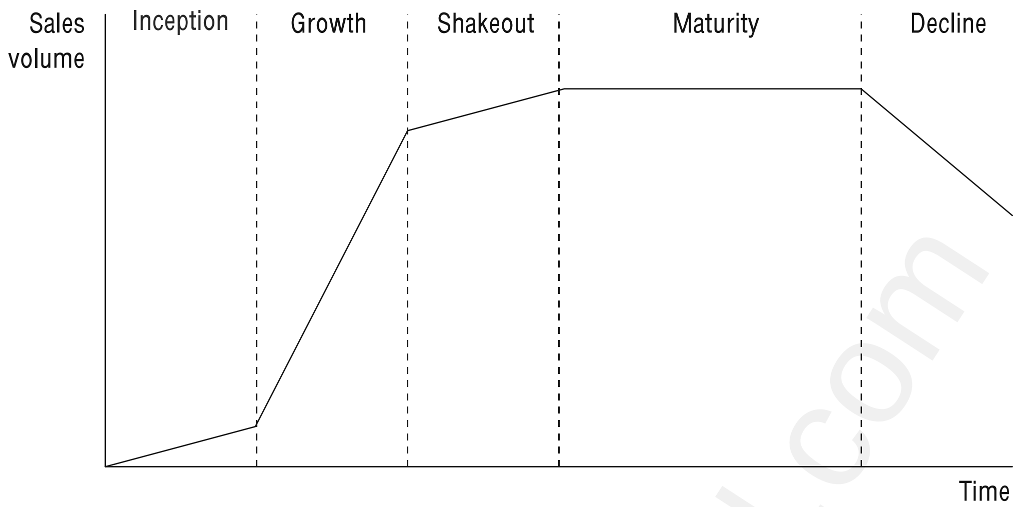
The threat of a substitute is high if:

- It offers an attractive alternative to the industry's product in terms of price and performance.
- The buyer's cost of switching to the substitute is low.

7.3 The bargaining power of customers

Customers want better quality products and services at a lower price. Satisfying this want might force down the profitability of suppliers in the industry. Just how strong the position of customers will be depends on a number of factors.

- How much the customer buys
- How many buyers there are: if there are relatively few buyers but each is large relative to the supplier, then the buyers will be powerful
- How critical the product is to the customer's own business (if the customer is completely reliant on a product, this will reduce the customer's bargaining power)
- Switching costs (ie the cost of switching supplier)
- Whether the products are standard items (hence, easily copied) or specialised
- The customer's own profitability: a customer who makes low profits will be forced to insist on low prices from suppliers
- Customer's ability to bypass the supplier (or take over the supplier)
- The skills of the customer purchasing staff, or the price-awareness of consumers
- When product quality is important to the customer, the customer is less likely to be price-sensitive, and so the industry might be more profitable as a consequence



Industry lifecycle

The characteristics of the industry at the different phases of the lifecycle are shown in the table below.

	Inception	**Growth**	**Shakeout**	**Maturity**	**Decline**
Customers	Experimenters, innovators	Early adopters	Growing selectivity of purchase	Mass market, Products well known	Price competition Commodity product
R&D	High	Extend product before competition	Seek lower cost methods of supply to access new markets	Low	
Company	Early mover Production focused	React to more competitors with increased marketing mass production	Potential consolidation through taking-over rivals. Long production runs	Battles over market share. Seek cost reduction. Long production runs	Cost control or exit
Competitors	A few No major barriers to entry	More entrants to the market	Many competitors, price cutting but weeding out of weaker players	Depending on industry, a few large competitors Difficult for newcomers to dislodge entrenched companies	Price-based competition, fewer competitors
Profitability	Low or negative, as an investment	Growing	Levelling off	Stable, high or under pressure	Falling, unless cost control

The industry life cycle has strategic implications for organisations operating in that industry. Management must pursue different strategies at each stage.

4.6 The customer lifecycle

The **customer lifecycle** concept is less developed than the equivalent product and industry lifecycle models, but it can be useful to consider the following matters.

(a) **Promotional expense** relating to a single customer is likely to be heavily **front-loaded**: it is much cheaper to retain a customer than to attract one.

(b) It is likely that **sales** to a customer will start at a low level and increase to a higher level as the customer gains confidence, though this is not certain and will vary from industry to industry.

(c) A customer who purchases a basic or commodity product initially may move on to **more differentiated products** later.

(d) In consumer markets, career progression is likely to provide the individual with steadily increasing amounts of disposable income, while the **family lifecycle** will indicate the ranging nature of likely purchases as time passes.

Any attempt to estimate lifecycle costs and revenues should also consider existing and potential **environmental impacts**, including, in particular, the likely actions of competitors and the potential for product and process innovation.

5 Opportunities and threats

FAST FORWARD

The strategic influence of the environment may be summarised into lists of **opportunities** and **threats**.

It is important to remember the purpose of all environmental analysis ideas is to provide input into the process of designing a **practical business strategy**.

One very useful way of thinking about the implications of environmental information is to consider it in terms of **opportunities and threats**.

5.1 Threats

For a commercial organisation the most urgent threats are likely to emerge from within the immediate industry arena. The **five forces** model provides a good summary of the threats inherent here, supplemented by strategic group analysis. Recognising threats in the wider PESTEL environment is, perhaps, more difficult since it covers such an enormous range of factors.

5.2 Opportunities

Opportunities may take the form of **strategic gaps**: these are potentially profitable aspects of the competitive environment that are not being exploited by rivals. JS&W give several examples of how these might arise.

(a) Potential **substitutes** for existing products might be created. This is largely a technology-based opportunity, but an important route to the development of substitutes is the imaginative development of new uses for existing products and methods.

(b) Other **strategic groups** may present opportunities, especially if there are changes in the macro-environment, such as deregulation or opening of new markets in developing countries.

(c) It may be possible to target **different strategic customers**. In the case of consumer goods, the development of internet selling means that the ultimate user is displacing the distributor as the strategic customer.

(d) There may be potential to market **complementary products**. For example, capital goods manufacturers routinely offer credit services to assist the customer to buy.

(e) New **market segments** may have potential, though there may be a need to adapt the product.

intermediaries, **market intelligence** is a key resource; knowledge of who needs to buy what, when and at which price, enables profitable trading. In obtaining this resource, personal contact and networking are being superseded by IT systems, whose effective use therefore becomes a threshold competence.

2.2.3 Design of products and processes

Well-designed and operated **business processes** can be a source of cost efficiency, minimising both direct and indirect costs. Examples include obvious matters such as labour productivity, materials yield and the careful control of working capital. JS&W also mention the **management of capacity-fill**. This problem is typical of service sectors such as transport or live entertainment, where there is no possibility of storing unfilled seats. This is, in fact, yet another kind of scale economy and is known in economic theory as the **utilisation of indivisibilities**.

We will look at business processes and aspects of improving processes in more detail later in this Study Text.

Product design also affects the cost base and can have impact on costs beyond those of supplies and the production process. Aircraft, for example, are now commonly designed so as to minimise **lifetime costs**, with ease of servicing and repair built in.

2.2.4 Experience

You are probably familiar with the way the **learning curve** effect has been used for many years as a means of estimating the future manufacturing costs of existing products. (The learning curve illustrates that as workers become more familiar with their jobs, they learn to do them more efficiently. As a process is repeated, it is expected that costs will be reduced due to this increased efficiency.)

The principle can be extended to activities other than manufacturing, to the extent that the passage of time should allow any organisation to improve the cost efficiency of any of its activities and thus experience a continuing decline in real unit costs. This can be seen in the **experience curve**: as output increases, the cost per unit of output falls. This wider experience curve effect holds out the possibility of developing core competences through the acquisition of experience, though the probability that this will happen is low. There are other important considerations.

(a) There should be an advantage in being the **first mover** in a new market, in that it should give an opportunity to create an experience-based cost advantage lead over later-entering rivals.

(b) **Outsourcing** may allow an organisation to benefit from the experience of suppliers. Outsourcing is discussed in more detail later in this Study Text.

(c) Since **competitive rivalry** prompts all the firms in an industry to seek cost advantage, as mentioned earlier, so it follows that they will all seek the experience advantages that come with growth. This will be particularly apparent during the growth phase of the industry lifecycle.

3 Strategic capability and sustainable competitive advantage

FAST FORWARD

If strategy is to be based on strategic capabilities, those capabilities must have four qualities.

- **Value to buyers**
- **Rarity**
- **Robustness** (difficult for competitors to imitate)
- **Non-substitutability**

Under conditions of **hyper-competition**, organisations must possess **dynamic capabilities:** the ability to develop and adjust competences to cope with rapidly changing environmental pressures.

Even if we do not entirely accept the resource-based view of strategy, it is clear that unique resources and core competences are of great importance in creating and sustaining competitive advantage. JS&W

(b) The substitute **competence**: an example is the deployment of expert systems as substitutes for expensive professional advisers.

3.5 Hypercompetition and dynamic capabilities

The nature of the strategic capabilities, as we have discussed them so far, is that they are **long-term phenomena**: tangible and intangible resources will be more valuable if they can be counted on to last a long time, while the development of core competences might well be expected to be a fairly protracted process.

Under conditions of **hypercompetition**, described earlier in this Study Text, strategic capability takes a different form. In order to deal with the rapid market changes seen under conditions of hypercompetition, firms must possess **dynamic capabilities**.

Key term

Dynamic capabilities are an organisation's abilities to develop and change competences to meet the needs of rapidly changing environments. *JS&W*

Such capabilities demand the ability to change, to innovate and to learn. They can take many forms and may include such things as systems for new product development or the acquisition of market intelligence and the absorption of new skills and products acquired by merger or acquisition. Indeed, we might regard the ability to 'develop and change competences' as a competence in its own right a higher-order competence, perhaps.

4 Knowledge

FAST FORWARD

The aim of **knowledge management** is to capture, organise and make widely available all the knowledge the organisation possesses, whether **explicit** (in recorded form) or **tacit** (in people's heads).

Knowledge management is a relatively new concept in business theory. It is connected with the theory of the **learning organisation** and founded on the idea that knowledge is a major source of competitive advantage in business.

Studies have indicated that 20 to 30 percent of company resources are wasted because organisations are not aware of what knowledge they already possess. Lew Platt, Ex-Chief Executive of Hewlett Packard, has articulated this, saying 'If only HP knew what HP knows, we would be three times as profitable'.

Knowledge is thus seen as an important **resource** and may in itself constitute a **competence**: it can certainly **underpin** many competences.

Key term

Organisational knowledge is the collective and shared experience accumulated through systems, routines and activities of sharing across the organisation. *JS&W*

4.1 Organisational learning

Organisational learning is particularly important in the increasing number of task environments that are both complex and dynamic. It becomes necessary for strategic managers to promote and foster a **culture that values intuition**, argument from **conflicting views** and **experimentation**. A willingness to back ideas that are not guaranteed to succeed is another aspect of this culture: there must be freedom to make mistakes.

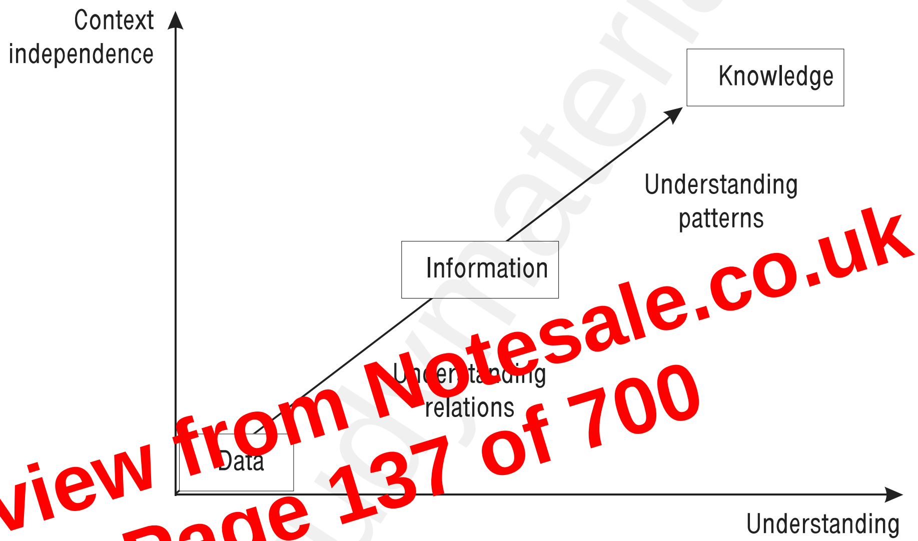
The aim of **knowledge management** is to exploit existing knowledge and to create new knowledge so that it may be exploited in turn. This is not easy. All organisations possess a great deal of data, but it tends to be unorganised and inaccessible. It is often locked up inside the memories of people who do not realise the value of what they know. This is what Nonaka calls **tacit knowledge**. Even when it is made **explicit**, by being recorded in some way, it may be difficult and time consuming to get at, as is the case with most paper archives. This is where knowledge management technology (discussed below) can be useful.

accounts people would like it back. However, if you found a list of customers in order of annual turnover, that would be rather more interesting from a marketing point of view. The information is **useful outside of its original context** of the accounts office.

This idea also applies to the difference between information and knowledge. If you were a visitor to a company and found a copy of the turnover listing, it would really only be useful to you if you were trying to sell the same sort of thing to the same customers. Its value outside its context would be small. However, if you found a marketing report that suggested, based on evidence, that customers were becoming more interested in quality and less interested in price, that would be applicable to a wide range of businesses, and possibly of strategic importance.

Here are a table and a diagram that summarise the progression from data to knowledge.

	Data	Information	Knowledge
Nature	Facts	Relationships between processed facts	Patterns discerned in information
Importance of context	Total	Some	Context independent
Importance to business	Mundane	Probably useful for management	May be strategically useful



Progression from data to knowledge

There is one final important point to note here and that is that the **progression** from data to knowledge is not the same in all circumstances. The scale is moveable and depends on the general complexity of the setting. Something may be **information** within its own context. Something similar may be **knowledge** in a different context. The difference will often be associated with the scale of operations.

Take the example of a customer going into insolvent liquidation with $200,000 outstanding on its account. For a small supplier with an annual turnover of, say, $10 million, a bad debt of this size would be of strategic importance and might constitute a threat to its continued existence. Advance notice of the possibility would be valuable **knowledge**. However, for a company operating on a global scale, the bad debt write-off would be annoying but still only one item in a list of bad debts – **data**, in other words.

4.2.2 Other ideas about knowledge

Individuals acquire knowledge in a variety of ways including those listed below:

- Education and training
- Experience of work
- Observation of others
- Informal exchanges such as coaching and brain storming

Here is an amended version of our earlier table. This one includes the relevant IT systems.

	Data	Information	Knowledge
Nature	Facts	Relationships between processed facts	Patterns discerned in information
Importance of context	Total	Some	Context independent
Importance to business	Mundane	Probably useful for management	May be strategically useful
Relevant IT systems	Office automation Data warehouse	Groupware Expert systems Report writing software Intranet	Data mining Intranet Expert systems

PER alert

Note that knowledge management is also important to you as an accountant. One of the Practical Experience Requirements you need to be able to demonstrate for your ACCA qualification is that you can 'Apply information systems and knowledge management to implement and support business functions and strategic objectives.'

5 Converting resources: the value chain

FAST FORWARD

The **value chain** describes those activities of the organisation that add value to purchased inputs. Primary activities are involved in the production of goods and services. Support activities provide necessary assistance. **Linkages** are the relationships between activities.

The **value chain** model of corporate activities offers a bird's eye view of the firm and what it does. Competitive advantage arises out of the way in which firms organise and perform **activities** to add value.

5.1 Value activities

Key term

Value activities are the means by which a firm creates value in its products.

Activities incur costs, and, in combination with other activities, provide a product or service which earns revenue.

5.2 Example

Let us explain this point by using the example of a **restaurant**. A restaurant's activities can be divided into buying food, cooking it, and serving it (to customers). There is no reason, in theory, why the customers should not do all these things themselves, at home. The customer however, is not only prepared to **pay for someone else** to do all this but also **pays more than the cost of** the resources (food, wages and so on). The ultimate value a firm creates is measured by the amount customers are willing to pay for its products or services above the cost of carrying out value activities. A firm is profitable if the realised value to customers exceeds the collective cost of performing the activities.

(a) Customers **purchase value**, which they measure by comparing a firm's products and services with similar offerings by competitors.

(b) The business **creates value** by carrying out its activities either more efficiently than other businesses, or by combining them in such a way as to provide a unique product or service.

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Case Study — **Apple and portfolio management**

American technology giant Apple, maker of the iPhone and iPad, actively manages its product portfolio in order to keep ahead of the competition. In March 2014, a report in the *Wall Street Journal* highlighted that the company had taken to hiring engineers from competing technology companies, including HTC. Apple's recruitment push has been largely driven by the need to produce new products faster in response to growing demand for the latest iPhone and iPad devices.

The lifecycle of many of Apple's products has reduced in recent years as competitors such as Samsung have been increasing the speed at which it develops its own range of mobile devices. To date, Apple has taken to releasing a new iPhone nearly every year to replace older models which are nearing the end of their lifecycle.

Case Study — **Television**

Over time, the design and specification of television sets has changed. Black and white screens have been superceded by colour; cathode ray tubes have been superceded by flat screens and plasma screens, and manufacturers have developed home cinema systems.

However, the switch to online distribution methods of video content has also had a significant impact on the television set industry. Online TV, mobile and tablet TV, and free TV catch up services offered by the major channels give viewers much greater choice, allowing them to watch programmes at their own convenience.

To prevent decline, the TV industry has had to adapt to cope with these changes, and internet enabled television has emerged. 3D televisions have also been developed to differentiate television from internet viewing and to capitalise on the changes in the cinema industry.

6.1.6 Difficulties of the product life cycle concept

(a) **Recognition**. How can managers recognise where a product stands in its life cycle?

(b) **Not always true**. The theoretical curve of a product life cycle does not always occur in practice. Some products have no maturity phase, and go straight from growth to decline. Some never decline if they are marketed competitively.

(c) **Changeable**. Strategic decisions can change or extend a product's life cycle.

(d) **Competition varies** in different industries. The financial markets are an example of markets where there is a tendency for competitors to copy the leader very quickly, so that competition has built up well ahead of demand.

6.2 Product portfolio models

Exam focus point

It has been common to analyse product portfolios using models such as the Boston Consulting Group (BCG) matrix. You will learn about such models in a later chapter. JS&W do not recommend their use in relation to portfolios of individual products, restricting them to the analysis of strategic business unit portfolios.

This means that where a question calls for some kind of product portfolio analysis, you should initially think in terms of the product life cycle. Nevertheless, there may be advantages in then considering the use of techniques such as the BCG matrix, but if you do so, you must also indicate that you know of JS&W's opinion.

this may form the basis for a strategy of product innovation. Conversely, where product lifecycles are short, as in consumer electronics, product development is fundamental to strategy.

7.7 Problems with R&D

(a) **Organisational**. Problems of authority relationships and integration arise with the management of R&D. The function will have to liaise closely with marketing and with production, as well as with senior management responsible for corporate planning: its role is both strategic and technical.

(b) **Financial**. R&D is by nature not easily planned in advance, and financial performance targets are not easily set. Budgeting for long-term, complex development projects with uncertain returns can be a nightmare for management accountants.

(c) **Evaluation and control**. Pure research or even applied research may not have an obvious pay off in the short term. Evaluation could be based on successful application of new ideas, such as patents obtained and the commercial viability of new products.

(d) **Staff problems**. Research staff are usually highly qualified and profession-orientated, with consequences for the style of supervision and level of remuneration offered to them.

(e) **Cultural problems**. Encouraging innovation means trial and error, flexibility, tolerance of mistakes in the interests of experimentation, high incentives etc. If this is merely a subculture in an essentially bureaucratic organisation, it will not only be difficult to sustain, but will become a source of immense 'political' conflict. The R&D department may have an 'academic' or university atmosphere, as opposed to a commercial one.

7.8 R&D and marketing

(a) Customer needs, as identified by marketers, should be a vital input to new product developments.

(b) The R&D department might identify possible changes to product specifications so that a variety of marketing mixes can be tried out and screened.

7.8.1 Intrapreneurship

FAST FORWARD

Intrapreneurship is entrepreneurship carried on at intermediate levels within the organisation.

The encouragement of intrapreneurship is an important way of promoting innovation. Such encouragement has many aspects.

(a) Encouragement for individuals to achieve results in their own way without the need for constant supervision.

(b) A culture of risk-taking and tolerance of mistakes.

(c) A flexible approach to organisation that facilitates the formation of project teams.

(d) Willingness and ability to devote resources to trying out new ideas.

(e) Incentives and rewards policy that support intrapreneurial activity.

7.8.2 Market pull and technology push

Marketers would have us believe that the best way to competitive advantage is to find out what the market wants and give it to them. We might call this approach, when applied to innovation, **market pull**. Unfortunately, it tends merely to produce better versions of products that already exist. A more fruitful approach may be the 'product orientation', disdained by the marketing fraternity: the world is full of products that noone asked for, including post-it notes and mobile phones that are also cameras. This approach we might call **technology push**.

9.2 Improving strategic capability

Despite the limitation discussed above, there may be opportunities to stretch existing capabilities and to add new ones.

(a) **Competences can be extended**. Competences that support existing business may be equally relevant to new activities.

(b) **Non-essential activities can cease**. It may be possible to make significant cost savings by abolishing, minimising or outsourcing current activities that do not support critical success factors.

(c) **Best practice can be extended**. Strategic capability identified in one part of the organisation might be introduced in other parts; though the difficulties associated with the management of change can make this very difficult.

(d) **Activities can be added and existing ones improved** in order to better support critical success factors.

(e) **Activities can be re-structured**. System overlaps and inconsistencies may require attention, particularly when there are marked differences between the requirements of the various market segments served.

(f) **Weaknesses can be remedied**. Known weaknesses in resources or activities might have the potential to create competitive advantage if suitable market opportunities exist. Such weaknesses must then be remedied by suitable investment and management activity.

(g) **External capability can be introduced** by acquisition and through alliances and joint ventures.

9.3 Developing competences through the human resource

Since much strategic capability resides in the organisation's staff in the form of their abilities and skills, human resource development can be particularly important in building that capability.

(a) **Recruitment and selection** practice can be designed to emphasise the need for particular aptitudes, such as leadership or innovation.

(b) **Training and development** can be targeted at specific requirements rather than generic skills.

(c) **Individual strategic awareness** can be developed so that staff understand how their activities enhance strategic capability.

10 SWOT analysis 6/14, 6/11, 6/10, 6/09

FAST FORWARD

The **SWOT analysis** combines the results of the environmental analysis and the internal appraisal into one framework for assessing the firm's current and future strategic fit, or lack of it, with the environment. It is an analysis of the organisation's strengths and weaknesses, and the opportunities and threats offered by the environment. Weirich's TOWS matrix emphasises the importance of threats and opportunities.

We examined the way in which **opportunities and threats** in the environment are detected and analysed in the previous chapters. In this chapter, we have discussed the analysis of the organisation's strategic capability; that is to say, its **strengths and weaknesses**. A complete awareness of the organisation's environment and its internal capacities is *necessary* for a rational consideration of future strategy, but it is not *sufficient*. The threads must be drawn together so that potential strategies may be developed and assessed. This is done by combining the internal and external analyses into a **SWOT analysis** or **corporate appraisal**.

Key term

SWOT analysis summarises the key issues from the business environment and the strategic capability of an organisation that are most likely to impact on strategy development. *JS&W*

The utilitarian approach may also be questioned for its potential effect upon minorities. A situation in which a large majority achieved great happiness at the expense of creating misery among a small minority would satisfy the 'greatest good' principle. It could not, however, be regarded as ethically desirable.

However, utilitarianism can be a useful guide to conduct. It has been used to derive wide ranging rules and can be applied to help us make judgements about individual, unique problems.

1.5 Deontological ethics

Deontology is concerned with the application of universal ethical principles in order to arrive at rules of conduct, the word deontology being derived from the Greek for 'duty'. Whereas the consequentialist approach judges actions by their outcomes, deontology lays down *a priori* criteria by which they may be judged in advance. The definitive treatment of deontological ethics is found in the work of Immanuel Kant.

Kant suggested that if we make moral judgements about facts, the criteria by which we judge are separate from the facts themselves: the criteria come from within ourselves and are based on an intuitive awareness of the nature of good.

For Kant, moral conduct is defined by categorical imperatives. A **categorical imperative**, however, defines a course of action without reference to outcomes. We must act in certain ways because it is right to do so – **right conduct is an end in itself**.

Kant arrived at two formulations of the categorical imperative with which we should be familiar:

(a) Never act in a way that you would condemn in others.

(b) Do not treat people simply as a means to an end. (Note that this does not preclude us from using people as a means to an end as long as we, at the same time, recognise their right to be treated as autonomous beings. Clearly, organisations and even society itself could not function if we could not make use of other people's services.)

1.6 Natural law

Natural law approaches to ethics are based on the idea that a set of objective or 'natural' moral rules exists and we can come to know what these rules are. In terms of business ethics, the natural law approach deals mostly with rights and duties. Where there is a right, there is also a duty to respect that right.

Unfortunately, the implications about duties can only be as clear as the rights themselves and there are wide areas in which disagreement about rights persists.

1.7 Duty and consequences

In their pure form, neither the duties of natural law nor Kant's categorical imperative will admit consideration of the consequences of our actions: we act in a certain way because we are obeying inflexible moral rules.

Unfortunately, such an approach can have undesirable results. If people have absolute rights that we must respect whatever the circumstances, we may find that our actions in doing so harm the common good. An example is the accused person who commits an offence while on bail. The potential threat to public safety has to be balanced against the right of the individual to liberty. There is thus a great potential for conflict between courses of action based on the consequentialist approach and those based on deontology or natural law.

While individual cases are bound to provoke debate, it would be reasonable to suggest that an inflexible approach to rules of conduct is likely to produce ethical dilemmas. Deciding what to do when the arguments point in opposite directions is always going to be difficult. However, generally we do not have the option of doing nothing, and this is particularly true of business.

the head of department who 'empire builds', and the IT manager who buys an unnecessarily sophisticated system are all failing in their responsibilities to the owners of the company (usually, the shareholders) even though they have not acted illegally or received any material benefit themselves.

Case Study

Bonus culture in the banking industry

The former bosses of the two biggest casualties of the 2008 banking crisis in the UK have apologised 'profoundly and unreservedly' for their banks' failure.

Former Royal Bank of Scotland (RBS) chief executive Sir Fred Goodwin told MPs on the Treasury Committee that he 'could not be more sorry' for what happened. He also admitted that the bonus culture in banks had contributed to the crisis and needed to be reviewed.

But he added if bankers felt they were not paid enough, they would leave.

Andy Hornby, former CEO of HBOS, also conceded that the culture of cash bonuses needed looking at. 'The bonus system has proved to be wrong. Substantial cash bonuses do not reward the right kind of behaviour,' he said.

However, when he was asked whether the bonus culture encouraged excessive risk taking and had exacerbated the banking crisis, Sir Fred Goodwin argued that traders were trading within set limits, and were simply doing 'what they were authorised to do.'

However, a rather different picture is emerging from HBOS. It has emerged that a senior HBOS employee was sacked in 2004 for warning that the bank's risky sales culture could 'lead to disaster.' Paul Moore – who was head of group regulatory risk – was dismissed for pointing out that the bank was ignoring checks and balances. He argued that 'anyone whose eyes were not blinded by money, power and pride' would have realised that problems were building up for HBOS and other banks.

Mr Moore also insisted that the subsequent banking crisis could have been avoided if there were adequate systems to hold bank chiefs to account. The real problem, and the cause of this crisis, was that people were too afraid to speak up, and the balance of power was weighted far too much in favour of the executive.

Nonetheless, bonuses and poor internal controls were not the only cause of the bank's problems.

Sir Fred Goodwin oversaw a number of acquisitions that made RBS one of the world's biggest banks. But his takeover of Dutch rival ABN Amro late in 2007 is now seen as ill-timed and a deal too far, in the light of RBS's inability to survive the credit crunch without a massive injection of Government funds.

Sir Fred admitted that the deal to buy ABN was 'a big mistake'. 'We bought it at the top of the market, and anything we paid was an error. We are sorry we bought ABN Amro,' he added.

Adapted from an online article:

'Former banking bosses say sorry' (February 2011) published on the *BBC website*; www.bbc.co.uk

2 Social responsibility

FAST FORWARD

There is a fundamental split of views about the organisation's relationship with its stakeholders and the nature of corporate responsibility.

- The **strong view** that a range of goals should be pursued
- The **weak view** that the business organisation is a purely **economic force**, subject to law

2.1.2 Competitors

Competitors can be stakeholders. You may find this easier to understand if you think of all the competitors in a given industry as stakeholders in that industry's overall status and the public's perception.

2.1.3 Stakeholder risks

Stakeholder	Interests to defend	Response to risk
Internal Managers and employees (eg restructuring, relocation)	• Jobs/careers • Money • Promotion • Benefits • Satisfaction	• Pursuit of systems goals rather than shareholder interests • Industrial action • Negative power to impede implementation • Refusal to relocate • Resignation
Connected Shareholders (corporate strategy)	• Increase in shareholder wealth, measured by profitability, P/E ratios, market capitalisation, dividends and yield • Risk	• Sell shares (eg to predator) or replace management
Bankers (cash flows)	• Security of loan • Adherence to loan agreements	• Denial of credit • Higher interest charges • Receivership
Suppliers (purchase strategy)	• Profitable sales • Payment for goods • Long-term relationship	• Refusal of credit • Court action • Wind down relationships
Customers (product market strategy)	• Goods as promised • Future benefits	• Buy elsewhere • Complain • Sue
External Government	• Jobs, training, tax	• Tax increases • Regulation • Legal action
Interest/pressure groups	• Pollution • Rights • Other	• Publicity • Direct action • Sabotage • Pressure on government

How stakeholders relate to the management of the company depends very much on what **type of stakeholder** they are – internal, connected or external – and on the **level in the management hierarchy** at which they are able to apply pressure. Clearly a company's management will respond differently to the demands of, say, its shareholders and the community at large.

2.2 Balancing priorities

Cyert and March suggest that a business is actually run in the interests of an **organisational coalition** of stakeholders. Political processes managed by the strategic apex lead to a compromise on what the company's goals actually are. This usually results in a satisficing approach to balance the various priorities.

5.1.5 The Guiding Principles of Integrated Reporting

The International Integrated Reporting Council identified seven Guiding Principles which support the preparation of an integrated report:

(a) Strategic focus and future orientation
(b) Connectivity of information
(c) Stakeholder relationships
(d) Materiality
(e) Conciseness
(f) Reliability and completeness
(g) Consistency and comparability

Strategic focus and future orientation

A good integrated report should help users understand the organisation's strategy with particular emphasis on how value can be created over the short, medium and long term. To convey this message, the integrated report is likely to set out the significant risks and external opportunities available to the organisation, with the associated detail of how such issues can be reduced or exploited.

The board of directors can also use the report to communicate how the organisation's current strategy has been shaped by past experiences. A focus on future oriented information allows the board to highlight any prospective legal and/or regulatory matters which may impact the organisations ability to achieve its objectives.

Connectivity of information

A key part of integrated reporting focuses on the interrelatedness or 'connectivity of information' throughout the organisation. The IIRC highlight that integrated reporting is aimed at joining up the flow of information to allow users of integrated reports to better understand how resources (capitals) are being used in the pursuit of the organisation's strategic aims and to show how the entity's strategy is adapted to reflect 'real world' changes in the external environment.

It is important to note that integrated reporting is not aimed at attaching a monetary value to every aspect of the organisation's operations. It is fundamentally concerned with letting stakeholders evaluate value creation, and it does this by communicating a range of qualitative and quantitative performance measures. Key performance indicators are effective in communicating performance.

For example, when providing detail on customer satisfaction, this can be communicated as the number of customers retained compared to the previous year. Best practice in integrated reporting requires organisations to report on both positive and negative movements in 'capital' to avoid only providing half the story.

Stakeholder relationships

Integrated reporting highlights the importance of stakeholder relationships. An Integrated Report should highlight how the organisation interacts with key stakeholder groups. This provides the board with the opportunity to show that it understands the interests of different groups and sets out the organisation's approach to responding to stakeholder needs. Proponents of integrated reporting argue that a stronger emphasis on the importance of stakeholders is central to improving the transparency and accountability of organisational reporting.

Materiality

One of the Guiding Principles of integrated reporting requires management to disclose matters which are likely to impact on an organisation's ability to create value. Internal weaknesses and external threats regarded as being materially important are evaluated and quantified (where possible). This provides users with an indication of how management intend to combat risks, should they materialise.

Conciseness

The IIRC recognises that a good Integrated Report should be concise and to the point. Users of the report are likely to want sufficient detail to help them understand the organisation's performance and future strategic direction, without the need to be presented with irrelevant information.

Reliability and completeness

As discussed earlier in respect of materiality, an Integrated Report requires a balanced presentation of both positive and negative information. IIRC highlight that reliable information needs to be 'free from material error' if it is to be useful to interested parties. This requires the organisation to have in place a sound system of internal reporting. Furthermore, to be effective, an integrated report should be complete, meaning that certain matters must not be omitted simply because they relate to unfavourable movements in 'capitals'.

Consistency and comparability

A good integrated report should communicate the same type of information from period to period, eg reporting the same KPIs year on year. To support user understanding when there have been significant movements between periods, the Guiding Principles highlight the need for organisations to provide an explanation for the change and to quantify this if possible.

The principle of comparability requires integrated reports to be presented to allow for easier comparison with similar entities. Comparability in integrated reporting is particularly difficult to achieve as every organisation is unique and will create value differently. The IIRC highlights that comparability in information can be improved in reporting through the use of benchmarking an entity's performance against industry metrics (KPIs) and ratios eg the percentage movement in staff training and development programmes compared to the industry average.

The issue of comparability is further complicated as, at present, there is no compulsory requirement for organisations to adopt integrated reporting at all.

5.1.6 Implications of introducing integrated reporting

Implications	Comment
IT costs	The introduction of integrated reporting will most likely require significant upgrades to be made to the organisation's IT and information system infrastructure. Such developments will be needed to capture KPI data. Due to the broad range of business activities reported on using integrated reporting (customer, supplier relations, finance and human resources) it is likely the costs of improving the infrastructure will be significant.
Time/staff costs	The process of gathering and collating the data for inclusion in the report is likely to require a significant amount of staff time. This may serve to decrease staff morale if they are expected to undertake this work in addition to existing duties. This may require additional staff to be employed.
Consultancy costs	Organisations producing their first integrated report may seek external guidance from an organisation which provides specialist consultancy on integrated reporting. Consultancy fees are likely to be significant.
Disclosure	There is a danger that organisations may volunteer more information about their operational performance than intended. Disclosure of planned strategies and key performance measures are likely to be picked up by competitors.

Stakeholders

The ACCA acknowledges its obligations to its key stakeholders. In it's integrated reports ACCA highlight how it engages with a number of groups including, members, students and employers. The 2013/14 report notes that 'one of the integrated reporting principles we have found particularly helpful is that of stakeholder engagement. Since we moved to an integrated reporting approach, we have consulted with a range of stakeholders on every report, asking whether it meets their needs and refining our reporting in response to their feedback.'

Strategic focus and risk

ACCA's 2011/12 report placed a strong focus on the steps the ACCA had been taking to achieve its vision up to 2015. This theme is continued in the 2013/14 report which introduces ACCA's new organisational strategy up to 2020. Those factors likely to impact on ACCA's ability to achieve its objectives are covered in a section designated to risk management.

Value creation

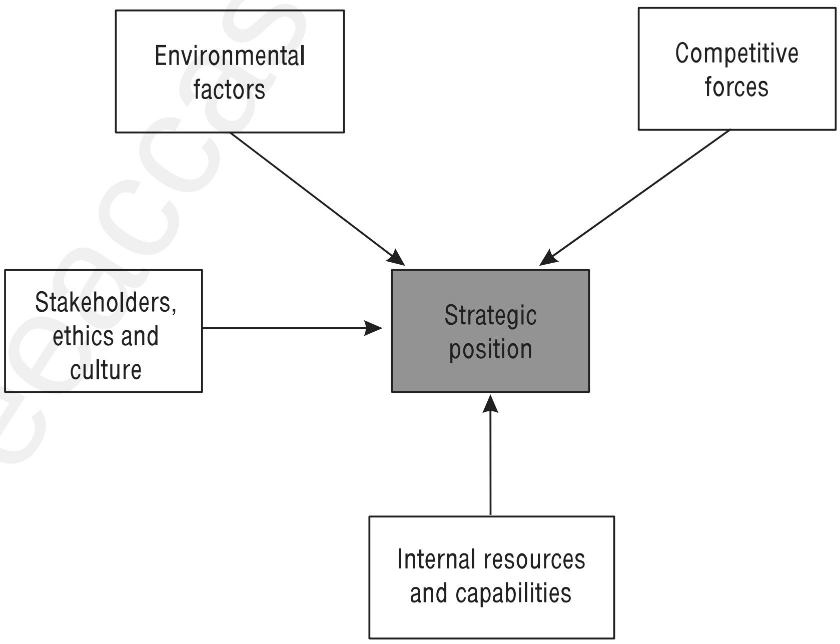
In addition to the traditional reporting of financial performance, the integrated reports also detail those 'capitals' regarded as being important in creating value over the long term. One capital mentioned focuses on the role of people in the organisation.

The ACCA regard having the right people with the right skills and capabilities as being critical in being able to deliver its strategy. Over the year, the ACCA enhanced its people capital through investments in staff development and training programmes.

Source: The ACCA's first integrated report and subsequent annual reports can be found at: www.accaglobal.com

5.2 Section summary

This chapter brings us to the end of Section A of the P3 syllabus, 'Strategic position'. In the next chapter, we will start looking at the 'Strategic choices' available to an organisation. These choices obviously depend on its current position and the various internal and external factors affecting it, which we have looked at in Section A. The diagram below summarises these factors which shape strategic position:



Answers to Quick Quiz

1 The extent to which it will exceed its minimum obligation to shareholders

2 Internal; connected; external stakeholders.

3 C A stakeholder group with high interest but low power does not have much ability to influence strategy on its own, but it may be able to influence other more powerful stakeholders. It should therefore be **kept informed**.

4 When moral expectations are accepted as obligations

5 The conduct of the organisation's senior officers

6 A social or environmental cost of the organisation's activities not borne by the organisation

7 Stories; symbols; power structures; organisational structures; control systems; rituals and routines

8 The common, basic assumptions and beliefs held by an organisation's decision-makers

Now try the question below from the Practice Question Bank

Number	Level	Marks	Time
Q6	Examination	20	36 mins

Study guide

		Intellectual level
B1	**The influence of corporate strategy on an organisation**	
(a)	Explore the relationship between a corporate parent and its business units	2
(b)	Assess the opportunities and potential problems of pursuing different corporate strategies of product/market diversification from a national, international and global perspective	3
(c)	Assess the opportunities and potential problems of pursuing a corporate strategy of international diversity, international scale operations and globalisation	3
(d)	Discuss a range of ways that the corporate parent can create and destroy organisational value	2
(e)	Explain three corporate rationales for adding value – portfolio managers, synergy managers and parental developers	3
(f)	Explain and apply the following portfolio models (the BCG growth/share matrix, public sector matrix, the parenting matrix or Ashridge Portfolio display) to assist corporate parents in managing their business portfolios.	3
B2	**Alternative approaches to achieving competitive advantage**	
(a)	Evaluate, through the strategy clock, generic strategy options available to an organisation	3
(b)	Advise on how price-based strategies, differentiation and lock-in can help an organisation sustain its competitive advantage	3
(c)	Assess opportunities for improving competitiveness through collaboration	3
B3	**Alternative directions and methods of development**	
(a)	Determine generic development directions (employing an adapted Ansoff matrix and a TOWS matrix) available to an organisation	2
(b)	Assess how internal development, mergers, acquisitions, strategic alliances, and franchising can be used as different methods of pursuing a chosen strategic direction	3
(c)	Establish success criteria to assist in the choice of a strategic direction and method (strategic options)	2
(d)	Assess the suitability of different strategic options to an organisation	3
(e)	Assess the feasibility of different strategic options to an organisation	3
(f)	Establish the acceptability of strategic options to an organisation through analysing risk and return on investment	3

Exam guide

This is another chapter that is packed with highly examinable material. In particular, it is very common in business strategy exams to be confronted with a complex scenario and be required to suggest sensible courses of action, with reasonable justification. It is very important, therefore, to understand the general circumstances in which a particular strategic option is appropriate. It is not sufficient to be able to describe the options without understanding when they are to be recommended. A strategy must be appropriate to its context, and therefore any strategy you recommend in an exam answer must be appropriate to the scenario described in the question.

The chapter concludes with a discussion of success criteria: these are the criteria against which possible courses of action are judged and they draw together the threads of choice we emphasise above. Pay careful attention to the nature of these criteria: they are not as simple as they might seem to be.

(c) **Legal and regulatory factors** such as industrial standards and protection of intellectual property, which encourage the development and spread of standardised technology and design.

(d) **Markets** trading in international commodities; commodities are not physically exchanged, only the rights to ownership. A buyer can, thanks to efficient systems of trading and modern communications, buy a commodity in its country of origin for delivery to a specific destination at some future time.

(e) **The internet**: major companies are developing online systems of internal co-ordination and procurement.

(f) **Government policy** in many countries seeks to control the balance of payments by discouraging imports. Government policy towards importers will also reflect their quite proper desire to expand their economies and hence, employment and improve the local standard of living. Local manufacture may thus be the only way to access some markets.

3.4 Designs for global businesses

FAST FORWARD

Bartlett and Ghoshal discern four types of organisations, depending on the strength or weakness of pressure to globalise and the need for local adaptation:

- Global environment: (geocentric) global product divisions
- International environment; (ethnocentric) international division
- Transnational environment; (polycentric) integrated systems and structures
- Multinational environment; (polycentric) national or regional divisions

Bartlett and Ghoshal find that the pressures driving globalisation exist independently of the need for local responsiveness; and that both vary from industry to industry. The relationship between these pressures influences both the management orientation and the structure of the company that operates internationally.

(a) The **global company**, if active in more than one industry, is likely to be organised into product divisions with global scope. Efficiency is likely to be a key strategic competency.

(b) Companies operating in industries that require **little local differentiation** and at the same time are not subject to pressure for globalisation will tend to be structured with an international or export division.

(c) The **multinational environment** drives a polycentric orientation, with largely autonomous local operating companies. Responsiveness to local demand is likely to be a key strategic competency.

(d) The **transnational environment** is particularly difficult to respond to. Global scale is desirable but local conditions require differentiated approaches. The structural response may be the **global heterarchy**. Each regional or national unit achieves global scale and influence within the overall organisation by exploiting its specialised competences on behalf of the whole company. Some headquarters functions, such as R&D may be diffused across the organisation. The role of the global strategic apex is to promote a corporate culture and shared values that will promote co-operation and co-ordination. *JS&W* call this type of company a **transnational**: we will discuss it in more detail later in this Study Text.

	Low requirement for local adaptation and responsiveness	**High requirement for local adaptation and responsiveness**
High pressure to globalise	**Global environment** Geocentric orientation Global product divisions (Chemicals, construction)	**Transnational environment** Polycentric orientation Integrated systems and structures (Pharmaceuticals, motor vehicles)
Low pressure to globalise	**International environment** Ethnocentric orientation International division (Paper, textiles)	**Multinational environment** Polycentric orientation National or regional divisions (Fast food, tobacco)

6 Business unit strategy: generic strategies

FAST FORWARD

Business unit strategy involves a choice between being the lowest cost producer (**cost leadership**), making the product different from competitors' products in some way (**differentiation**) or specialising on a segment of the market (**focus**, by addressing that segment via a strategy of cost leadership or differentiation). **Porter** believes that a firm *must* choose one of these or be **stuck-in-the-middle**.

Competitive advantage is anything which gives one organisation an edge over its rivals. *Porter* argues that a firm should adopt a competitive strategy intended to achieve competitive advantage for the firm.

Competitive strategy means 'taking offensive or defensive actions to create a dependable position in an industry, to cope successfully with ... competitive forces and thereby yield a superior return on investment for the firm. Firms have discovered many different approaches to this end, and the best strategy for a given firm is ultimately a unique construction reflecting its particular circumstances'. (*Porter*)

6.1 The choice of competitive strategy

Porter believes there are three **generic strategies** for competitive advantage.

Key terms

Cost leadership means being the lowest cost producer in the industry as a whole.

Differentiation is the exploitation of a product or service which the *industry as a whole* believes to be unique.

Focus involves a restriction of activities to only part of the market (a segment).

- Providing goods and/or services at lower cost (**cost-focus**)
- Providing a differentiated product or service (**differentiation-focus**)

Cost leadership and differentiation are industry-wide strategies. Focus involves segmentation but also the pursuit, **within the chosen segment only**, of a strategy of cost leadership or differentiation.

Exam focus point

Porter's generic strategy model is one of a handful of truly vital theories that you **absolutely must master** for your exam. Study this section with great care and understand the implications of each strategy for the companies that might adopt them. Understanding this area of theory will not only equip you to make sensible suggestions in your answers to many questions, it will also enable you to appreciate important background detail in a wide range of question scenarios.

6.1.1 Cost leadership

A cost leadership strategy seeks to achieve the position of lowest-cost producer in the **industry as a whole**. By producing at the lowest cost, the manufacturer can compete on price with every other producer in the industry, and earn the higher unit profits, if the manufacturer so chooses.

How to achieve overall cost leadership

(a) Set up production facilities to obtain **economies of scale**.

(b) Use the **latest technology** to reduce costs and/or enhance productivity (or use cheap labour if available).

(c) In high technology industries, and in industries depending on labour skills for product design and production methods, exploit the **learning curve effect**. By producing more items than any other competitor, a firm can benefit more from the learning curve, and achieve lower average costs.

(d) Concentrate on **improving productivity**.

(e) **Minimise overhead costs**.

(f) **Get favourable access to sources of supply**.

Classic examples of companies pursuing cost leadership are Black and Decker and South West Airlines. Large out-of-town stores specialising in one particular category of product are able to secure cost leadership by economies of scale over other retailers. Such shops have been called **category killers**; an example is PC World.

6.1.2 Differentiation

A differentiation strategy assumes that competitive advantage can be gained through **particular characteristics** of a firm's products. Products may be divided into three categories.

(a) **Breakthrough products** offer a radical performance advantage over competition, perhaps at a drastically lower price (eg float glass, developed by Pilkington).

(b) **Improved products** are not radically different from their competition but are obviously superior in terms of better performance at a competitive price (eg microchips).

(c) **Competitive products** derive their appeal from a particular compromise of cost and performance. For example, cars are not all sold at rock-bottom prices, nor do they all provide immaculate comfort and performance. They compete with each other by trying to offer a more attractive compromise than rival models.

How to differentiate

(a) **Build up a brand image** (eg Pepsi's blue cans are supposed to offer different 'psychic benefits' to Coke's red ones).

(b) **Give the product special features** to make it stand out (eg Russell Hobbs' Millennium kettle incorporated a new kind of element, which boils water faster).

(c) **Exploit other activities of the value chain** (for example, quality of after-sales service or speed of delivery).

Note: We looked at the value chain earlier in this Study Text. If you cannot remember the activities described in the value chain, you should refer back to it to refresh your memory.

Generic strategies and the five forces

Competitive force	Advantages		Disadvantages	
	Cost leadership	Differentiation	Cost leadership	Differentiation
New entrants	Economies of scale raise entry barriers	Brand loyalty and perceived uniqueness are entry barriers		
Substitutes	Firm is not so vulnerable as its less cost-effective competitors to the threat of substitutes	Customer loyalty is a weapon against substitutes		
Customers	Customers cannot drive down prices further than the next most efficient competitor	Customers have no comparable alternative Brand loyalty should lower price sensitivity		Customers may no longer need the differentiating factor Sooner or later customers become price sensitive
Suppliers	Flexibility to deal with cost increases	Higher margins can offset vulnerability to supplier price rises	Increase in input costs can reduce price advantages	

7.1 Sustaining price-based strategies

(a) **Low margins** can be sustained, either by increased volumes or by cross-subsidisation from another business unit.

(b) A **cost leader** can operate at a price advantage, but to be sustainable, cost leaders must constantly and aggressively drive down all of their costs.

(c) A cost leader or a company with extensive financial resources can win a **price war**.

(d) A **no-frills strategy** can succeed in the long term if it is aimed at a segment that particularly appreciates low price.

7.2 Sustaining differentiation

Sustaining differentiation is difficult. To begin with, it is more than just being *different*: the difference must be **valued by customers**. Secondly, a difference that a competitor can easily imitate gives no sustainable advantage.

(a) **Attempts at imitation can be obstructed** by, for example, securing preferred access to customers or suppliers through bidding or licensing procedures.

(b) Some resources are **inherently immobile**. This can be the result of **intangibility**, as in the case of brands; high customer switching costs, as with proprietary technology; or **co-specialisation**, which occurs when organisations' value chains are intimately linked.

(c) **Cost advantage** can be used to sustain differentiation, rather than price advantage by investing in innovation, brand management or quality improvement.

7.3 Lock-in

Lock-in is achieved in a market when a company's product becomes the **industry standard**. Direct competitors are reduced to minor niches and **compatibility** with the industry standard becomes a prerequisite for complementary products. Microsoft has achieved this position in the market for PC operating systems and is only challenged by Linux because the latter product is free to use. Sony regularly attempts to establish industry standards in order to achieve market dominance, with varying degrees of success. The original Walkman became the industry standard, but the Betamax video recording standard lost to VHS. The concept of lock-in is equally applicable to companies following strategies of cost leadership or differentiation.

Factors affecting lock-in

(a) **Perception of dominance**: potential competitors and suppliers of complementary products will only conform to an attempt to set standards if they perceive the standard-setter as dominant in the market, usually in terms of market share.

(b) **First mover advantage**: a standard is more likely to be set early in the lifecycle of a new product than when it is mature.

(c) **Self-reinforcement**: once dominance is achieved, conforming with the standard becomes necessary for survival.

(d) **Fierce defence**: a firm that achieves lock-in will defend its position vigorously. Visa threatened to impose coercive settlement fees on its top 100 card issuers if they attempted to move their operations to MasterCard.

Lock-in is also known as the **delta model**, which is the term used by Hax and Wilde, who described it in their book of the same name.

9.2.5 New products: new markets (diversification)

Diversification occurs when a company decides to make **new products for new markets**. It should have a clear idea about what it expects to gain from diversification.

(a) **Growth.** New products and new markets should be selected which offer prospects for growth which the existing product-market mix does not.

(b) **Investing surplus** funds not required for other expansion needs, bearing in mind that the funds could be returned to shareholders. Diversification is a high risk strategy, having many of the characteristics of a new business start-up. It is likely to require the deployment of **new competences**.

We discuss divisionalisation and the role of the corporate headquarters further later in this Study Text.

9.3 Diversification and synergy

Synergy combined results produce a better rate of return than would be achieved by the same resources used independently. Synergy is used to justify diversification.

9.3.1 Obtaining synergy

Synergy is probably difficult to achieve in practice when one company takes over another. All too often, the expectations of synergy that help to justify a business combination fail to materialise. Synergy is probably more discussed in takeover bids than actually implemented.

Question — **Diversification**

A large organisation in road transport operates nationwide in general haulage. This field has become very competitive and with the recent down-turn in trade, has become only marginally profitable. It has been suggested that the strategic structure of the company should be widened to include other aspects of physical distribution so that the maximum synergy would be obtained from that type of diversification.

Suggest two activities which might fit into the suggested new strategic structure, explaining each one briefly. Explain how each of these activities could be incorporated into the existing structure. State the advantages and disadvantages of such diversification.

Answer

The first step in a suggested solution is to think of how a company operating nationwide in general road haulage might diversify, with some synergistic benefits. Perhaps you thought of the following.

(a) To move from **nationwide to international haulage**, the company might be able to use its existing contacts with customers to develop an international trade. Existing administration and depot facilities in the UK could be used. Drivers should be available who are willing to work abroad, and the scope for making reasonable profits should exist. However, international road haulage might involve the company in the purchase of new vehicles (eg road haulage in Europe often involves the carriage of containerised products on large purpose-built vehicles). Since international haulage takes longer, vehicles will be tied up in jobs for several days, and a substantial investment might be required to develop the business. In addition, in the event of breakdowns, a network of overseas garage service arrangements will have to be created. It might take some time before business builds up sufficiently to become profitable.

(b) Moving from general haulage to **speciality types of haulage**, perhaps haulage of large items of plant and machinery, or computer equipment. The same broad considerations apply to speciality types of haulage. Existing depot facilities could be used and existing customer contacts might be developed. However, expertise in specialist work will have to be 'brought in' as well as developed within the company and special vehicles might need to be bought. Business might take some time to build up and if the initial investment is high, there could be substantial early losses.

the BBC reported, CEO of RBS, Ross McEwan said, 'The divestment of Citizens is a key component of our plan to continue to strengthen RBS's capital position. The achievement of our plan will allow us to focus fully on the needs of our customers'.

Source:

'RBS US subsidiary Citizens in public share sale' (May 2012) published on the *BBC*

www.bbc.co.uk

Demerger can realise underlying asset values in terms of share valuation. ICI's demerger of its attractive pharmaceuticals business led to the shares in the two demerged companies trading at a higher combined valuation than those of the original single form.

Privatisation has been pursued by governments all over the world to raise funds and transform culture and performance.

10 Method of growth 12/13

FAST FORWARD

The **method of growth** can vary.

- Companies can grow organically, building up their own products and developing their own market
- They may choose to acquire these ready-made by buying other companies. Acquisitions are risky because of the incompatibility of different companies
- Many firms grow by other means, such as joint ventures, franchising and alliances

Exam focus point

The compulsory question in the December 2013 exam paper required students to explain and evaluate three methods of pursuing growth (internal growth, acquisition and strategic alliance) in relation to the organisation described in the case study scenario.

10.1 Organic growth

Organic growth (sometimes referred to as **internal development**) is the primary method of growth for many organisations, for a number of reasons. Organic growth is achieved through the development of internal resources.

10.1.1 Reasons for pursuing organic growth

(a) **Learning.** The process of developing a new product gives the firm the best understanding of the market and the product.

(b) **Innovation.** It might be the only sensible way to pursue genuine technological innovations, and exploit them. (Compact disk technology was developed by Philips and Sony, who earn royalties from other manufacturers licensed to use it.)

(c) There is **no suitable target for acquisition.**

(d) Organic growth can be **planned more meticulously** and offers little disruption.

(e) It is often **more convenient** for managers, as organic growth can be financed easily from the company's current cash flows, without having to raise extra money.

(f) The **same style of management and corporate culture** can be maintained.

(g) **Hidden or unforeseen losses are less likely** with organic growth than with acquisitions.

(h) **Economies of scale** can be achieved from more **efficient use of central head office** functions such as finance, purchasing, personnel and management services.

Resource deployment analysis makes a wider assessment of feasibility in terms of **resources** and **competences**. The resources and competences required for each potential strategy are assessed and compared with those of the firm. A two stage approach may be followed.

(a) Does the firm have the necessary resources and competences to achieve the **threshold** requirements for each strategy?

(b) Does the firm have the core competences and **unique resources** to maintain **competitive advantage**?

When assessing feasibility in this way, it is important to remember that it may be possible to acquire new competences and resources or to stretch existing ones. Such innovation is likely to be difficult to imitate.

12.3 Acceptability

The acceptability of a strategy depends on expected performance outcomes and the extent to which these are acceptable to stakeholders.

(a) **Financial considerations**. Strategies will be evaluated by considering how far they contribute to meeting the dominant objective of increasing shareholder wealth.

We will look at financial management decisions in more detail later in this Study Text, but there are a number of the financial indicators which should be considered to assess the acceptability of a strategy.

(i)	Return on investment	(v)	Cash flow
(ii)	Profits	(vi)	Price/Earnings
(iii)	Growth	(vii)	Market capitalisation
(iv)	EPS	(viii)	Cost-benefit analysis

Profitability analysis techniques include **forecast ROCE**, **payback period** and **NPV**, all of which you should be familiar with. These methods should not be overemphasised.

(i) They are developed for assessing **projects** where cash flows are predictable. This is unlikely to be easy with wider **strategies**.

(ii) There may be **intangible** costs and benefits associated with a strategy, such as an enhanced product range or image or loss of market share. **Cost-benefit analysis** is probably more appropriate for dealing with such development. See below.

Shareholder value analysis has the potential to provide a more realistic assessment of overall strategy than traditional financial measures such as NPV and forecast ROCE. This is because its emphasis on value management and understanding the organisation's system of value drivers requires managers to take an integrated view of current and potential future strategies and their overall effects.

(b) **Customers** may object to a strategy if it means reducing service, but on the other hand, they may have no choice.

(c) **Banks** are interested in the implications for cash resources, debt levels and so on.

(d) **Government**. A strategy involving a takeover may be prohibited under competition legislation.

(e) **The public**. The environmental impact may cause key stakeholders to protest. For example, out of town superstores are now frowned upon by national and local government in the UK.

(f) **Risk**. Different shareholders have different attitudes to risk. A strategy which changes the risk/return profile, for whatever reason, may not be acceptable. Financial ratio projections and sensitivity analysis may be useful in the assessment of risk.

Cost-benefit analysis may be an appropriate approach to acceptability where intangible effects are important, which is particularly the case in the public sector. This type of analysis attempts to put a monetary value on intangibles such as safety and amenity so that the impact of a strategy on all parties may be assessed.

PART C

Organising and enabling success

	Control	Change	Knowledge	Globalisation
Functional	* * *	*	* *	*
Multi-divisional	* *	* *	*	* *
Holding	*	* * *	*	* *
Matrix	*	* * *	* * *	* * *
Transnational	* *	* * *	* * *	* * *
Team	*	* *	* * *	*
Project	* *	* * *	* *	* *

Goold and Campbell propose nine tests that may be used to assess proposed structures. The first four relate to the organisation's **objectives** and the **restraints** under which it operates.

(a) **Market advantage**: where processes must be closely co-ordinated in order to achieve market advantage, they should be in the same structural element.

(b) **Parenting advantage**: the structure should support the parenting role played by the corporate centre. For example, a portfolio manager would need only a small, low cost corporate centre.

(c) **People test**: the structure must be suited to the skills and experience of the people that have to function within it. For example, skilled professionals used to a team-working approach might be frustrated by a move to a functional hierarchy.

(d) **Feasibility test**: this test sweeps up all other constraints, such as those imposed by law, stakeholder opinion and resource availability.

The tests forming the second group are matters of **design principle**.

(a) **Specialised cultures**: specialists should be able to collaborate closely.

(b) **Difficult links**: it is highly likely that some inter-departmental links will be subject to friction and strain. A good example would be the link between sales and production when there are frequent problems over quality and delivery. A sound structure will embody measures to strengthen communication and co-operation in such cases.

(c) **Redundant hierarchy**: the structure should be as flat as is reasonably attainable.

(d) **Accountability**: effective control requires clear lines of accountability.

(e) **Flexibility**: the structure must allow for requirements to change in the future, so that unexpected opportunities can be seized, for example.

3 Processes

FAST FORWARD

Control processes determine how organisations function. They may be analysed according to whether they deal with inputs or outputs and whether they involve direct management action or more indirect effects. **Balanced scorecards** are direct output-based processes.

Processes are an important part of how organisations work. JS&W analyse them into four categories according to whether they deal with inputs or outputs and whether they operate by direct contact or through more indirect means. You should note that all of the processes discussed here are **control** processes.

3.1 Types of control process

	Input	Output
Direct	Supervision Planning processes	Performance targets Balanced scorecard
Indirect	Self-control Cultural processes	Internal markets

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4.4.2 Hollow organisation structure

The hollow structure shares some similarities with the network organisation (see later). Outsourcing is central to the creation of the hollow organisational structure, as non-core processes such as human relations, payroll and logistics are outsourced to specialist providers.

Outsourcing non-core processes enables an organisation to concentrate on its core value adding activities, being those areas that provide the organisation with a competitive advantage. Value adding activities often relate to R&D, marketing and manufacturing. The outsourcing of certain functions effectively makes the organisation a 'hollowed out' entity, allowing it reduce its workforce and cut costs. The remaining staff are then free to manage the relationships created with the third party outsourcer.

Steps involved in creating a hollow organisation structure

Steps	Comment
1	Identify those non-value adding activities which do not underpin the entity's competitive performance. As we shall see later in the Study Text, the use of Harmon's process-strategy matrix is a useful tool for organisations to use in identifying those non-value adding activities. Once all relevant activities have been assessed, the most appropriate strategy to manage them can be implemented. Strategies may focus on improving existing processes, automating or outsourcing them. This we shall discuss in greater detail later in the text.
2	Explore the market for suitable outsource providers to take over certain business activities to allow these to be performed more efficiently.
3	Establish a working relationship with each outsource provider to ensure that the entity's operations are not hindered by the arrangement.
4	Bring the outsourcers own objectives in line with those of the entity through the use of incentives. For example if outsourcers can reduce costs and pass savings on then this may result in a longer term agreement being established between the parties.

Case Study — **Nike and Outsourcing**

Sportswear company, Nike has suffered over the years from a bad press due to management's decision in the early 1990s to outsource non-core manufacturing operations to parts of the world with lower labour costs. Nike has been accused of allowing subcontractors to get away with paying workers less than the recognised minimum wage in some developing countries. There have also been accusations that some outsource parties have employed children to work in manufacturing plants, often in poor working conditions.

In part, Nike has been able to overcome some previous hostility by using the money saved through its outsourcing operations to undertake aggressive marketing campaigns to rebuild the company's tattered image.

Nike has also been able to get its outsource manufacturers to work with the company to improve the conditions for their workers. As part of Nike's ongoing re-branding exercise, the company became the first in the industry to publish a list of the factories it has agreements with.

Max Nisen highlights that, 'instead of denying every allegation, Nike has mostly managed to put the most difficult chapter in its history behind it and other companies who outsource could stand to learn a few things from Nike's turnaround'.

Adapted from an article:

'How Nike solved it's sweatshop problem' by Max Nisen (May 2013) published on the *Business Insider* website; www.businessinsider.com

Chapter Roundup

- Globalisation, other aspects of rapid environmental change and, above all, the need to **exploit knowledge** make the **structures**, **processes** and **relationships** that make up configurations vital for strategic success.
- In a functional structure, people are organised according to the type of work that they do.
- The **multi-divisional structure** divides the organisation into semi-autonomous divisions that may be differentiated by territory, product, or market. The holding company structure is an extreme form in which the divisions are separate legal entities.
- **Matrix structures** attempt to ensure co-ordination across functional lines by the embodiment of dual authority in the organisation structure.
- The **transnational structure** attempts to reconcile global scope and scale with local responsiveness.
- Both team and project based structures extend the matrix approach by using cross-functional teams. The difference is that projects naturally come to an end and project teams disperse.
- **Control processes** determine how organisations function. They may be analysed according to whether they deal with inputs or outputs and whether they involve direct management action or more indirect effects. **Balanced scorecards** are direct output-based processes.
- **Centralisation** offers control and standardisation; **decentralisation** utilises talent and local knowledge.
- Goold and Campbell identified three major approaches to running divisionalised conglomerates: **strategic planning**, **strategic control** and **financial control**.
- External relationships are increasingly co-operative, rather than adversarial. Various forms of partnership, alliance, consortium may lead to the development of a **network organisation**.
- The **boundary-less organisation structure** involves the organisation collaborating with outside parties to make it more flexible during times of change. Hollow and modular organisation structures are underpinned by the use of **outsourcing**. **Hollow organisations** are created by outsourcing non-value adding activities to third parties. **Modular organisations** outsource a particular part of a production process, which is subsequently assembled in-house to create a completed product.
- Outsourcing and offshoring involve external providers taking on activities previously carried out in-house. **Offshoring** involves using external providers in different countries. **Shared servicing** is an alternative approach where shared service centres consolidate the transaction-processing activities within a company. Cost savings are often highlighted as being the main motivator for all three types of arrangement.
- The **shamrock organisation**, or flexible firm, has a core of permanent managers and specialist staff supplied by a contingent workforce of contractors and part-time and temporary workers. This form is popular during recessions.
- A **virtual organisation** is a geographically distributed network with little formal structure, probably held together by IT applications, partnerships and collaboration.
- Understanding what customers want from companies is a major issue. The use of customer feedback surveys are not new. However, advances in internet technologies have led to the development of **user contribution systems**. Such systems allow for closer interaction between individuals and companies. **Crowdsourcing** involves obtaining information from a large group of people, often external to the organisation for the purpose of helping to generate ideas and suggestions which can be implemented to improve organisational performance.

The **nature** of change may be incremental and built on existing methods and approaches, or it may require a 'big bang' approach if rapid response is required, as in times of crisis.

Scope of change

Nature of change

	Realignment	Transformation
Incremental	Adaptation	Evolution
'Big bang'	Reconstruction	Revolution

Types of change

(a) **Adaptation** is the most common type of change. It does not require the development of a new paradigm and proceeds step by step.

(b) **Reconstruction** can also be undertaken within an existing paradigm but requires rapid and extensive action. It is a common response to a long-term decline in performance.

(c) **Evolution** is an incremental process that leads to a new paradigm. It may arise from careful analysis and planning or may be the result of **learning processes**. Its transformational nature may not be obvious while it is taking place.

(d) **Revolution** is rapid and wide ranging response to extreme pressures for change. A long period of **strategic drift** may lead to a crisis that can only be dealt with in this way. Revolution will be very obvious and is likely to affect most aspects of both what the organisation does and how it does them.

1.2 The context of change (Contextual features model) 6/14,12/12, 12/10

Exam focus point

The compulsory question in the December 2010 exam required candidates to identify and analyse the contextual factors of a strategic change. The scenario focused on the purchase by a parent company of a smaller, struggling entity. The parent company had different business interests in the fishing industry and was in the process of finalising its takeover of a seafood restaurant chain. There were 13 marks available for applying and justifying an appropriate model (such as the contextual features model) to use in the scenario.

The compulsory question in the June 2014 exam required candidates to evaluate the effect of contextual features on the introduction of strategic change at a company involved in the printer cartridge market. This requirement was worth 14 marks. The Balogun and Hope Hailey model was specifically provided in the scenario in the form of a diagram. As a result, candidates were not required to recall the model, but were expected to apply their knowledge to the scenario. The examining team highlighted that a number of candidates seemed unfamiliar with the contextual features model. 'They were forced to guess what each of the contextual factors is and many answers made little reference to the scenario. Many candidates did not focus their answers on strategic change and consequently candidates did not score too well on this part of the question'.

The context of change is provided by the organisational setting; this has many aspects and can therefore be very complex. However, this complexity can be approached in a manageable way by considering it under eight general headings proposed by Balogun and Hope Hailey. One of the eight headings is **scope**: this has already been discussed. The rest are discussed below.

The headings represent a wide range of influences and the specific considerations affecting the impact of each may vary from organisation to organisation. For example, the first on the list, **time available**, may be largely determined by stakeholder sentiment in one organisation; and by anticipated political change, in another, with different aspects of the market situation influencing both.

1.2.1 Aspects of context

(a) The **time available** may vary dramatically, but can often be quite limited when responding to competitive or regulatory pressure.

(b) The **preservation** of some organisational characteristics and resources may be required.

2.1 Five management styles

We have looked at leadership earlier in this Study Text and one of the aspects of a leader's role will be to implement strategic change. However, it is important that the style in which the change is managed is appropriate to the context.

JS&W identify five styles of change management:

- **Education and communication**
- **Collaboration/participation**
- **Intervention**
- **Direction**
- **Coercion/edict**

2.1.1 Education and communication

Education and communication is an approach based on persuasion: the reasons for change and the means by which it will be achieved are explained in detail to those affected by it. It is appropriate when change is **incremental**. This style is time-consuming, but can be useful if there has been misinformation in the past. However, it is a top-down approach and depends on a **willingness** to accept management's plans as appropriate. This may not, in fact, be present.

2.1.2 Collaboration/participation

Collaboration, or **participation**, brings those affected by strategic change into the change management process, drawing them into issue identification, prioritisation and the creation of new routines to implement newly established strategy, for example. It may improve decision quality by bringing wider experience and knowledge to bear. However, it may be time-consuming and it will be **subject to the influence of the existing culture and paradigm**, which may limit its potential effectiveness. This approach is both ethical, in basic deontological terms, and advantageous in practice, since it can nurture a positive attitude, thus building both **readiness** and **capability** for change. It is suited to incremental change.

2.1.3 Intervention

Intervention is undertaken by a **change agent** (see below) who delegates some aspects of the change process to teams or individuals, while providing guidance and retaining overall control. Delegated aspects can include both design and implementation activities. Final responsibility for achieving the necessary change remains with the change agent, but this kind of participation can build **commitment** and a **sense of ownership**. This style is appropriate for incremental change.

2.1.4 Direction

Direction is a top-down style in which **managerial authority** is used to establish and implement a change programme based on a clear future strategy. It is thus suited to **transformational change**. It has the potential advantages of speed and clarity, but may lead to **resistance**. Its success depends in part on the adequacy of the proposed strategy: if this is inappropriate, the best managed of change programmes will not result in wider strategic success.

2.1.5 Coercion

Coercion is an **extreme form of direction**, being based on the use of power to impose change. It is likely to provoke opposition but may be the best approach in times of confusion or crisis.

2.2 Using styles

There may be advantages to making use of more than one of the change management styles outlined above.

(b) **Charismatic leaders** energise people and build a vision of the future. Change management is a natural part of what they do. This approach is also known as **transformational** leadership and we referred to it in this way in our earlier discussion.

Using this analysis, we may say that the **control** approach is a form of **transactional leadership**, while the other four approaches fall into the **charismatic** category.

3.2 Middle management

Strategic leaders pursuing change may see their middle managers as implementers, at best, and possibly, as potential blockers. Their commitment to change is important and they have significant roles to play in change management.

(a) **Implementation** and **control** where change is introduced in a top-down way

(b) **Translation** of the overall change strategy into forms suited to specific local contexts: this may require **reinterpretation** and **adjustment** of strategic factors such as relationships with suppliers and customers.

(c) Provision of **advice** to higher management on requirements for change and potential obstacles

3.3 Outsiders

Outsiders may contribute to the change process in a range of roles.

(a) A new **chief executive** may be appointed to bring a fresh point of view and break down the constraints of the existing paradigm. A **hybrid** chief executive is one who has appropriate experience of the industry, or even of the organisation, but is not part of the existing culture.

(b) New **managers** in other positions can enhance the capability to change and increase **diversity** of opinion and practice. However, their success is likely to depend on the visible backing of the chief executive.

(c) **Consultants** may be employed to fill a number of planning and facilitating roles. Like newly appointed managers, they bring a fresh approach and are not constrained by the existing paradigm. This enables them to challenge things that are taken for granted. Also, their appointment signals the importance of the change process.

(d) Other external **stakeholders** are capable of influencing change and may have a part to play.

4 Change management levers

FAST FORWARD

A **turnaround strategy** is required when a business is in terminal decline. Such a strategy uses its own change management techniques. More widely applicable change management levers are often related to aspects of the cultural web.

- Challenging the paradigm
- Changing routines
- Use of symbolic processes
- Political activity and use of power structures
- Communication and monitoring
- Tactics, including careful timing, care over job losses and exploration of quick successes

Many of the levers that can be used to implement change are related to aspects of the **cultural web**. We will consider these in this section, but first we will consider the special case of **turnaround**.

4.1 Turnaround

When a business is in terminal decline and faces closure or takeover, there is a need for rapid and extensive change in order to achieve cost reduction and revenue generation. This is a **turnaround strategy**. JS&W identify **seven elements of such a strategy**.

4.5.4 Symbols

Change managers may utilise existing symbols and symbolic activities or challenge them as seems appropriate.

4.6 Communication and monitoring

It is obvious that change management must include effective communication and explanation of the **need for change**, what the plan is intended to **achieve** and what it involves. Good communication is a very important factor in overcoming resistance to change, particularly in the matter of building trust. Strategic complexity may make this difficult, but a clear vision must be provided.

A wide range of **communication media** is available and it is important that **appropriate selections** are made. Media that provide richness, immediacy and interactivity are appropriate when complex and important material is to be communicated, while more routine matters can be dealt with in less complex ways. It is important for change agents to be aware that what seems simple and routine to them may have significantly greater importance for ordinary members of the organisation.

The **intervention style** of change management inherently provides extensive means of communication in the form of the individuals and teams involved. These people form an important route through which information can flow into the organisation.

Communication efforts should include clear and plentiful opportunities and routes for **feedback**, so that omissions, poorly constructed messages, misunderstandings and anxiety can be dealt with.

Care must be taken with **emotional aspects** of communication so that appropriate media, language and symbols are used.

Monitoring of behaviour to ensure that required changes are not subverted is essential.

4.7 Tactics

The change process can be forwarded by the use of specific tactics of change management.

4.7.1 Timing

The time at which actions are taken can be selected for tactical effectiveness.

(a) A **crisis** can be used to justify extensive change, so monitoring a mounting crisis and delaying action until it is ripe may enhance acceptance.

(b) **Windows of opportunity** may occur, as, for example, when a takeover occurs.

(c) **Messages** about timing must be coherent so that, for example, rapid action is not undermined by the retention of procedures that enforce long time frames.

(d) Fear and anxiety about change as such may be reduced if unpleasant consequences can be **decoupled in time** from the main change programme: an example would be a programme of redundancy that does not commence until other change objectives such as the outcomes of product and market reviews have been implemented.

4.7.2 Job losses

The threat of job losses associated with change is likely to be bad for morale and provoke resistance. Redundancy programmes must be managed with care.

(a) A single, rapid and extensive round of cuts is preferable to a long drawn out programme of smaller reductions: the former can be stressful but the latter creates **long-term uncertainty and anxiety**.

(b) Where **delayering** is required, it may be possible to concentrate the job losses among managers identified as being opposed to change: these are likely to be more senior figures.

(c) Those who lose their jobs should be dealt with as sympathetically and **compassionately** as possible; the provision of services such as outplacement, counselling and retraining may help.

Quick Quiz

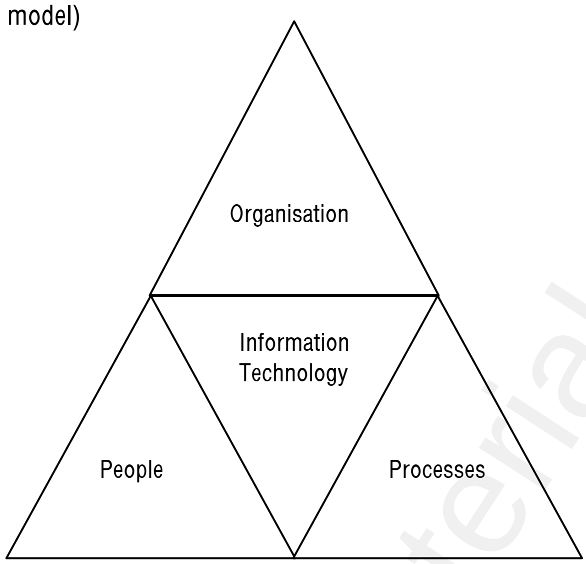
1. What is meant by the scope of change?
2. Which styles of management are required to effect revolution?
3. What is a change agent?
4. What is the difference between charismatic leadership and transactional leadership?
5. What are the objectives of political activity that may be sought by change managers?
6. How can change managers create opportunities for early success?

1.4.3 Design

FAST FORWARD

The **POPIT model (four view model)** focuses the project team's attention on four inter-related areas when undertaking a business process change. Some analysts argue that project teams focus too much on the process and technological aspects of business change and ignore the impact change has on people and the organisation.

The POPIT (four view model)



Source: Adapted from Business Analysis (2nd edition), Paul, Yeates & Cadle

1.4.4 POPIT model

Once a change project has been selected, the work of detailing how the new process will actually work begins. A useful framework to consider at this stage is the POPIT model, sometimes referred to as the four view model. POPIT provides the project team with four key areas that need consideration when enhancing a business process.

Exam focus point

The examining team has indicated that candidates should be prepared to use the POPIT model as a framework for answering a question in the exam. For example, a case study could illustrate a scenario where elements of the model have been neglected, and candidates could then be asked to assess the impact of this on the implementation of a change project.

Usefulness of POPIT

In recent years, concern has started to grow among business analysts that too many business change projects have failed to adequately consider the four perspectives of the POPIT model. All too often, attention is heavily focused on the technological and process aspects of change without fully understanding how a change will affect people and the organisation as a whole. The application of the POPIT model forces project teams to take a far more holistic view of business change, identifying those issues may hinder the project's success.

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POPIT heading	Areas for consideration
Information Technology	**Information systems** Business processes need to be configured so that they help facilitate the flow of critical information. The board of directors will want internal and external information which they can use to make decisions about the strategic direction of the business. Middle management will require information about key aspects of performance which affect the ability of their department to achieve the overarching strategy. For example, a breakdown of production down time. Operational level staff will need information about operational performance which affects the organisation on a day-to-day basis. For example, daily sales data.

1.4.5 Implementation

Force field analysis

The implementation stage of business change is likely to be the most challenging. This is due to the influence of certain stakeholder groups. Failure to gain the support and acceptance of staff may undermine any changes.

As highlighted earlier in the Study Text, the use of a force field analysis can prove particularly useful in identifying those forces driving and restraining change. By understanding the motives of those resisting change, an organisation should be better placed to weaken such opposition.

Communication

The use of a communication plan which highlights the benefits of the change is likely to prove central to overcoming resistance. Communication needs to be of a professional nature to help build confidence and create staff 'buy in' to the new processes.

Case Study — **NHS National Programme for IT – Part One**

In 2002, the UK government unveiled an ambitious IT project to overhaul the National Health Service's (NHS) IT infrastructure. Daniel Martin, writing in the *Daily Mail*, reported that the 'National Programme for IT' project was intended to modernise existing processes by developing 'a national email system with the ability to transfer X-rays and prescriptions electronically. It included an "electronic care record", a process intended to allow hospitals and surgeries to share patient's medical information'.

In 2011, the government announced its intention to scrap the project, having spent £12.7bn on it to date. The decision followed findings issued by the Major Projects Authority (MPA) which found that the IT scheme was 'not fit to provide services to the NHS'. The MPA report concluded 'there can be no confidence that the programme has delivered or can be delivered as originally conceived'.

Alistair Maughan, writing in *Computer Weekly*, states that 'it is a hallmark of successful ICT and outsourcing projects that there should be good consultation with all stakeholders involved, particularly end-users'. The National Programme for IT had been dogged by the concerns of key stakeholders about the project's aims. Local NHS trusts were deeply suspicious over the loss of control over existing systems. Doctors raised concerns over the accessibility of the system, and the British Medical Association expressed unease over the increased risk to patient privacy amid concerns of losing patient data.

As Maughan suggests, 'few projects can succeed over the outright opposition of the proposed users'.

The main writing on the subject is Hammer and Champy's *Reengineering the Corporation* (1993), from which the following is taken.

Key term

Business process re-engineering is the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical contemporary measures of performance, such as cost, quality, service and speed.

The key words here are **'fundamental', 'radical', 'dramatic'** and **'process'**.

(a) **Fundamental** and **radical** indicate that BPR assumes nothing: it starts by asking basic questions such as, 'Why do we do what we do?', without making any assumptions or looking back to what has always been done in the past.

(b) **'Dramatic'** means that BPR should achieve 'quantum leaps in performance', not just marginal, incremental improvements.

(c) '**Process'** is explained in the following paragraphs.

BPR is not automation or rationalisation. **Automation** is the use of computerised working methods to speed up the performance of existing tasks. **Rationalisation** is the streamlining of operating procedures to eliminate obvious inefficiencies. Rationalisation usually involves automation.

1.5.1 Principles of BPR

Hammer presents **seven principles** for BPR:

(a) Processes should be designed to achieve a desired **customer-focused outcome**, rather than focusing on existing **tasks**. The whole process should be **market-driven**.

(b) Personnel who use the **output** from a process should **perform** the process. For example, a company could set up a database of approved suppliers; this would allow personnel who actually require supplies to order them themselves, perhaps using online technology, thereby eliminating the need for a separate purchasing function.

(c) Information processing should be **included** in the work that **produces** the information. This eliminates the differentiation between information gathering and information processing.

(d) **Geographically dispersed** resources should be treated as if they are **centralised.** This allows the benefits of centralisation to be obtained, for example, economies of scale through central negotiation of supply contracts, without losing the benefits of decentralisation, such as flexibility and responsiveness.

(e) Parallel activities should be **linked,** rather than **integrated.** This would involve, for example, co-ordination between teams working on different aspects of a single process.

(f) Workpeople should be **self-managing**, exercising greater autonomy over their work**.** The traditional distinction between workers and managers can be abolished: decision aids such as expert systems can be provided where they are required.

(g) Information should be captured **once** at **source.** Electronic distribution of information makes this possible.

1.5.2 Is there a BPR methodology?

Davenport and Short prescribe a **five-step approach** to BPR:

Step 1 Develop the **business vision and process objectives**. BPR is driven by a business vision which implies specific business objectives such as cost reduction, time reduction, output quality improvement, Total Quality Management and empowerment.

Step 2 **Identify the processes** to be redesigned. Most firms use the 'high impact' approach, which focuses on the most important processes or those that conflict most with the business

Electronic data interchange was the main networking technique for integrating large-scale corporate IT systems in the early 1990s. It was rather unwieldy and expensive to operate and so was only used by larger companies and their more important suppliers. The growth of the internet and of its **World Wide Web** aspect in particular means that similar capabilities are now available at much reduced cost. Despite the setback caused by the bursting of the **dotcom bubble**, the internet has had a major effect on business processes. Larger organisations use it to manage and circulate information, as well as making extensive use of it for retailing, while many small businesses trade exclusively over the Web.

We will return to look at the internet and e-business more comprehensively later in this Study Text.

1.12 The effect of business consolidations

FAST FORWARD

Business considerations and the dispersal of manufacturing bring new demands for software integration and operations control and co-ordination.

Extensive redesign of processes often takes place as a result of **mergers and acquisitions**. There has been significant growth in this kind of process development as a result of accelerating globalisation. The acquisition of **foreign subsidiaries**, in particular, usually leads to extensive work to integrate systems or to redesign and replace them where they are incompatible.

At the same time, large scale manufacturing operations have become much more dispersed as work is transferred to low-wage economies in order to control costs. Controlling and co-ordinating such dispersed and complex operations have required the development of new, standardised systems.

1.13 The current position

FAST FORWARD

Improvement projects should be tied to **specific performance goals**. Change management must be to a high standard. IT specialists must take a strategic view if they are to make appropriate input.

Harmon makes several comments about the current state of the art of business process change.

First, he emphasises the need to tie improvement projects to **specific corporate goals**: if this is not done, the project will lose focus, develop a life of its own and solve unimportant problems as a result.

Second, he remarks on the difficulty of installing new processes when the operational staff and managers do not support the changes involved. Considerable effort must be expended on **change management**, including obtaining 'buy-in' and **aligning incentives** with the new processes.

The **role of IT specialists** is a third concern. Harmon feels that they have a special contribution to make because of the ubiquity of IT systems within the organisation: IT specialists are increasingly required to take a strategic view of the corporation as a whole so that they can support the line managers who have responsibility for operating and improving business processes. At the same time it is necessary for those line managers to understand the difficulties and concerns of the IT specialists.

1.13.1 Terminology

FAST FORWARD

Harmon suggests three terms:

- **Process improvement** is a tactical, incremental technique.
- **Process re-engineering** is a strategic level rethinking of core processes.
- **Process redesign** is for intermediate scale processes that need significant change.

Harmon suggests a specific terminology for process change efforts that emphasises the scale of what is contemplated.

(a) **Process improvement** is a **tactical level**, **incremental** technique that is appropriate for developing smaller, stable existing processes.

overall. Under this structure, the executive committee would set overall goals and strategies, delegating decisions about process development to the process architecture committee.

Harmon recommends that the organisation be **structured around its systems and processes,** rather than functionally. Where this is done, a process that is selected for redesign will have a process manager in charge of it; this manager becomes the **project sponsor** for the redesign project. More traditionally structured organisations will have to appoint a project sponsor. The project sponsor does not undertake detailed redesign work: this role is concerned with overall decision-making and championing the redesign at the highest levels.

A **process redesign steering committee** is required. This body has high level representation of all the departments involved in the process. It has two main functions. The first is to be responsible for approving the work of the redesign team. The second is to ensure that managers and staff affected by the redesign support the changes to be made and will implement them.

A **project facilitator** must be appointed to act as project manager. This important role may be allocated to a consultant, since skill at facilitating project redesign is required, rather than familiarity with the specific business processes under consideration. In any case, it is important that the facilitator remains neutral and is not committed to any functional or departmental group.

3.4 Planning

The facilitator and the redesign team need a **project charter** or overall plan to define the scope of their work; this should include an account of how the process they design supports the organisation's overall strategy and goals and how it relates to other processes and stakeholders.

Ideally, this plan will have been defined at a higher echelon of management, such as the executive committee or the process architecture committee. If this has not been done, it will be for the project sponsor, facilitator and the steering committee, once appointed, to develop this plan themselves. The facilitator will then take charge of the outline plan and refine it after appropriate consultation.

The planning phase ends with the agreement of a **detailed project plan**, including **time and cost budgets**, at the executive committee level. To reach this stage, the project sponsor, facilitator and steering group must produce extensive documentation. This will state the project's assumptions, goals, constraints, scope and success measures. It will outline the changes that are required and how they fit in with the rest of the organisation. It is particularly important that resource and systems constraints are considered in detail.

At the same time, the members of the **process redesign team** must be identified.

3.5 Analysing the existing process

This phase may not be present in all projects.

(a) Some organisations may already have full analysis documentation.
(b) There may not be an existing process.
(c) It may be decided to omit this phase if radical change is envisaged.

Where this phase is undertaken, it results in the **full documentation** of the processes and sub-processes concerned. This involves the use of process flow diagrams and organisation charts. Goals, activities, inputs and outputs are identified, named and described in detail. Known problems with the system are noted, as are descriptions of past attempts to improve them. It is also necessary to consider **how the process is managed**, what personal managerial responsibilities are involved and whether improvements to the management system are required. In particular, **performance measures and incentives** should be examined.

When the analysis is complete, the **project goals and assumptions** should be re-examined and revised as necessary. A coherent and robust redesign plan may then be created and presented to higher management. Approval by those who must later implement and manage the new design is essential and support from these senior managers is an indispensable output from this stage.

6.7.2 Software installation

Installation might be required of the supplier; this might include initial loading, testing and troubleshooting. Both the software package and any hardware required should be installed by the package supplier in order to avoid disputes over responsibility for problems.

6.7.3 System implementation

Implementation is the introduction of the new system into service. It may be achieved by simply changing from the old to the new at a given point in time, such as the start of work on a particular day (**direct changeover**), or there may be a period of **parallel running**. The first method is a high risk strategy and likely to require technical support, possibly from vendor staff on site. Parallel running requires extra staff, which the vendor may be able to supply. However, parallel running permits cross-checking of the respective outputs as both the new and old systems process current data. An upper time limit for parallel running should be set though, because although parallel running is a low risk approach compared to a direct changeover, it is costly to operate because it uses double resources.

Nonetheless, parallel running highlights the importance of **testing the solution**. Once the new system has been introduced, there needs to be a period of testing to ensure that the data in the new system is accurate and the system is running as intended.

As an alternative to either direct changeover or parallel running, an organisation may opt for a phased approach.

Pilot operation. The new system is installed on a branch by branch, or location by location, basis. This approach is particularly well-suited to large or geographically dispersed projects, and allows the system to be tested in a single location before being rolled out to all the others.

Restricted data running. Under this approach, a single part of the system file is run on the new system initially, and then once it has been tested and found to be working as intended, other parts of the system are converted. Again, the benefit of this approach is that it limits the impact any errors could have on the overall data quality.

Note that a phrased approach can still either be direct or parallel run at each stage of its roll-out.

6.7.4 User Training

Training in the new system will be required: its nature, content, cost and location must all be considered. Four key considerations are:

- Who needs to be trained?
- Will training be provided on the job or through structured courses?
- Will training be provided internally or by external experts?
- Will all staff be trained at the same time or will training be phased over time?

6.8 Operability requirements

Implementation requirements continue beyond the initial phase and into the productive life of the system.

(a) **Documentation** should be clear, complete, easy to use, helpful and kept up to date.

(b) Continuing **support** will be required and considerations will include such matters as helpline availability, response times and policy on support for superseded versions of software.

(c) **Upgrade policy** includes such matters as cost, frequency, documentation and method of distribution.

(d) **Legal protection** is required to cover the possibility of the supplier's business being wound up. The source code should be lodged **in escrow**.

Typical weighting for operability requirements overall: 2

6.9 Time and cost constraints

Overall requirements relating to time and, particularly, cost will almost certainly be **imperatives**. However, it may also be appropriate to consider time and cost **trade-offs** against other issues in the overall requirement.

Typical weighting for cost constraints: 20; for time constraints: 2

7 Selecting software packages 6/14, 6/12

Skidmore and Eva suggest that once the evaluation requirements have been set, the process of selecting a package may be thought of as falling into five phases:

- Obtaining tenders
- First pass selection
- Second pass selection
- Implementation
- The long-term relationship

Exam focus point

Question 3 in June 2014 focused on a construction company which had purchased a new CRM software package. The company had poorly executed the evaluation, selection and implementation of the software solution. The first requirement for 15 marks asked candidates to suggest a process for evaluating, selecting and implementing software packages and to explain how this process would have prevented the problems experienced by the company.

The examining team noted that 'very few candidates focused on a process that encompassed evaluation, selection and implementation. Too many answers identified a problem in the scenario and then suggested how this might have been avoided. Such an approach did gain credit, but it tended to lead to long disjointed answers, with much repetition and no overall coherent process.'

7.1 Identifying potential suppliers

The selection procedure is built around a detailed **invitation to tender** (ITT), but before this can be issued, potential suppliers must be identified. One way to do this is to **advertise the general system requirement** in the trade press and ask for responses from suppliers. This very open approach may be legally required, particularly in the public sector, but it may attract an unmanageably large number of responses, many of which may be of little value. Some less appropriate suppliers may be weeded out by making a small charge for the issue of the ITT.

A more structured approach is to **research the market** using trade directories, internet searches and personal business awareness.

In either case, the aim should be to identify a reasonable number of potential suppliers for further consideration. Some allowance must be made for wastage in the early stages – so, if, say, eight to twelve formal tenders are required, it may be necessary to identify fifteen to twenty candidates.

7.2 The invitation to tender

When a suitable number of potential suppliers has been identified, ITTs may be issued to them. The ITT is a fairly complex document and will include a number of sections. These are described below.

(a) **Administrative information**

  (i) Where, how, to whom and by when the tender should be submitted
  (ii) Procedure for dealing with queries
  (iii) Rules about tendering
  (iv) Confidentiality arrangements

Quick Quiz

1 What are the three conditions that value adding activities satisfy?

2 What are the four basic redesign patterns Harmon describes?

3 List three disadvantages of using bought software packages rather than developing in-house software

4 What are the seven techniques for information gathering to establish software requirements?

5 In the context of assessing software packages, what are imperatives?

Study guide

		Intellectual level
C1	**Organising and enabling success**	
(e)	Discuss how big data can be used to inform and implement business strategy	2
E1	**Principles of information technology**	
(a)	Advise on the basic hardware and software infrastructure required to support business information systems	2
(b)	Identify and analyse the general information technology controls and application controls required for effective accounting information systems	2
(c)	Analyse the adequacy of general information technology controls and application controls for relevant application systems	3
(d)	Evaluate controls over the safeguarding of information technology assets to ensure the organisational ability to meet business objectives	3
E2	**Principles of e-business**	
(a)	Discuss the meaning and scope of e-business	2
(b)	Advise on the reasons for the adoption of e-business and recognise barriers to its adoption	3
(c)	Evaluate how e-business changes the relationships between organisations and their customers	3
(d)	Discuss and evaluate the main business and marketplace models for delivering e-business	3
E3	**E-business application: upstream supply chain management**	
(a)	Analyse the main elements of both the push and pull models of the supply chain	2
(b)	Discuss the relationship of the supply chain to the value chain and the value network	2
(c)	Assess the potential application of information technology to support and restructure the supply chain	3
(d)	Advise on how external relationships with suppliers and distributors can be structured to deliver a restructured supply chain	3
(e)	Discuss the methods, benefits and risks of e-procurement	2
(f)	Assess different options and models for implementing e-procurement	2

Exam guide

We would expect aspects of e-business to be relevant to many questions, both in Section A of your exam and in Section B. Think back to the relational diagram of the main syllabus capabilities: information technology is in the middle tier, and so you should be asking yourself how it affects business strategy (the top tier). At one level, you need to consider how the proper co-ordination and alignment of IT systems is essential to support strategic implementation; but at another level, you also need to consider how IT can shape that strategy itself – through e-business and e-commerce.

We would expect that from time to time, there might be complete questions linked directly to e-business and e-marketing.

(d) **Organisational type** – surveys of sectors such as retail, tourism and manufacturing have identified a number of major concerns including: privacy, trust, uncertainty of financial returns and lack of reliable measurement, fraud, lack of support and system maintenance. For small and medium-sized enterprises, there is a wide range of barriers:

(i) Cost of implementation
(ii) Need for immediate return on investment
(iii) Complexity of technologies like electronic data interchange (EDI) which could require new skills
(iv) Lack of organisational readiness, with many small and medium-sized enterprises having limited existing IT resources
(v) Lack of perceived benefits
(vi) Lack of assertiveness by the owner/manager
(vii) Security, including confidentiality and fraud

2 Organisations and their customers

FAST FORWARD

Both businesses and customers can originate e-commerce activity; thus there are four main categories: B2B, B2C, C2B and C2C. **Channel structures** are the means by which products and services are delivered to customers. **Disintermediation** removes intermediaries from supply channels while **reintermediation** establishes new ones. **Countermediation** is the creation of a new intermediary by an established company to compete via a business with established intermediaries.

2.1 Varieties of e-commerce

Exam focus point

An article titled 'E-commerce' (2005) written by Jim Stone is available in the technical articles section for P3 on the ACCA website. It would be worth taking the time to study this article.

E-commerce can be divided into four main categories:

- B2B (Business-to-Business)
- B2C (Business-to-Consumer)
- C2B (Consumer-to-Business)
- C2C (Consumer-to-Consumer)

B2B (Business-to-Business) involves companies doing business with each other, as when manufacturers sell to distributors and wholesalers sell to retailers. Pricing is based on quantity of order and is often negotiable.

Case Study — **Alibaba**

Alibaba, which operates predominantly in China, is the world's largest e-commerce company. According to the company's website, its mission is to 'make it easy to do business anywhere'. Alibaba was set up in 1999 by a Chinese English teacher (Jack Ma), with the aim of helping small Chinese businesses trade globally. As Linda Yueh, the BBC's chief business correspondent explains, Alibaba is effectively a 'combination of eBay and Amazon. It is an online company with multiple revenue streams that are more conventional than a social network site. Alibaba.com is a B2B, or business-to-business, website. It links up businesses around the world looking for suppliers. For instance, they link wholesalers to distributors around the world, from the UK to China to the US'. Businesses can trade almost anything from olive oil to computer components.

Adapted from two online sources:

1) 'Company overview' published on the *Alibaba* website: www.alibabagroup.com/en/about/overview

2) 'Alibaba: The next Facebook?' by Linda Yueh (June 2013) published on the *bbc* website; www.bbc.co.uk

(c) **Employee support/information:** advice on first aid, healthy working at computer terminals, training courses offered and resources held in the corporate library and so on.

(d) **Notice boards** for the posting of messages to and from employees: notice of meetings, events, trade union activities.

(e) **Departmental home pages:** information and news about each department's personnel and activities to aid identification and cross-functional understanding.

(f) **Bulletins or newsletters:** details of product launches and marketing campaigns, staff moves, changes in company policy, links to relevant databases or departmental home pages.

(g) **Email** facilities for the exchange of messages between employees in different locations.

(h) **Upward communication:** suggestion schemes, feedback, questionnaires.

A **firewall** is a security device that effectively isolates the sensitive parts of an organisation's system from those areas available to external users. It examines all requests and messages entering and exiting the intranet and blocks any not conforming to specified criteria.

3.3.2 Extranets

Extranets are web based but serve a combination of users. Whereas an intranet resides behind a **firewall** and is accessible only to people who are members of the same company or organisation, an **extranet** provides various levels of accessibility to **outsiders**.

Only those outsiders with a valid **username** and **password** can access an extranet: varying levels of access rights enable control over what people can view. Extranets are becoming a very popular means for business partners to exchange information. They can share data or systems to provide smoother transaction processing and more efficient services for customers. An extranet may be used for a variety of purposes:

(a) To provide a pooled service which a number of business partners can access and exchange **news** which is of use to partner companies and clients

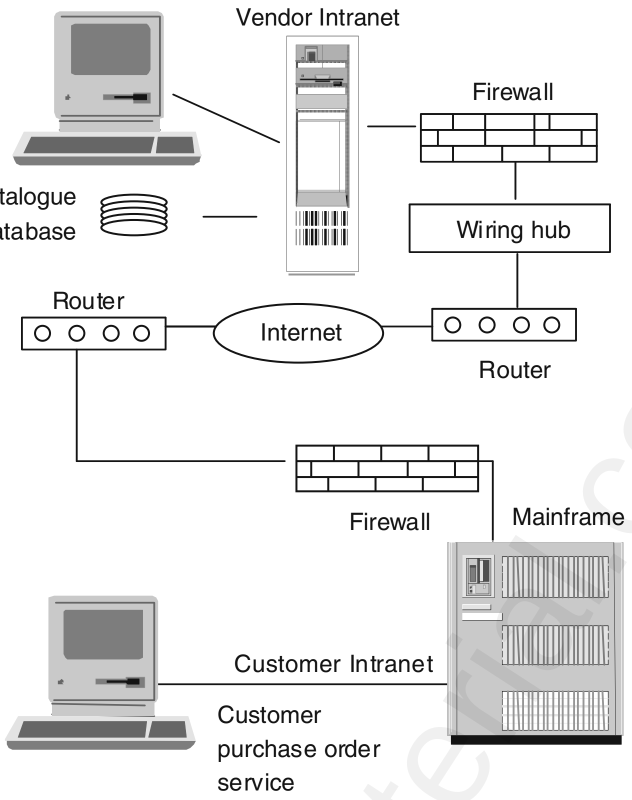
(b) To share **training** or **development resources**

(c) To publicise loyalty schemes, sponsorships, exhibition attendance information and other **promotional tools**

(d) To exchange potentially large volumes of **transaction data** efficiently

(e) To provide **online presentations** to business partners and prospects

The basic components of an extranet are an internet connection which goes via a **router**, an HTTP server, a firewall and the essential data and files. All the infrastructure and applications can sit inside the firewall or outside in a secure area called a demilitarised zone (DMZ). An organisation could connect its browser based purchase order system to the product catalogue database on a supplier's intranet (see diagram below).



3.4 Electronic mail

The term **electronic mail** is used to describe various systems for sending data or messages electronically via a telephone or data network and a central server computer. Email has replaced letters, memos, faxes, documents and even telephone calls, combining many of the possibilities of each medium with new advantages of speed, cost and convenience. Messages are written and read in a special program such as Microsoft Outlook (for an individual) or part of a groupware package such as Microsoft Exchange or Novell, if used in a large company. This software has convenient features such as: message copying (to multiple recipients); integration with an address book (database of contacts); automatic alert messages sent when the target recipient is unable to access his or her email immediately, with alternative contact details; stationery and template features, allowing corporate identity to be applied; facilities for mail organisation and filing.

Some websites, eg Hotmail and Yahoo provide free email facilities and only require a web browser.

3.5 Client/server architecture

In general, all of the machines on the internet can be categorised into two types: servers and clients. The machines that provide services to other machines are **servers;** and the machines that are used to connect to those services are **clients.** It is possible and common for a machine to be both a server and a client, but for our purposes here, you can think of most machines as one or the other.

A server machine may provide one or more services on the internet. For example, a server machine might have software running on it that allows it to act as a web server, an email server and a file transfer protocol (FTP) server. Clients that come to a server machine do so with a specific intent, so clients direct their requests to a specific software application running on the overall server machine. For example, if you are running a web browser on your machine, it will most likely want to talk to the web server application on the server machine; your Telnet application will want to talk to the Telnet server and your email application will talk to the email server.

decisions themselves could even become automated. So, for example, a retailer could use algorithms to optimise decisions about inventory levels and pricing in response to current and predicted sales data.

4.3.5 New products and services

Companies can use data about social trends and consumer behaviours to create new products and services to meet customer's needs, or to enhance existing products and services so that they meet customers' needs more exactly. For example, the emergence of real-time location data, from traffic light sensors and satellite navigation systems, could enable insurance companies to refine the pricing of their insurance policies according to where, and how, people drive their cars.

More generally, big data could also provide new business opportunities in its own right. For example, Facebook's advertising business incorporates analysis of a user's actions as well as their friends' actions. Equally, Amazon could be seen as an example of a company which has built its business strategy using data and analytics; for example, through the way it makes recommendations for customers linked to the purchases made by other customers with similar interests.

4.4 Data and customers

So far in this section, we have looked at the way organisations can use big data to understand more about what their customers want. However, Web 2.0 technologies (which we discuss in a later chapter) mean that data is increasingly available to customers as well as organisations.

For example, online customer reviews are now commonplace, and smartphone applications now enable customers to evaluate and compare product prices in real time. This increased availability of data creates a new market transparency which can give customers a greater insight into what they are buying and who they are buying from.

In this respect, the data helps customers to base purchasing decisions not only on price, but also on a company's social reputation – for example, in terms of customer's feedback in relation to the quality of service they have received.

Case Study — **Big data: Helping to shape strategy**

The following case study outlines how companies are now using data about their customers to analyse their competitors in order to shape their own competitive strategy.

In 2013, Donna Ferguson, writing in *The Guardian* newspaper, illustrated how a number of major supermarket chains have taken to using big data as a means to better understand their rivals.

The use of in-store loyalty cards as a means of capturing data about customers and their shopping habits to enable the effective targeting of shoppers with promotions, is not a new occurrence. Tesco's Clubcard and Sainsbury's Nectar card schemes have been in existence for many years.

Today, retailers have started to exploit data about their shoppers by tracking purchases made by individual debit and credit cards. As Guy-Montague-Jones of *The Grocer* highlights, retailers are able to 'build up a demographic profile of you, and collect data about how loyal you are, what you buy and how much you spend'.

Retailers that operate online shops are now able to use data about a shoppers' previous purchasing behaviour to target individuals with particular products when they log on. Analysis of shopping patterns are now even being used to help store managers decide what items to stock. Ferguson notes that 'Sainsbury's discovered that a cereal brand called Grape-Nuts was worth stocking – despite weak sales – because the shoppers who bought it were extremely loyal to Sainsbury's, and were often big spenders'.

Furthermore, following extensive data analysis, Sainsbury's purchased the remaining 50% of Sainsbury's bank, which it did not own, as those individuals who used the bank's services were found to 'become more loyal and spend more in-store'.

Competitor analysis

Establishing new stores

The supermarket chain Waitrose has taken to using shoppers' Visa card data obtained in-store to analyse which competing stores customers are using when not frequenting a Waitrose outlet. This data has been used to help the company decide where to locate new stores. The article highlights that the data analytics firm Beyond Analytics was hired by Waitrose to integrate 'Visa transaction data with Waitrose's own data to figure out what proportion of potential customers were buying groceries from other supermarkets, and the general locations of these competitors'.

Trends in shopping patterns

Rival supermarket Morrisons has historically shunned loyalty card schemes. However, it recently confirmed that it will 'buy in' demographic data about its shoppers to extrapolate trends in shopping patterns to help it target offers at customers. Clearly, if Morrisons' rivals are aware of the data that the company is buying in, then they will be able to target existing customers with their own promotional offers in a bid to undermine competing moves.

Selling data

Ferguson notes that big brands have become increasingly prepared to pay 'a lot of money' to purchase data about shopping patterns from the major supermarkets. 'A brand of say, coffee will approach Sainsbury's, Morrisons or Tesco and ask to buy access to customers purchasing rival brands, so it can put an offer to these customers.'

Adapted from: Ferguson, D (June 2013) 'How supermarkets get your data – and what they do with it.' [Online] *The Guardian*. www.theguardian.com

4.5 Criticisms of big data

An article in *The Financial Times* entitled 'Big data: are we making a big mistake', raised a number of criticisms over the ability of big data to deliver the anticipated benefits.

Critics argue:

(a) Big data is simply a buzzword, a vague term that has turned into an obsession in large organisations and the media. Very few examples exist where analysing vast amounts of data have resulted in significant new discoveries.

(b) There is a focus on finding correlations between data sets and less of an emphasis on causation. Critics suggest that it is easier to identify correlations between two variables than to determine what is actually causing the correlation.

(c) A failure to understand the factors giving rise to a correlation mean that analysts have no idea what factors may cause the correlation to break down.

Case Study — **Google Flu Trends**

Google Flu Trends was presented as a means of tracking and predicting the spread of influenza across the US.

The programme used algorithms which identified correlations between the symptoms people searched for online and flu symptoms. However, after providing a swift and accurate account of flu outbreaks for several winters, in the 2012-3 season, Flu Trends overstated the spread of flu-like illnesses across the US by almost a factor of two.

The cause of this problem was that ultimately Google did not know what linked the search terms with the spread of flu, and Google's algorithms weren't designed to identify what caused what. They were simply finding statistical patterns in the data; and as such, focused on correlation rather than causation.

information on actual demand to move inventory and schedule production in the chain: therefore, they require integrated internal systems and linkages throughout the supply chain.

A supply chain is almost always a **combination of both push and pull**, where the interface between the push-based stages and the pull-based stages is known as the push-pull boundary. An example of this would be Dell's **build-to-order** supply chain. Inventory levels of individual components are determined by forecasting general demand, but final assembly is in response to a specific customer request. The push-pull boundary would then be at the beginning of the assembly line. At this point on the supply chain timeline, it is typically coordinated through a **buffer inventory**.

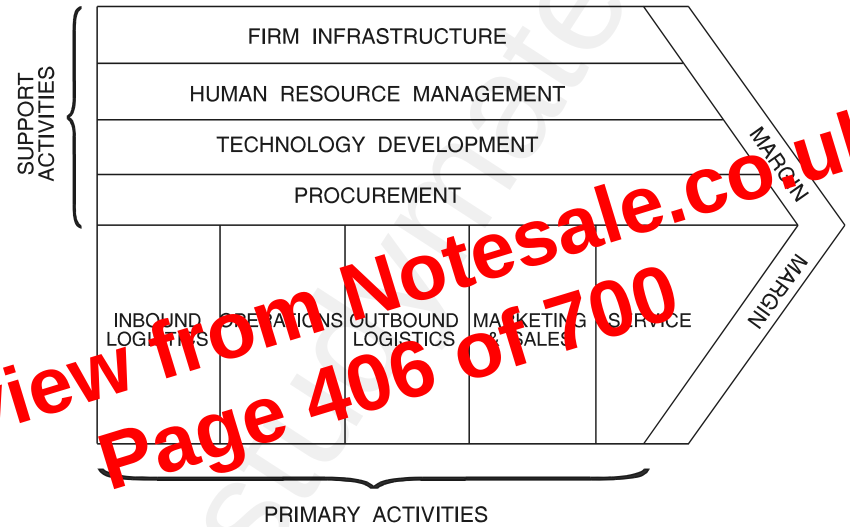
6.3 Relationship with the value chain and the value network

FAST FORWARD

IS may be used to improve the working of the links between activities in the value chain and between value chains in the value network. One important consequence of this is that improved communication with customers results, making it easier for them to purchase.

Knowledge brought forward from earlier studies

The **value chain** concept has already been described in detail earlier in this Study Text. Here is the diagram to refresh your memory.



6.3.1 Using the value chain with IS

Management can use this model to assess the degree of **effectiveness** and **efficiency of resource use**.

(a) **Efficiency** is the measure of how well the resources are being used and measures could include profitability, capacity use and yield gained from that capacity.

(b) **Effectiveness** is the assessment of how well the resources are allocated to the most competitively significant activities within the value chain.

An analysis of resource utilisation

(a) **Identify the value activities**. This stage should include an assignment of costs and added value and an identification of the **critical activities**. These are the various value activities which underpin the production and delivery of products or services, including the supply and distribution chains.

(b) **Identify the cost or value drivers**. The factors that sustain the competitive position are called **cost drivers** or **value drivers**. For example, e-commerce allows transportation companies of all sizes to exchange cargo documents electronically over the internet. It enables shippers, freight forwarders and trucking firms to streamline document handling without the monetary and time investment required by the traditional document delivery systems. By using e-commerce, companies can

Step 4 **Investigate how IT might spawn new businesses**. These might be based on the exploitation of new categories of information and the sale of information-processing capacity.

Step 5 **Develop a plan to exploit IT**. Effectively, this is the creation of a comprehensive strategy and has implications for most parts of the organisation.

For any organisation, it is possible to assess the **information content** (the information intensity), of the value chain activities and linkages. Porter and Millar's **information intensity matrix** considers the role of IT and suggests how it can be exploited for competitive advantage. The matrix evaluates the information intensity of the value chain (how product value is transformed through activities and linkages in the value chain) against that of the product (what the buyer needs to know to obtain the product and to use it to obtain the desired result). When assessing the degree of information in the product, oil, for example, has a low information content while banking has a high information content.

The degree of information in the value chain also varies. It is low in the case of a cement manufacturer who makes a simple product in bulk, but high in the case of a complex, sophisticated process such as oil refining.

Information intensity of the value chain	Information content of the product: Low	Information content of the product: High
High	Oil refining	Banking, Airlines
Low	Cement	Fashion

Information intensity matrix

If the information content of the **product** is high, IT can be used to **enhance product delivery** as, for example, with internet sites for newspapers. When the information in the **value chain** is high, it implies that sophisticated information systems are required to **manage the linkages** optimally.

The segment where the information content of both the product and the value chain are **high** includes banking and financial services. For example, ATMs, credit cards, debit cards and customer databases have all been integrated to give a much more personalised service as well as lowering service costs. There are banks in the UK such as First Direct that have no branches and retail online, through ATMs and 24 hour telephone phone links.

The segment where the information content of both the product and the value chain are **low** contains traditional process-manufactured, widely available commodity products with several potential producers, such as bricks and cement. The fact that information content is low does not mean that there is no scope for exploiting IT to achieve a business advantage. Firms in this segment might be low-cost producers who are looking for linkages in the value chain to contribute to overall cost leadership. For example, there could be a niche market for specialist bricks in garden design, where expertise is in short supply. Information about their use could provide added value. The production process offers little scope for IT but, since the process is presumably well known and closely controlled, information could be used to provide a more efficient operation. For example, airline pilots are encouraged to use autopilot to fly planes because consumption of fuel increases by as much as 30% during a manually controlled flight.

In all sectors, e-business is increasing the pressure for supply chain responsiveness in three ways.

(a) **Increased competition**. Easier market entry enables new entrants to steal significant market share at the expense of unresponsive existing suppliers.

(b) **Increased volumes and speed of data**. There is a requirement to gather, process and act on massively increasing volumes of data in a rapid and intelligent manner.

(c) **More demanding customer requirements**. These include reduced cost, shorter lead times and reliability of supply.

Additionally, what is not well recognised is the increased capability of customers to bypass their traditional supplier and **cut out the middle man**. This threat is equally applicable right along the supply chain, with the consumer bypassing the retailer, and businesses bypassing tiers of their suppliers. To remain in the chain, companies do not just have to demonstrate the value they add, but also demonstrate their ability to manage their own suppliers.

7 E-procurement 6/11

7.1 The methods, benefits and risks of e-procurement

FAST FORWARD

E-procurement is the purchase of supplies and services through the internet and other information and networking systems, such as Electronic Data Interchange (EDI).

It is typically operated through a secure website, possibly using a paperless system based on a purchasing card. It brings time and efficiency improvements but it also brings threats to control and security. Implementation may proceed according to a variety of models, but initially it is easiest to introduce IS to only part of the improvement cycle.

An important part of many B2B sites, e-procurement is also referred to by other terms, such as **supplier exchange**.

Traditionally, e-procurement has been seen as a simple process from creation of need to placing an electronic purchase order with a supplier and the possible payment by an electronic bank payment system such as BACS. Today the transactional process is considered to be only part of the e-procurement function. It includes purchasing, transportation, goods receipt and warehousing before the goods are used. A properly implemented system can connect companies and their business processes directly with suppliers while managing all interactions between them. This includes management of correspondence, bids, questions and answers, previous pricing, and multiple emails sent to multiple participants.

It focuses on the complete purchasing mix, or the **five rights of purchasing**, which are that goods and services must be delivered:

- At the right **time**
- In the right **quantity**
- In the right **quality**
- At the right **price**
- From the right **vendor**

7.1.1 Methods

Typically, e-procurement websites allow authorised and registered users to log in using a password. The supplying organisation will set up its website so that it recognises the purchaser, once logged in, and presents a list of items that the purchaser regularly buys. This saves searching for the items required and also avoids the need to key in name, address and delivery details. Depending on the approach, buyers or sellers may specify prices or invite bids. Transactions can be initiated and completed. Once the purchases are made, the organisation will periodically be billed by the supplier. Ongoing purchases may qualify customers for volume discounts or special offers.

A very limited form of electronic procurement is the **purchasing card**, which is a paperless purchase and payment system aimed at the end-user who can now order and pay for goods directly with a small number of suppliers. Buyers identify themselves with their card number when placing an order; the supplier

Answers to Quick Quiz

1 E-business involves transactions over the internet. If an e-business transaction is of a financial nature, it is e-commerce

2 The removal of intermediaries from a supply chain

3 The infomediary collects data about consumers and their purchasing habits and sells it to other businesses

4 The arrangement of software, machinery and tasks in an information system needed to achieve a specific functionality

5 The push model

6 Information content of the product and information intensity of the value chain

7 Public web, exchange, supplier centric, buyer centric, B2B market place

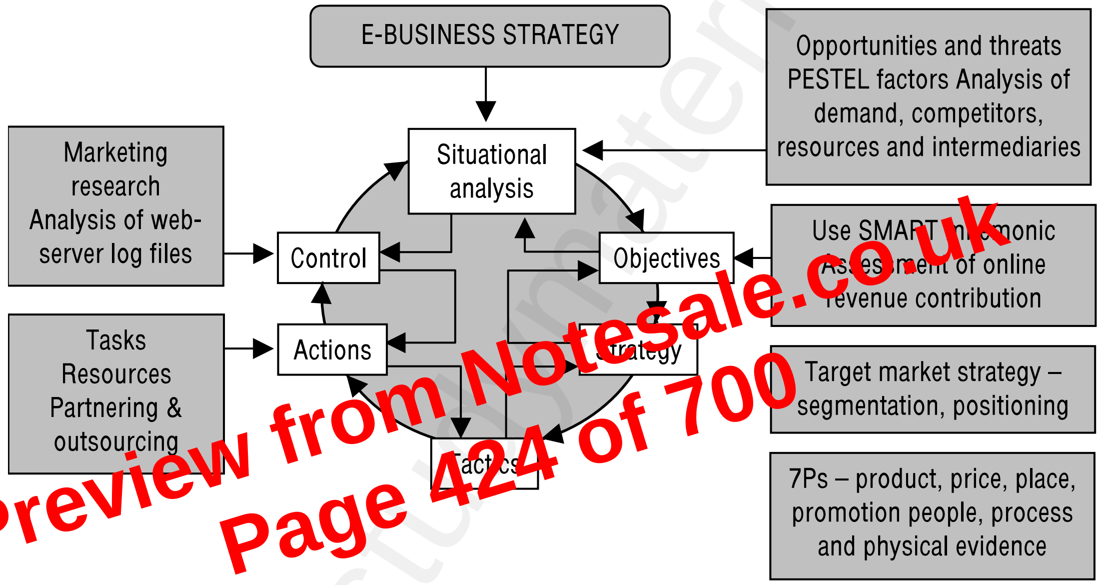
Now try the question below from the Practice Question Bank

Number	Level	Marks	Time
Q12	Examination	25	45 mins

The **SOSTAC ® planning framework** developed by Paul Smith provides a structured and effective approach to marketing strategy. It can be used by managers in the private, public and non-profit sectors.

S = Situation Analysis	Where are we now? What is the external environment in which we are operating? What are our own strengths and weaknesses?
O = Objectives	Where do we want to get to? What is our goal?
S = Strategies	How do we get there? What do we need to do to be successful?
T = Tactics	What are the individual steps we need to take to achieve our objective?
A = Actions	What are the things we need to do? What is our 'to-do' list? Who will do what?
C = Control	What will we measure to know we are succeeding? How will we know when we have arrived?

The planning framework is expanded in the diagram below to show the techniques/actions that make up each stage:



Framework for e-marketing planning

In developing an effective e-marketing plan, the media of e-marketing used at certain stages will include the following.

Competitor analysis	Scanning competitor internet sites Competitor benchmarking to compare e-commerce services within a market Competitive intelligence systems give a structured approach to monitoring and disseminating information on competitor activities
Intermediary analysis	Identify and compare intermediaries for a marketplace Search portals and look for new approaches for traffic building Research whether competitors are using disintermediation or reintermediation

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1.4.6 Process

The **process** element of the marketing mix is the internal methods and procedures companies use to achieve all marketing functions such as new product development, promotion, sales and customer service. The restructuring of the organisation and channel structures described for product, price, place and promotion all require new **processes**.

Exam focus point

Note the link here to process redesign: changes in the business structures usually need to be supported by changes in business process.

1.4.7 Physical evidence

The physical evidence element of the marketing mix is the tangible expression of a product and how it is purchased and used. In an online context, physical evidence is customers' experience of the company through the website and associated support. It includes issues such as ease of use, navigation, availability and performance. Responsiveness to email enquiries is a key aspect of performance. The process must be right to enable an acceptable response within the notified service standards such as 24 hours.

1.4.8 Example

A university can put its reading list on a website and students wishing to purchase any given book can click directly through to an online bookseller such as Amazon.com. The university gets a commission; the online bookseller gets increased business; the student gets a discount. Everyone benefits except the traditional bookshop.

Benefits of e-marketing
It promotes **transparent pricing** – because potential customers can readily compare prices not only from suppliers within any given country, but also from suppliers across the world.
It facilitates **personalised attention** – even if such attention is actually administered through impersonal, yet highly sophisticated IT systems and customer database manipulation.
It provides sophisticated **market segmentation** opportunities. Approaching such segments may be one of the few ways in which e-commerce entrepreneurs can create **competitive advantage**.
The website can either be a **separate** or a **complementary** channel.
A new phenomenon is emerging called **dynamic pricing**. Companies can rapidly change their prices to reflect the current state of demand and supply.

These new trends are creating **pressure** for companies. The main threat facing companies is that **prices will be driven down by consumers' ability to shop around**.

1.5 Price and pricing strategies 6/14, 12/11

FAST FORWARD

One of the most complex decisions involved in the marketing mix is deciding on the **price** of the product or service. There are eight steps in the process of establishing prices:

- Select a pricing objective
- Assess target market's evaluation of price and its ability to buy
- Determine the nature and price elasticity of demand
- Analyse demand, cost and profit relationships
- Evaluate competitor's prices
- Determine the basis for pricing
- Select a primary strategy
- Determine the final price

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Negotiated pricing	The final price is established through bargaining between the seller and buyer. This is common for products such as houses and cars as well as for second-hand items.
Secondary market pricing	One price is set for the primary market and another (usually lower) price is set for another market. This might be used by a restaurant that offers cheap deals for eating earlier in the evening.
Periodic discounting	Temporarily reducing prices on a systematic basis, for example many retailers hold January and summer sales. The disadvantage of these is that, due to their predictable pattern, customers learn to expect the reductions and wait to make their purchases then.
Random discounting	Temporary reductions are made as above but on an unsystematic basis. This means the customer cannot predict when the sales are likely to be and so will purchase in line with their own requirements rather than waiting for the reductions to be made.

New product pricing

When a new product is launched, a base price will have to be set for it. This can be done in two key ways.

Price skimming	The price is set at the highest possible price that customers who most desire the product will pay. This provides the most flexible base price as demand is not very price sensitive at the introductory stage of a new product. For example, when flat screen TVs were first introduced they were extremely expensive compared to regular TVs. Now that they have become the norm, their price has fallen dramatically. By setting the price at the highest level possible, a lot of profit can be made from sales of only a few units to customers who desperately want to be the first to own a new product. This high profit helps organisations recover the high research and development costs they will have faced in the run up to its launch and will probably have limited production capacity, so will need to earn a higher revenue per unit.
Penetration pricing	A price is set below the prices of competing brands in order to penetrate a market and produce a larger unit sales volume. This approach is less flexible than price skimming as it is harder to raise than to lower a price. Often a penetration price may be used for a product after first skimming the market with a higher price. Penetration pricing is most useful where it is believed that competitors could easily enter the market.

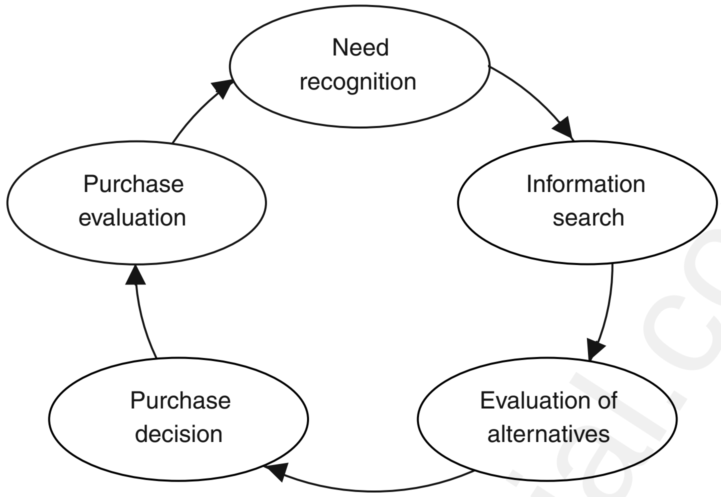
Product-line pricing

Product-line pricing means establishing and adjusting prices of multiple products within a product line. There are four main ways of doing this.

Captive pricing	The basic product is priced low, but related products are priced high. For example, a printer may be sold at a low price, but the ink cartridges may be very expensive.
Premium pricing	The highest quality, or most versatile, products are given the highest price and the rest of the products in the range are priced to appeal to price-sensitive customers or those that desire specific features.
Bait pricing	One item in the product line is priced very low with the aim of selling a higher-priced item in the line. It may advertise its cheaply priced most basic model in the hope the customer will actually purchase a more expensive version.
Price lining	A limited number of prices are set for lines of merchandise, eg various styles and brands of clothing that all sell for $40, and another higher quality line that all sell for $65. If price lining is used, the demand curve looks like a series of steps.

An important part of the marketing process is to understand why a customer or buyer makes a purchase. Without such an understanding, businesses find it hard to respond to the customer's needs and wants.

Research suggests that customers go through a five-stage decision-making process in any purchase. This is shown in the diagram below:



Five-stage decision-making process

The model implies that customers pass through all stages in every purchase. However, in more routine purchases, customers often skip or reverse some of the stages.

Step 1 The buying process starts with **need recognition**: for example, I am hungry, we need a new sofa, I have a headache, or responds to a **marketing stimulus**, as, for example, when passing a restaurant and being attracted by the smell.

Step 2 The customer then needs to decide how much information (if any) is required. If the need is strong and there is a product or service that meets the need close to hand, then a purchase decision is likely to be made there and then. If not, then the process of **information search** begins. A customer can obtain information from personal, commercial, public and experiential sources.

Step 3 In the **evaluation** stage, the customer must choose between the alternative brands, products and services. Where a purchase is 'highly involving' the customer is likely to carry out extensive evaluation.

Step 4 The purchase decision is made.

Step 5 The final stage is the post-purchase **evaluation of the decision**. It is common for customers to experience concerns after making a purchase decision. This arises from the phenomenon known as **cognitive dissonance**. This occurs when the customer receives different information from two trusted sources and experiences confusion and a lack of certainty. The customer, having bought a product, may feel that an alternative would have been preferable. In these circumstances, that customer will not repurchase immediately, but is likely to switch brands next time.

2.4.1 Types of buying behaviour

Types of buying behaviour – there are four typical types of buying behaviour based on the type of product that is to be purchased.

(a) **Complex buying behaviour** occurs when the individual purchases a high value brand and seeks a lot of information before the purchase is made.

(b) **Habitual buying behaviour** occurs when the individual buys a product out of habit, such as a newspaper.

2.5.4 Opt-in email

Opt-in emails are promotional emails that have been requested by the individual receiving them. Unlike promotional emails that get sent out to large lists of recipients without regard to whether or not they want the information, opt-in emails are only sent to people who specifically request them.

Opt-in emails are targeted and often personalised and carry information about specific topics or promotions that users are interested in learning about. Typical opt-in emails contain newsletters, product information or special promotional offers. For example, if a user frequented a website that sold books and music online, that user could opt in to receive announcements when his or her favourite author or musician released new material. The promotional email may even present the recipient with a special promotional offer to purchase the product at a discount available only to those on the opt-in list.

2.6 Increasing the activity and value of established, retained customers

FAST FORWARD

Customer activity may be enhanced by the use of data mining and cookies.

CRM is concerned with the creation, development and enhancement of individualised customer relationships with carefully targeted customers and customer groups.

Paul Postma, in *The New Marketing Era,* highlights two major shifts in the way customer information is used in the new marketing era:

(a) 'In a traditional market approach, people have all sorts of ideas about the target group, or they think up some obvious target group for a certain product. Without a marketing database, people are able to approach this target group only as a generic whole, by choosing the correct advertising medium and tailoring the creative ideas to the prescribed target group. In the new approach…we no longer calculate the market from within the company, but instead communicate, listen and record. The **database** will teach us what the market has to say…'

(b) 'In the new marketing era, we are shifting from derivative and self-reported information to **behavioural analysis**… Information technology makes it possible to determine behaviour, even at an individual level, and even in mass markets. This information is by far the most trustworthy when forecasting future behaviour.'

2.6.1 Database marketing

Database marketing has been defined by Shaw and Stone as 'an interactive approach to marketing, which uses individually addressable marketing media and channels to extend help to a company's target audience, stimulate their demand and stay close to them by recording and keeping an electronic database memory of customer, prospect and all communication and commercial contacts, to help them improve all future contacts and ensure more realistic planning of all marketing'.

A database, in marketing terms, is a collection of data that can be organised to give marketing information. The customer database is one example.

Allen et al suggest the following projects which can be conducted using database marketing techniques.

Project	Method
Identify the best customers	Use RFM analysis (Recency of the latest purchase, Frequency of purchases, and Monetary value of all purchases) to determine which customers are most profitable to market to
Develop new customers	Collect lists of potential customers to incorporate into the database
Tailor messages based on customer usage	Target mail and email based on the types and frequency of purchases indicated by the customer's purchase profile
Recognise customers after purchase	Reinforce the purchase decision by appropriate follow-up

(b) **Target mailing** will reduce costs and increase response rate. A simple example of this is to send this season's catalogue to customers who purchased from the last catalogue. To achieve this, the mailing lists need to be linked to sales history.

(c) **Sales analysis** is widely used by large sophisticated channel marketing businesses, but this strategy is basically simple and easy to implement using an integrated CRM system. For example, it should be easy to generate a list of customers who have not purchased for over a year. These could then be targeted by email, direct mail or telephone by asking them if they want to receive the next catalogue, and offering them some sort of discount to become a customer again. It is also possible to understand simple relationships; for example, anybody purchasing a computer printer must need to buy toner cartridges. A simple gap analysis allows a list to be formed of the details of anyone who has purchased a printer without toner cartridges, and thus provides a targeted list for a sales campaign. Again, a fully integrated CRM system will enable this.

(d) **Order building**: another role for the CRM system should be to provide the organisation's order taker or website with key data about each customer. Customers placing orders can then be reminded of their usual order requirements, any related products on offer and further product information. As well as increasing sales, this also helps to build the customer relationship.

Integrated CRM software is also known as **front office solutions**. This is because they deal directly with the customer, eg applications for sales, marketing and customer service.

Many call centres use CRM software to store all of their customers' details. When a customer calls, the system can be used to retrieve and display information relevant to the customer. By serving the customer quickly and efficiently, and also keeping all information on a customer in one place, a company aims to make cost savings, and also encourage new customers.

CRM solutions can also be used to allow customers to perform their own service via a variety of communication channels. For example, you might be able to check your bank balance via your WAP phone without ever having to talk to a person, saving money for the company, and saving you time.

A CRM solution is characterised by its functionality.

(a) **Scalability** is the ability to be used on a large scale and to be reliably expanded to whatever scale is necessary.

(b) **Multiple communication channels** provide the ability to interface with users via different devices such as phone, WAP, internet and so on.

(c) **Workflow** is enhanced by the ability to route work automatically through the system to different people based on a set of rules.

(d) **Databases** provide centralised storage (in a data warehouse) of all information relevant to customer interaction.

(e) **Customer privacy** is enhanced by, for example, data encryption and the destruction of records to ensure that they are not stolen or abused.

Integration with back-office systems

For CRM to be truly effective, the e-commerce platform must be seamlessly incorporated into the back office system (finance, payroll and HR applications). A simple example is that when product information in the back office system is altered (such as inventory levels), this should also update the website. When customers place orders on the web, they should be able review their order history whether placed on the website or over the telephone.

When contemplating a CRM system, management will have previously invested in systems for other business functions. These legacy systems will be at the application and database levels within the organisation and it will not be financially viable to abandon these applications so their integration is a vital part of the decision to implement a CRM system.

3.2 The choice of single-vendor solutions or a more fragmented choice

CRM software is available either as a complete purchase from a software vendor or outsourced from an application service provider, or ASP. ASPs host the CRM applications and sell subscription-based services. ASPs are more affordable than standalone software and require little maintenance on the organisation's part. However, ASPs are often static in what they offer and will not provide the level of customisation offered by purchased software.

CRM software is often sold in modules, so checking on modular availability can help trim costs. Before shopping, think about the organisation's goals. Is retaining existing customers important? Reducing time in the sales cycle? Or is it more valuable to expand into an online market? The data that is collected, analysed, and reported on should directly support these objectives. CRM systems typically offer so many tracking options that it is easy to get caught up in data overload, collecting every possible piece of information about each and every customer, potential customer, and transaction. But it is far wiser to save time, effort, and money by deciding in advance what information is most worthwhile to collect, how it will be measured and what will be done with it.

In an ideal world, the organisation would choose to have a single integrated database such that any employee would have total visibility about a customer and could access all visit, sales and support histories; the system would be bought from a single vendor for ease of implementation and support.

In reality, most organisations will have different applications for different communications channels, separate databases in different functional areas and multiple vendors. E-commerce systems are often separate from traditional systems. Such fragmentation makes implementation and maintenance of such systems a headache for managers and will often result in poor levels of customer service for the customer. The solution that many companies are looking to move to is close to the situation above.

However, the best option might be to adopt a CRM system phase by phase. The company needs to identify the areas where the return on investment would be highest and adopt CRM technology there.

Another good approach is to automate one of the key departments with an inexpensive CRM solution and if the project becomes successful, adopt a cross-company CRM solution.

For either of these options the present customer related information that is going to be integrated with the CRM system should be carefully analysed, consolidated, structured and cleaned up prior to adoption.

Chapter roundup (cont'd)

- Electronic media may be used to acquire customers by using a wide range of techniques. These vary from analogues of traditional mass-communications methods such as advertising and newsletters, through specialised online forms such as search engine registration, to previously targeted means such as personalised emails and website messages to logged-in return customers.
- The processes involved in making a purchase may be complex or relatively simple, depending on the nature of the need.

  The greatest contrast lies between business and consumer purchases. Online purchaser behaviour is complicated by the special conditions of the online environment.

  Segmentation of online consumer purchasers may be based on general online activity and the degree of confidence and competence displayed.
- Retention of online customers may be based on careful use of customer databases and by offering wider benefits. Databases allow for personalised communications, promotions and offers. Wider benefits may be offered by access to extranets and online communities.
- Customer activity may be enhanced by the use of data mining and cookies.
- There are four main areas of CRM automation.
  - **Sales** – lead management, order tracking, sales support
  - **Service** – help desk, FAQs problem resolution
  - **Marketing** – prospect database, campaign management
  - **Reporting** – presentation of performance data

  E-commerce systems must be integrated with back office systems such as inventory management and sales ledger.

  Systems choice is subject to considerations previously dealt with, concerning design, integration, modality and customisation.

Quick Quiz

1 The SOSTAC planning framework can be used to develop a marketing strategy. What does SOSTAC stand for?

2 What are the six Is of marketing?

3 What are the four ways an online brand be created?

4 What are the three phases of CRM identified by Chaffey?

5 What are the five phases of making a purchase?

6 What is scalability?

2.4 Stakeholder analysis

Key term

> **Project stakeholders** are the individuals and organisations that are involved in, or may be affected by, project activities and outcomes.

We discussed the strategic importance of stakeholders earlier in this Study Text. Fairly obviously, where a project is of strategic significance, stakeholders will be considered at several points during the development of the strategy. The stakeholder concept can also be applied to the management of projects of less overall significance. This would form part of that strategic approach to project management advocated by Grundy and Brown.

It is important to understand who has an interest in a project, because part of the responsibility of the project manager is **communication** and the **management of expectations**. An initial assessment of stakeholders should be made early in the project's life, taking care not to ignore those who might not approve of the project, either as a whole, or because of some aspect such as its cost, its use of scarce talent or its side-effects. Each stakeholder's degree of interest in and support for (or opposition to) the project should be estimated.

2.5 Preparation of a business case

When the project selection process is complete and a project selected for action, there is likely to be a great deal of information available to justify the decision to proceed. However, it is unlikely that a full account of the project has been prepared. A **business case** is a reasoned account of **why** the project is needed, **what** it will achieve and **how** it will proceed.

The business case is a fundamental component of the PRINCE2 methodology, which is built on the assumption that a project is, in fact, **driven by its business case**. An important use of the business case in any project is to maintain **focus** and prevent **mission creep** by regular reference back to it. It is possible that final approval for a large project will depend upon the preparation of a satisfactory business case.

A business case is not, of course, something that is confined to commercial organisations: the principles are equally applicable to any organisation undertaking a project.

Building the business case is covered in detail later in this chapter.

2.6 The project charter

The **project charter** (or project initiation document) complements the business case: while the business case explains the **need** for work on the project to start, the charter gives **authorisation** for work to be done and resources used. The charter also has an important role in internal communication within the organisation, since it can be given wide distribution in order to keep staff informed of what is happening. The exact content of a charter will vary from organisation to organisation and from project to project, but some elements are likely to be present in all charters.

- Project title
- Project purpose and objectives
- Project start date and expected finish date
- Details of the project sponsor and project
- Authorisation by the main stakeholders

Other elements of information may be included.

- Outline schedule of work
- Budget information
- Outline of project scope and work sequence
- Further details of roles and responsibilities

2.7 Statement of project scope

As we have already indicated, the word **scope** is used in project management to mean both the outcomes that are required and the work that is to be done to achieve them. It is obviously of great importance that everyone involved in a project should have a common understanding of these matters. If this common understanding is not reached, sooner or later there will be acrimonious disputes. A careful specification of

- Intangible elements, such as improved moral, can be difficult to value. In some organisations managers will not consider intangible benefits at all. This can make it difficult, or even impossible to make an effective business case. The best policy with intangible benefits is to state them but not value them, leaving the reader to come to their own conclusion about their worth
- Values are often based on assumptions which may or may not turn out to be accurate. Only assumptions that are common within the organisation should be made, and the values calculated based on these should always be under, rather than overstated

Exam focus point

One of the questions in the June 2014 exam focused on an examining body (the Institute of Independent Analysts (IIA)) which was looking to replace its conventional assessment process with computer-based assessments. The IIA had developed a business case for the project which included a financial appraisal in the form of an NPV working. The question required candidates to critically evaluate the financial case (cost/benefit) of the computer-based assessment project.

The NPV was based on a number of assumptions about the associated costs and benefits of undertaking the project. A significant number of the assumptions provided were, at best, highly questionable.

The examining team were disappointed to note that although the question asked for a critical evaluation of the financial case, a significant number of candidates appeared to be unable to evaluate the numbers. 'Too many candidates just repeated the information in words…'the figures show that the initial software costs are $200,000', or passing some subjective assessment unsupported by information given in the scenario; for example 'the security figures look a bit high'. '

These comments illustrate the importance of adopting a critical mindset when evaluating financial assumptions.

3.1.6 Investment appraisal

Once the costs and benefits have been assessed, they must be presented in a way that allows the reader to see whether, and when, the project will pay for itself.

3.1.7 Impact assessment

Any impacts the project may have on the organisation, in addition to the cost, should be described here. For example, changes may need to be made to the organisational structure, or specialist staff may need to be recruited.

All changes such as these should be clearly described, along with details of any costs these changes will incur.

3.1.8 Risk assessment

Strong business cases clearly identify the risks involved and illustrate the suitable countermeasures available. For every risk, the following should be stated.

- **Description** of the cause of the risk and its impact
- **Impact assessment** of the scale of the damage that would be suffered, should the risk event occur
- **Probability** of how likely that risk is to occur
- **Countermeasures** describing how the likelihood of the risk occurring can be reduced, how to lessen its impact if it occurs, and how the risk can be transferred (eg insurance)
- **Ownership** of the risk (the individual responsible for managing that risk should be defined)

3.1.9 Recommendations

This section should summarise the business case and clearly state the decisions that senior management are being asked to take.

3.1.10 Appendices and supporting information

Detailed information should be put into appendices to separate out the supporting detail from the main points included in the body of the case. Statistics, charts and the detailed cost/benefit calculations may also be put into the appendices.

3.2 Identifying the benefits

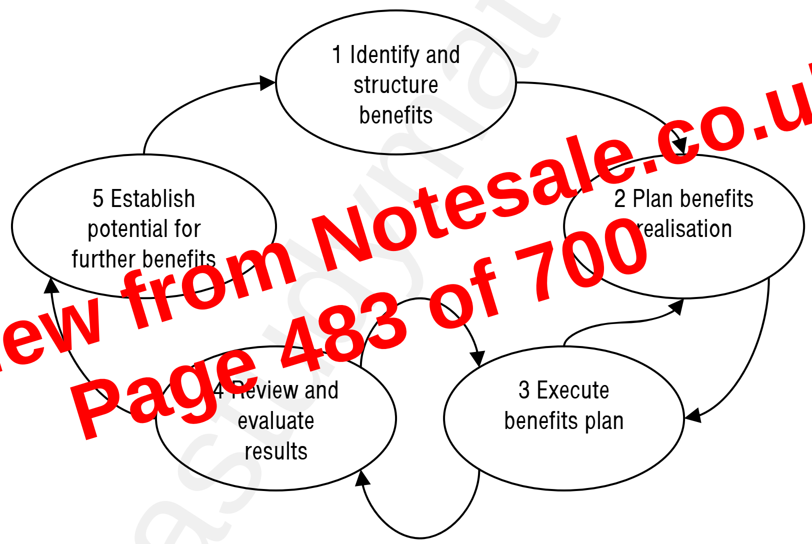
FAST FORWARD

A business case should be based on the ability to measure each benefit and estimate expected improvements. Benefits can be classified as **observable**, **measureable**, **quantifiable** or **financial**.

Some projects are more successful than others at delivering benefits. To understand why this is, observation of methodologies used in projects was carried out and the **benefits management** approach was developed. This approach aims to avoid the loss of achievable benefits as well as to realise more extensive benefits than from previous investments. It is possible that this approach may also reduce costs, as those costs which deliver nothing of value can be eliminated.

Benefits management has much in common with change management and the business process change lifecycle model as it recognises that the way in which a major change is managed must be appropriate to the content of the change and the context of the organisation involved.

Benefits management is not a one-off process; it will be revised constantly throughout the life of the project. It is made up of five key stages as shown by the following diagram.



Ward and Daniel

The first stage of the diagram, **identifying and structuring benefits**, is important for inclusion in the business case. The point of the business case is to secure funding by demonstrating the benefits for the organisation that the project will bring.

The purpose of identifying and structuring benefits is to:

- Establish agreed objectives for the investment
- Identify all the potential benefits that may arise if the objectives of the investment are met (including where in the organisation it will occur)
- Understand how those benefits could be realised
- Determine ownership of the benefits
- Determine how the benefits can be measured to prove they have occurred
- Identify any issues that could delay the project or cause it to fail

It is often necessary with such benefits to have more than one measure in order to determine if the benefit has been fully realised. These measures should be relevant to both the measure itself and the changes needed to realise it. This helps to ensure that the improvement can be directly attributable to the investment.

3.2.4 Quantifying benefits

A big challenge when defining benefits for inclusion in the business plan is to find a way of **quantifying** the benefits.

Quantifiable benefits differ from measurable benefits because it is possible to quantify the degree of improvement **before** the change is actually made.

Many investment cases are criticised for being unable to provide sufficient evidence to back up the assumptions made to quantify the benefits listed in their business case. If the quantification cannot be verified, then any financial figure placed on this benefit will be meaningless. This is therefore the most crucial stage in building a sound economic case for investment. There are five approaches to quantifying benefits.

1 **Evidence.** Relevant detailed evidence may be obtained from existing systems over an appropriate period of time. This method is particularly useful when the change requires **stopping** the carrying out of a certain process.

2 **Modelling and simulating** can be carried out using computer software to identify the level of performance that could be achieved if particular new processes are adopted, providing a basis for estimates for what could be achieved in the specific situation under review.

3 **Benchmarking**. Benefits can be quantified by evaluating the changes in relation to best practices in the industry, or in similar processes in different industries. This is a helpful technique for quantifying the effects of process improvement initiatives but less helpful when attempting to quantify the benefits of innovations.

4 **Reference sites** are examples of the change being made or of the technology being used in other organisations or industries. Unless it is a first-of-its-kind innovation, there should be a reference site available, often from the suppliers of the technology who will be keen to demonstrate its prior success. Once a relevant implementation has been identified, it will be necessary to determine:

   - How the technology has been deployed
   - What changes had to be made in order to obtain the required improvement in performance
   - The starting point (in performance terms) of the reference organisation in order to determine how much of their achievement is relevant and feasible for the current organisation.

5 **Pilot implementations** can be used, both to test technology and to evaluate potential benefits from new systems and ways of working. This method is necessary where proof of the benefit is required. The process is tested on a small scale and the benefits are recorded, then extrapolated to provide the total expected benefit. Ideally, a comparable control group, working in the old way, will be monitored simultaneously to provide a baseline.

3.2.5 Financial benefits

A business case should aim to express as many of the benefits as possible in financial terms in order for the expected return of the investment to be calculated. However, over-reliance on financial benefits will limit the benefits included because, as we have seen, not all benefits can be reliably quantified and hence, no reliable financial value can be attached to it.

Quantifiable benefits can be converted to financial benefits by applying a financial formula (such as cost or price) to that benefit. However some quantified benefits, such as increased productivity, can be difficult to convert to a financial benefit, especially if the improved productivity arises from a saving in staff time. This is because the value placed on such benefits can be very subjective and varies greatly across organisations.

The project manager will also have to decide what action to take in terms of reviewing the scope and specification of the project in light of any changes that have arisen. Any decision made should be based on the overall project objectives, not just the immediate problem, and all stakeholders should be involved in any decisions to change the plan. The plan may also be revised in light of any further benefits that have been identified during the implementation of the plan.

Of course, it is also possible that implementation will reveal that some benefits are no longer feasible or relevant. Again, the benefits plan will have to be modified accordingly, along with any associated business changes.

4 Strategic aspects of the project plan

FAST FORWARD

Many large-scale projects, particularly those involving major change, are strategically significant, and project management can merge into strategic management. Force field analysis identifies enablers, constraints and showstoppers.

The unique nature of each project means that careful planning is an essential component of project management. Many project costs, time overruns and outright failures can be traced to failures of planning.

Project management as a discipline is commonly associated with fairly clearly defined issues such as preparing for a conference, organising an office move or installing a new IT system. Projects such as these can be of strategic importance, but even when they are, there is often an unspoken assumption that once the go-ahead is given, the job of project management is essentially one of detailed planning, organisation and control, with, perhaps, a little trouble-shooting thrown in. It is important to understand that this is unlikely to be the case with truly strategic projects: with projects such as the turnaround of an underperforming division or an initial move into a foreign market, **project management and strategic management are likely to merge into one another**. As a corollary, we can say that at the level of the strategic project, project planning is likely to make use of a strategic planning approach. A failure to think strategically is likely to lead to project failure.

4.1 Why do projects go wrong?

Project planning is fundamental to project success. **Realistic timescales** must be established, use of **shared resources** must be planned and, most fundamental of all, jobs must be done in a sensible **sequence**. However, even if all these aspects are satisfactory, there are other potential pitfalls that the project planner must avoid or work around. Here are some examples.

(a) **Unproven technology**
The use of **new technological developments** may be a feature of any project. The range of such developments extends from fairly routine and non-critical improvements, through major innovations capable of transforming working practices, costs and time scales, to revolutionary techniques that make feasible projects that were previously quite impracticable. As the practical potential of a technical change moves from minor to major, so too moves its potential to cause disruption if something goes wrong with it. A classic example is Rolls Royce's attempt to use carbon fibre in the design of the RB211 engine in the early 1970s. Not only did the project fail to meet its objectives, its failure led to the company's financial failure and subsequent takeover by government.

(b) **Changing client specifications**
It is not unusual for clients' notions of what they want to evolve during the lifetime of the project. However, if the work is to come in on time and on budget, they must be **aware** of what is **technically feasible**, **reasonable** in their **aspirations**, **prompt** with their **decisions** and, ultimately, **prepared to freeze the specification** so that it can be delivered.
Note that the term 'client' includes *internal* specifiers.

(c) **Politics**
This problem area includes politics of all kinds, from those internal to an organisation managing its own projects, to the effect of national (and even international) politics on major undertakings.

5.3 Gantt charts

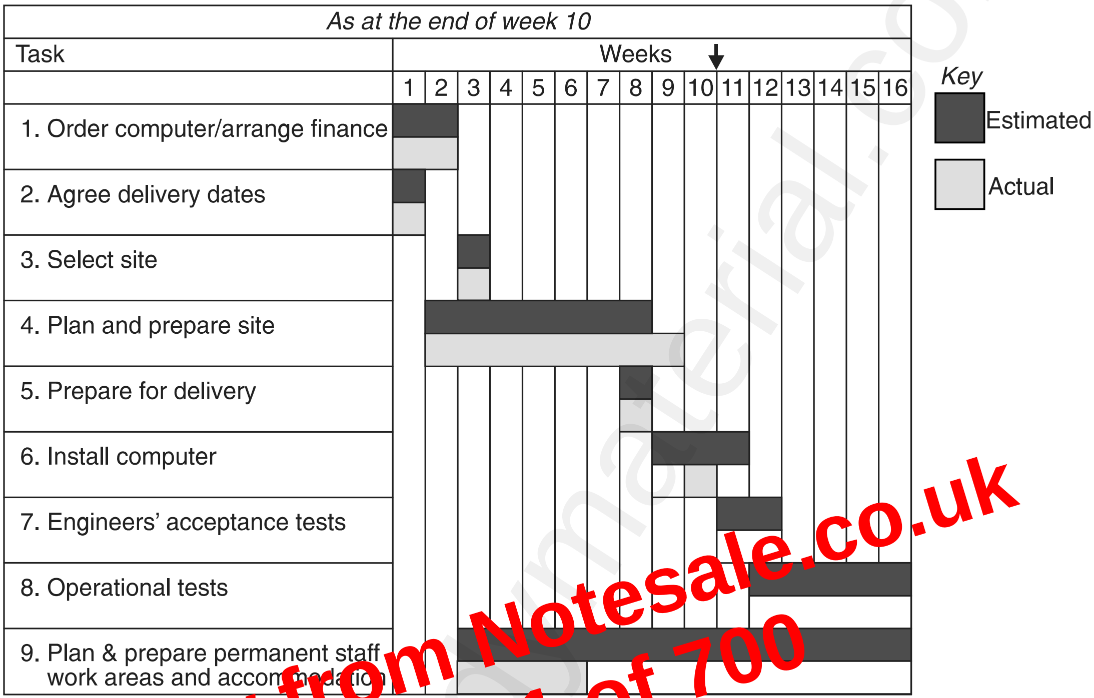
FAST FORWARD

A **Gantt chart** shows the deployment of resources over time.

A **Gantt chart**, named after the engineer Henry Gantt who pioneered the procedure in the early 1900s, is a horizontal bar chart used to plan the **time scale** for a project and to estimate the **resources** required.

The Gantt chart displays the time relationships between tasks in a project. Two lines are usually used to show the time allocated for each task, and the actual time taken.

A simple Gantt chart, illustrating some of the activities involved in a network server installation project, follows.



The chart shows that at the end of the tenth week, Activity 9 is running behind schedule. More resources may have to be allocated to this activity if the staff accommodation is to be ready in time for the changeover to the new system.

Activity 4 had not been completed on time, and this has resulted in some disruption to the computer installation (Activity 6), which may mean further delays in the commencement of Activities 7 and 8.

A Gantt chart does not show the interrelationship between the various activities in the project as clearly as a **network diagram** (covered later in this chapter). A combination of Gantt charts and network analysis will often be used for project planning and resource allocation.

5.4 Network analysis

FAST FORWARD

Network analysis illustrates interactions and dependencies. It is used to plan the sequence of tasks making up project scope and to determine the critical path. PERT uses probabilities to make estimates of likely completion and milestone dates.

Network analysis, also known as **Critical Path Analysis** (CPA), is a useful technique to help with planning and controlling large projects, such as construction projects, research and development projects, and the computerisation of systems.

CPA aims to ensure the progress of a project, so the project is completed in the **minimum amount of time**. It pinpoints the tasks **on the critical path**, which is the longest duration sequence of tasks in the

- Provide any support required when members leave the team, either during the project or on completion

6.3 Duties of a project manager

The project manager's responsibilities give rise to a number of fairly standard duties and managerial activities

Duty	Comment
Outline planning	See above for project definition and initiation
Detailed planning	Work breakdown structure, budgeting, resource requirements, network analysis for scheduling
Obtain necessary resources	Resources may already exist within the organisation or may have to be bought in. Resource requirements unforeseen at the planning stage will have to be authorised separately by the project board or project sponsor
Team building	Build cohesion and team spirit in the project team
Communication	Keep all stakeholders suitably informed and ensure that members of the project team are properly briefed. Manage expectations
Co-ordinating project activities	Co-ordination will be required between the project team, external suppliers, the project owner and end-users
Monitoring and control	Monitor progress against the plan, and take corrective measures where needed
Problem-resolution	Even with the best planning, unforeseen problems may arise
Quality control	Understand and manage quality procedures; agree and manage any appropriate trade-off of functionality against achieving deadlines

It is also possible to view the **process of project management** as having **five stages**:

- Initiation
- Planning
- Leadership
- Controlling
- Completing

The first, second, fourth and fifth of these phases correspond closely to the phases of the **project life cycle**, which was discussed earlier in this chapter. The third phase, leadership, forms a major part of the subject matter of this section.

6.4 The skills required of a project manager

FAST FORWARD

Project managers require the following **skills**: Leadership and team building, organisational ability, communication skills (written, spoken, presentations, meetings), some technical knowledge of the project area and interpersonal skills.

To perform these duties and meet these responsibilities, a project manager requires a wide range of skills.

6.7.5 Problems with teams

Unfortunately, team working is rarely such an undiluted success. There are certain constraints involved in working with others.

(a) Awareness of **group norms** and the desire to be acceptable to the group may **restrict individual effort**.

(b) **Too much discord**. Where an individual is a member of more than one group, conflicting roles and relationships can cause difficulties in communicating effectively.

(c) **Personality problems** will arise if one member dislikes or distrusts another; is too dominant or so timid that the value of their ideas is lost; or is so negative in attitude that constructive communication is rendered impossible.

(d) **Rigid leadership** and procedures may stifle initiative and creativity in individuals. Team working requires that managers share power with the team. Some managers find this difficult to do. Also, a coaching style of management is most appropriate for teams and this must be learned.

(e) **Differences of opinion** and political conflicts of interest are always likely.

(f) **Too much harmony**. Teams work best when there is room for disagreement. They can become dangerously blinkered to what is going on around them, and may confidently forge ahead in a completely **wrong** direction. I L Janis describes this as **groupthink**. The cosy consensus of the group prevents consideration of alternatives, constructive criticism or conflict. Alternatively, efforts to paper over differences may lead to bland recommendations without meaning.

(g) **Corporate culture and reward systems**. Teams will fail if the company promotes and rewards the individual at the expense of the group. Similarly, when team rather than individual output is measured, it is easier for un-motivated individuals to get by with minimal effort.

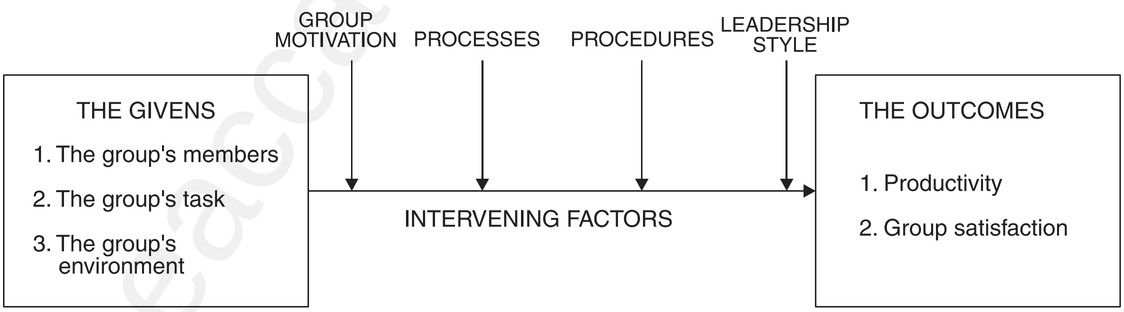
(h) **Too many meetings**. Teams should not try to do everything together. Not only does this waste time in meetings, but team members are exposed to less diversity of thought. Decision making by teams can be excessively time-consuming and may not offer any advantage over the normal process of decision-making by individual managers after consultation.

(i) **Powerlessness.** People will not bother to work in a team or on a task force if its recommendations are ignored.

(j) **Risky shift**. Group processes are such that individual characteristics can be reinforced and become exaggerated. A good example is the way that a group of risk-averse individuals may adopt a far less risk-averse approach to collective decision-making.

6.7.6 Creating an effective work team

The management problem is how to create effective, efficient work teams. Handy takes a contingency approach to the problem of team effectiveness.



Management can operate on both **givens** and **intervening factors** to affect the **outcomes**.

organisations (particularly those involved in long, complex projects) produce more comprehensive progress reports, with more explanation and comment.

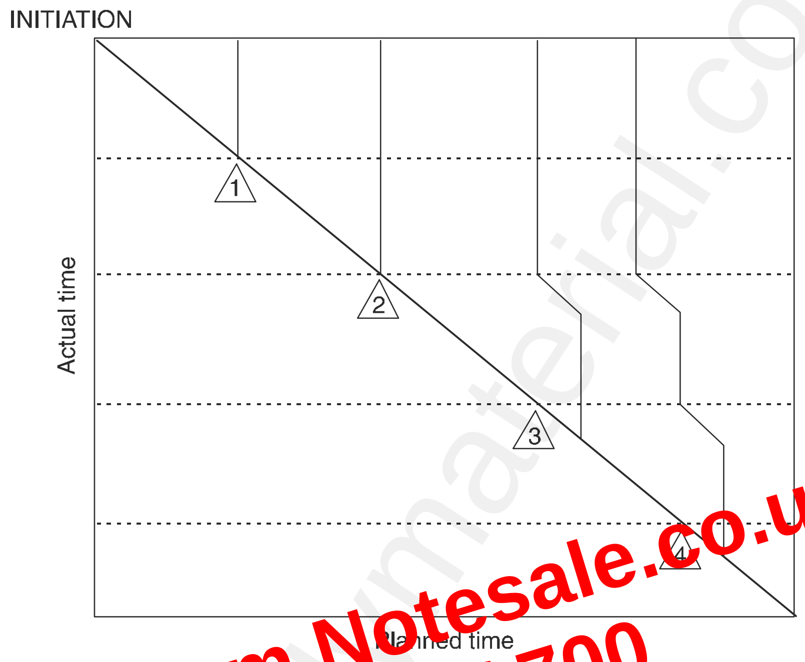
The report should monitor progress towards key milestones.

Key term

A **milestone** is a significant event in the life of the project, usually completion of a major deliverable.

A progress report may include a **milestone slip chart** which compares planned and actual progress towards project milestones. Planned progress is shown on the X-axis and actual progress on the Y-axis. Where actual progress is slower than planned, progress slippage has occurred.

Milestone slip chart



On the chart above, milestones are indicated by a triangle on the diagonal planned progress line. The vertical lines that meet milestones 1 and 2 are straight – showing that these milestones were achieved on time. At milestone 3 some slippage has occurred. The chart shows that no further slippage is expected as the progress line for milestone 4 is the same distance to the right as occurred at milestone 3. The progress report should also include an updated budget status – such a report could adopt the format shown in the following example.

7.3 Dealing with slippage

Exam focus point

One of the question scenarios in the December 2008 exam described a software implementation project which was slipping behind schedule, and appeared unlikely to meet its target delivery data. The question asked candidates to evaluate a range of options available to the project manager to deal with the slippage.

When a project has slipped behind schedule, there are a range of options open to the project manager. Some of these options are summarised in the following table.

Action	Comment
Do nothing	After considering all options it may be decided that things should be allowed to continue as they are
Add resources	If capable staff are available and it is practicable to add more people to certain tasks it may be possible to recover some lost ground. Are extra funds available to hire more staff? Could some work be subcontracted?

7.6.1 Post-project and post-implementation reviews

Key term

The **post-project review** is a formal review of the project that examines the lessons that may be learned and used for the benefit of future projects.

The review considers the success of the project by asking the following.

(a) Was the project achieved on time and within budget?

(b) Was the management of the project as successful as it might have been, or were there bottlenecks or problems? This review covers:

(i) Problems that might occur on future projects with similar characteristics.
(ii) The performance of the team individually and as a group.

In other words, any project is an **opportunity to learn how to manage future projects more effectively**.

The post-project review should involve input from the project team. A simple questionnaire could be developed for all team members to complete, and a reasonably informal meeting held to obtain feedback, on what went well (and why), and what didn't (and why).

Case Study — **BBC and DMI**

In 2008, the BBC (British Broadcasting Corporation) launched the Digital Media Initiative (DMI) project. The project aimed to modernise the BBC's existing production operations, moving the corporation away from the use of video tape towards digital production.

In 2013, the project was abandoned after years of technical problems in getting the technology to work and delays in reporting on the project's progress. In an article published on the BBC website in February 2014, the corporation reported that the estimated project cost was £125.9m.

The Guardian newspaper, highlighting the findings of a National Audit Office inquiry, reported that the deteriorating fortunes of DMI were not adequately reported, either within management or, critically, to the BBC Trust. A 'code red' warning of the imminent project failure for example from the BBC's own internal project management office from February 2012 wasn't reported to the trust until July that year.

The BBC Director General (the most senior executive officer at the organisation) at the time had believed that the technology was being used on programmes including the early evening 'One Show'.

A later report by the National Audit Office reported that 'the BBC had hoped to save £98m by introducing the new system. However, the final estimate of the benefits it brought to the BBC was zero. The report blamed the project's failure on confusion, a lack of planning and insufficient scrutiny'.

Commenting on the National Audit Office report, Margaret Hodge MP of the Public Accounts Committee (the body which overseas UK government spending) wrote, 'this report reads like a catalogue of how not to run a major programme. The BBC needs to learn from the mistakes it made and ensure that it never again spends such a huge amount of licence fee payer's money with almost nothing to show for it'.

The BBC responded, saying it had adopted new procedures for managing big projects in the light of the problems with the DMI project.

Adapted from two online articles:

1) 'Mark Thompson apologises over project failure at BBC', (February 2014) published on the *BBC* website; www.bbc.co.uk

2) 'BBC's Digital Media Initiative failed because of more than poor oversight', by Steve Hewlett (February 2014) published on *The Guardian* website; www.theguardian.com

8.4 Disadvantages of project management software packages

Some **disadvantages** of project management software are:

(a) Some packages are difficult to use. Some people may achieve better results using simpler techniques (pen and paper!) but feel pressured into using project management software by company policy.

Often, project management software is unnecessary for small, stand-alone projects, where the scope of the project does not justify the time or costs involved in the software. However, project management software can be very useful for multiple, larger projects.

(b) Some project managers become so interested in producing perfect plans that they spend too much time producing documents and not enough time managing the project. In particular, there is a danger they do not adjust the initial project plan to reflect actual progress through the project (for example, to reflect tasks that are completed late or are re-sequenced).

(c) The project manager's level of interpersonal contact may suffer as he or she spends too much time looking at the software. (This problem is similar to the one some accountants suffer from when they spend too much time looking at spreadsheets, rather than talking to operational managers to understand what is really happening in the business.)

Exam guide

P3 is not a strategic financial management paper and we do not expect the examining team to present technically difficult questions on finance. Nonetheless, the evidence of the papers to date suggests you are likely to encounter numerical analysis of some kind in Question 1 and the examining team has indicated that there will continue to be opportunities for calculation. However, in P3 it is important that you link your financial skills and computations to business strategy, rather than simply performing calculations in their own right.

There is no certainty that the numerical analysis will be of a financial kind. It is possible that financial matters will appear in optional Section B questions (rather than the Section A case study), and in this case, the context could be the mutual impact of finance and strategy on one another (for example, benefits realisation from projects, or supplier evaluation in software selection), rather than simply doing computations.

1 The finance function

1.1 Transformation of the role of the accountant and the finance function

FAST FORWARD

The role of the finance function and finance professional is changing. Today's finance professional is expected to take on a broader advisory and strategic role. This gradual evolution has given rise to the notion of the finance function acting as a **business partner**, where finance professionals share their finance expertise with operational teams. Furthermore, the '**hybrid accountant**', is now regarded as the modern model of an accountant in business, where they act as internal consultants and business analysts.

In this section, we explore how the traditional role of the finance function and that of the finance professional is continuing to evolve. In recent times there has been a noticeable shift in the role that finance plays in modern organisations, moving away from being a mechanism for simply reporting on performance, to taking on a broader advisory and strategic role.

1.1.1 The role of the traditional finance function

The specific activities and roles undertaken by the traditional finance function include:

(a) Processing transactions, maintaining accounting records and delivering month-end reports efficiently and at low cost.

(b) Communicating results to internal and external stakeholders.

(c) Ensuring the effective operation of corporate governance and control. This has become increasingly important in the wake of various financial scandals and the requirements of legislation such the American Sarbanes-Oxley Act (which you should recall from your P1 studies).

1.1.2 The finance function as a business partner

The finance function has faced pressures to become more actively involved in business operations. Many finance functions have therefore re-focused their roles as business partners, adopting a more commercial, action-orientated approach. This means gaining broad knowledge of the business, participating as full members of operational teams and bringing financial expertise to the management process. They are expected to **integrate management accounting information** with **strategic management accounting data.**

Important areas where the finance functions role has developed have included:

- Providing more useful information on business units, projects, products and customers
- Collaborating in the formulation of corporate objectives, strategic plans and budgets
- Monitoring outcomes against plans and initiating responsive action to improve performance
- Supplying business cases for new investments
- Communicating and interpreting financial and non-financial information for a range of stakeholders
- Helping operational and strategic managers understand information on which decisions are based

1.2 Importance of decision making to organisations

FAST FORWARD

A large part of the modern accountant's role is to work closely with the business to improve **strategic decision making** to enhance the business' ability to create value. This, however, does present some challenges for traditional accounting systems.

As ACCA's report highlights, the ever changing business environment requires finance professionals to support organisations in a far broader sense. In the context of developing business strategy, perhaps the most important of these job roles is the provision of information and analysis on which decisions are based. A key part of the modern accountant's role is to work closely with the business to improve decision making and to enhance the business' ability to create value.

This change in the focus of the modern accountant's role also reflects an increasing recognition that high quality decision-making is becoming critical to superior business performance and may form the basis of a competitive advantage.

1.2.1 The challenge for modern accountants

The challenge lies in providing more relevant information for decision making. Traditional accounting systems may not always provide this.

(a) **Historical costs** are not necessarily the best guide to decision making. One of the criticisms of management accounting in a strategic context is that management accounting information is biased towards the **past rather than the future**.

(b) **Strategic issues** are not easily detected by accounting systems. Much accounting information has been devised for internal consumption. However, it is important to balance this with external factors, especially as strategic management involves competitor and environmental considerations.

(c) **Financial models** of some sophistication are needed to enable accountants to provide useful information.

In other words, to support strategic decisions, accounting itself needs to become more strategic. The rest of this section is devoted to exploring how accountants (and more specifically, management accountants) can add value to organisations acting as strategic management accountants.

1.3 What is strategic management accounting?

FAST FORWARD

Strategic management accounting is a form of management accounting in which emphasis is placed on information about factors which are external to the organisation, as well as non-financial and internally generated information.

The role of the **strategic management accountant** covers **financial analysis, planning and control.**

Key term

Strategic management accounting is a form of management accounting in which emphasis is placed on information about factors which are external to the organisation, as well as non-financial and internally-generated information.

1.3.1 The role of the strategic management accountant

Ward suggests that the role of the strategic management accountant can be analysed as follows.

(a) **Financial analysis** indicates the **current position** of a business and its financial performance in comparison with competitors, as well as breaking it down into product and customer profitability analyses. (The concept of customer profitability was discussed earlier in the Study Text in Chapter 3).

(b) **Financial planning** quantifies the goals and objectives of the business, normally in a budget.

- Identify the type of decision
- Offer appropriate financial performance indicators
- Distinguish between economic and managerial performance
- Provide relevant information
- Separate committed from discretionary costs
- Distinguish discretionary from engineered costs
- Use standard costs strategically
- Allow for changes over time

These are now discussed in more detail.

1.5.1 Aid strategic decisions

As part of a strategic management system, the SMAS will provide one-off information to support and evaluate particular strategic decisions and information for strategic management, in order to monitor strategies and the firm's overall competitive position. Changes in the external environment and competitor responses should be easily incorporated into the system.

1.5.2 Close the communication gap

The SMAS converts financial data into information for strategic decision-making. Financial data is off-putting to many people. Consequently, the originator of such information should make sure that it is tailored.

- Ask the recipient how he or she would like the **format** of the report
- Provide only the **relevant** supporting financial data
- Identify the **key assumptions** on which the information is prepared

1.5.3 Identify the types of decision

Ward states that, despite the one-off nature of many strategic decisions, it is possible to identify the following types of financial decision.

(a) **Changing the balance of resource allocation** between different business areas, for example, by increasing spending in one area.

(b) **Entering a new business area** (eg new product development, new markets). Some account will have to be taken of the time scale in which the strategy is expected to consume resources, as benefits may be some time in coming.

(c) **Exit decisions** which come in two forms.

 (i) **Closing down** part of the business and selling off the assets
 (ii) Selling the business as a **going concern**

To support such decisions, the SMAS should:

- Incorporate **future cash flows** rather than historic costs
- Include only those items which will be **changed** by the particular decision

1.5.4 Offer suitable financial performance indicators

Two general points can be made.

(a) **Financial data is not enough**. Customers drive a business, and competitors can ruin it, so performance measures which ignore key variables of customer satisfaction or competitor activity ignore critical strategic issues.

(b) **The financial information must suit the competitive strategies**. A report complaining about the expense of an advertising campaign ignores the fact that failing to advertise could lead to loss of market share.

1.5.5 Distinguish economic versus managerial performance

A business's **overall economic performance** results from both controllable and uncontrollable factors.

(a) **Risk**. Shareholders may be happy with the risk, if it is balanced by suitable return, but a manager may be unhappy if their career is at risk from pursuing a strategy, the success of which is outside their control.

(b) **Performance**. Judging a manager's contribution on the basis of the overall economic performance of the business may not reflect their contribution at all. Managers should therefore be judged on their contribution in areas over which they have control.

1.5.6 Provide relevant information

Relevant financial information should be provided, which presents strategic decisions from the organisation's viewpoint. Specific, tailored reports should support individual decisions and activities, perhaps with **profitability analyses** for each market segment.

1.5.7 Separate committed from discretionary costs

Ignore sunk costs. This has a number of ramifications for the making of business strategies.

- A cost may be **committed,** even though it has not actually been incurred
- **Discretionary costs** are those over which the decision-maker still has choice.

1.5.8 Distinguish between discretionary and engineered costs

Engineered costs are those which derive from a relatively predictable relationship between input materials and output units of production.

1.5.9 Use standard costs strategically

Standard costs (covered later in this chapter) consist of a physical usage element (eg volume of materials) and a price element. The split between the **price** and **usage** elements is indicative of:

- The extent to which the firm is **vulnerable** to suppliers raising prices
- The possible impact of **trade-offs** between, say, labour and materials

Trade-offs. If the relationships between the input material and output quantities are known, or variable, then standard costing can show the financial effects of different mixes.

(a) For example, if there is a trade-off between labour and raw materials, changes in the relative costs of these factors can indicate a suitable mix: more expensive labour would result in less of a valued raw material being used.

(b) If the price of a raw material escalates suddenly, the standard costing system can be amended with the new price, and a new mix analysis calculated which takes it into account.

Absorbing indirect/fixed overheads into products can lead to poor pricing decisions, in the short term. If a factory is working at 60% capacity utilisation, this could lead to higher indirect costs being absorbed per unit. This information, if wrongly interpreted, could be used to suggest a price rise, rather than a reduction to encourage more sales and hence, an increased utilisation of capacity.

2 Finance and strategy

FAST FORWARD

In commercial organisations, managing for value is about creating shareholder value, while in the public sector; it is about obtaining value for money. Managers must understand the key cost and value drivers affecting their operations. Financial risk is determined exclusively by gearing, but there are several sources of business risk. Financial risk may be balanced against business risk, so that overall risk is managed.

In the first part of this chapter, we explored the evolution in the role of the finance function and that of the modern finance professional. In this section, we take a closer look at the main financial issues most organisations face.

JS&W suggest that organisations of all types must deal with three broad issues of finance.

- **Managing for value**
- **Funding**
- **Financial expectations of stakeholders**

2.1 Managing for value

For commercial organisations, managing for value is about **creating value** for shareholders, while in the public sector, it is about **obtaining best value** for the money spent.

2.1.1 Shareholder value

Shareholder value depends on long-term capacity to generate cash. This will enable the payment of dividends, which, in turn, will drive up the market value of the business, offering capital gain as an alternative form of value. Ability to generate cash is influenced by three main factors.

(a) **Funds from operations**, which are determined by sales revenues and costs.

(b) The net cost of financing the **capital base of non-current and current assets** required to support operations: an important aspect of this factor is the efficiency with which these assets are used.

(c) **Capital structure** (gearing), which will determine the company's **cost of capital** (and its financial risk).

2.1.2 Best value in the public sector

Most public sector managers are concerned only with managing their budgeted cash spending. However, they should understand the significance of the factors outlined above as they apply to their responsibilities. A good example is the need for efficient exploitation of non-current assets.

2.1.3 Drivers of cost and value

Value creation does not occur and costs do not arise evenly across the organisation, so managers should have a firm grasp of the **key cost and value drivers** affecting their operations. Some of these may be outside the organisation, elsewhere in the value network, so the ability to influence suppliers and distributors may be crucial to success. This will depend on **relative bargaining power**, as discussed elsewhere in this Study Text.

Choice of **generic strategy** interacts with cost and value: strict control of cost is obviously fundamental to cost leadership, while differentiation will inevitably have cost implications associated with such matters as brand communications, product quality and customer service.

The structure of costs and value creation is likely to **change over time**, as, for example, illustrated by the cost and profit aspects of the **product life cycle**. The cash flow aspect of the **Boston matrix** analysis also illustrates this.

2.2 Funding strategies

There are likely to be several considerations relevant to funding decisions for commercial organisations. Among these are: the ownership structure; whether a company is quoted or privately held; and, perhaps most significantly, the attitude of the owners and senior managers to **risk**. One of the most important commercial funding decisions is **capital structure**, or **gearing**. Gearing up, with a high proportion of loan capital, enables holders of equity to benefit significantly when overall returns are in excess of the cost of debt, since the surplus accrues to them. The natural corollary to this is, however, that when times are hard and returns are depressed below the rate payable to lenders, it is the holders of equity that have to find the shortfall. This is **financial risk**.

(b) The company might want to issue new shares, partly to raise cash but more importantly, to obtain a **stock market listing**. When a UK company is floated, for example, on the main stock market, it is a requirement of the Stock Exchange that at least a minimum proportion of its shares should be made available to the general investing public if the shares are not already widely held.

(c) The company might issue new shares to the shareholders of another company, in order to **take it over**.

7 Bank loans

FAST FORWARD

Bank loans tend to be a **source** of **medium-term finance**, linked with the purchase of specific assets. Interest and repayments will be set in advance.

7.1 Loans and overdrafts

Banks often provide term loans as medium or long-term financing for customers. The customer borrows a fixed amount and pays it back with interest over a period or at the end of it. This contrasts with an overdraft facility, when a customer, through its current account, can borrow money on a short-term basis up to a certain amount. Overdrafts are repayable on demand.

7.2 Loan or overdraft

A customer might ask the bank for an overdraft facility when the bank would wish to suggest a loan instead; alternatively, a customer might ask for a loan when an overdraft would be more appropriate.

(a) In most cases, when a customer wants finance to help with day-to-day trading and cash flow needs, an **overdraft** would be the **appropriate method** of financing. The customer should not be short of cash all the time, and should expect to be in credit in some days, but in need of an overdraft on others.

(b) When a customer wants to borrow from a bank for only a **short period of time**, even for the purchase of a major asset such as an item of plant or machinery, an overdraft facility might be more suitable than a loan, because the customer will stop paying interest as soon as the account goes into credit.

(c) When a customer wants to borrow from a bank, but cannot see its way to repaying the bank except over the course of a few years, the **medium- or long-term nature** of the financing is best catered for by the provision of a loan rather than an overdraft facility.

7.2.1 Advantages of an overdraft over a loan

(a) The customer only pays interest when it is overdrawn.

(b) The bank has the flexibility to review the customer's overdraft facility periodically, and perhaps agree to additional facilities, or insist on a reduction in the facility.

(c) An overdraft can do the same job as a loan: a facility can simply be renewed every time it comes up for review.

(d) Being short-term debt, an overdraft will not affect the calculation of a company's gearing.

7.2.2 Advantages of a loan over overdraft

(a) Both the customer and the bank **know exactly** what the repayments of the loan will be and how much interest is payable, and when. This makes planning (budgeting) simpler.

(b) The customer does not have to worry about the bank deciding to reduce or **withdraw** an overdraft facility before being in a position to repay what is owed. Overdrafts are normally **repayable on demand**. There is an element of 'security' or 'peace of mind' in being able to arrange a loan for an agreed term.

(c) Loans normally carry a **facility letter** setting out the precise terms of the agreement.

the anticipated cost based on a standard hour. Where actual costs exceed the standard, profit will be adversely affected.

10.2.4 Fixed overhead variances

Fixed overhead spending variance is the difference between the actual and budgeted spending on fixed overheads. Higher than budgeted overheads lead to less profit, so have an adverse effect.

10.2.5 Example: Flexible budgets and budgetary control

Penny manufactures a single product, the Darcy. Budgeted results and actual results for May are as follows.

	Budget	*Actual*	*Variance*
Production and sales of the Darcy (units)	7,500	8,200	
	$	$	$
Sales revenue	75,000	81,000	6,000 (F)
Direct materials	22,500	23,500	1,000 (A)
Direct labour	15,000	15,500	500 (A)
Production overhead	22,500	22,800	300 (A)
Administration overhead	10,000	11,000	1,000 (A)
	70,000	72,800	2,800 (A)
Profit	5,000	8,200	3,200 (F)

Note. (F) denotes a favourable variance and (A) an unfavourable or adverse variance.

In this example, the variances are meaningless for the purposes of control. All costs were higher than budgeted but the volume of output was also higher; it is to be expected that actual variable costs would be greater those included in the fixed budget. However, it is not possible to tell how much of the increase is due to **poor cost control** and how much is due to the **increase in activity**.

Similarly, it is not possible to tell how much of the increase in sales revenue is due to the increase in activity. Some of the difference may be due to a difference between budgeted and actual selling price but we are unable to tell from the analysis above.

For control purposes, we need to know the answers to questions such as the following:

- Were actual costs higher than they should have been to produce and sell 8,200 Darcys?
- Was actual revenue satisfactory from the sale of 8,200 Darcys?

Instead of comparing actual results with a fixed budget which is based on a different level of activity to that actually achieved, the correct approach to budgetary control is to compare actual results with a budget which has been **flexed** to the actual activity level achieved.

Suppose that we have the following estimates of the behaviour of Penny's costs:

(a) Direct materials and direct labour are variable costs.

(b) Production overhead is a semi-variable cost, the budgeted cost for an activity level of 10,000 units being $25,000.

(c) Administration overhead is a fixed cost.

(d) Selling prices are constant at all levels of sales.

Variance	Possible reason for variance
Direct labour efficiency	Poor supervision A worker with a low skill grade taking longer to do the work than was envisaged for the correct skill grade Low-grade materials, leading to high levels of scrap and wasted labour time Problems with a customer for whom a service is being rendered Problems with machinery, leading to labour time wasted Dislocation of materials supply, leading to workers being unable to proceed with production
Direct labour rate	Poor performance by the human resources department Using a higher grade of worker than was planned Change in labour market conditions between the time of setting the budget and the actual event
Fixed overhead spending	Poor supervision of overheads General increase in costs of overheads not taken into account in the budget

Exam focus point

It is important that you are able to use flexed budgets and variance analysis in order to help you identify where problems lie in an organisation.

Also notice that adverse variances may not necessarily indicate problems. For example, consider a publishing company who has an adverse variance against their print budget (actual costs higher than budgeted costs). While this could indicate a problem in the printing processes, it could equally just be due to their being a greater demand for books, causing more books to be sold and therefore higher print costs to be incurred.

10.4 Investigating variances

Finding out why variances have occurred can be expensive. Reports and other information have to be scrutinised and discussions with individuals and groups may have to be carried out. Sometimes production may even have to be stopped.

Given the cost of investigating, and the number of small variances that will inevitably occur (hitting a target precisely is unlikely), organisations need a policy relating to which variances will be investigated and which will be accepted.

Knowing the reason for a variance is useful to help management bring things back under control and enables future targets to be met. In general, the following rules are useful.

- Significant **adverse** variances should be investigated as, if it continues to occur, it could become very costly
- Significant **favourable** variances should be investigated but with lower priority than for adverse variances. It may turn out that the target set was too low
- Insignificant variances should be kept under review. Although the individual variance may be insignificant, the cumulative effect (over time, or when considered along with related insignificant variances) may not be. In such cases, and investigation may be worthwhile

The **general rule of addition** for two events, A and B, which are not mutually exclusive, is as follows.

Probability of (A or B) = P (AUB) = P(A) + P(B) – P(A and B)

For example, in a standard pack of 52 playing cards, what is the probability of selecting an ace or a spade?

Ace = 4/52
Spade = 13/52
Ace of spades = 1/52

Therefore, the probability of selecting an ace or a spade is:

4/52 + 13/52 – 1/52 = 16/52 = 4/13

Dependent or **conditional** events are events where the outcome of one event depends on the outcome of the others. The probability of two dependent events occurring is calculated by **multiplying** the individual probabilities together. **Contingency** tables can be useful for dealing with conditional probability.

For example, the probability of rolling a six, followed by another six is:

$1/6 \times 1/6 = 1/36$

Probability is used to help calculate **risk** in decision making. The higher the probability of an event occurring, the lower the associated risk will be.

Risk involves situations or events which may or may not occur, but whose probability of occurrence can be calculated statistically and the frequency predicted.

Uncertainty involves situations or events whose outcome cannot be predicted with statistical confidence.

11.2 Expected values

An **expected value** (or **EV**) is a weighted average value, based on probabilities. The expected value for a single event can offer a helpful guide for management decisions.

Although the outcome of a decision may not be certain, there is some likelihood that probabilities could be assigned to the various possible outcomes from an analysis of previous experience.

If the probability of an outcome of an event is p, then the expected number of times that this outcome will occur in n events (the expected value) is equal to n × p.

The concepts of probability and expected value are vital in **business decision making**. The expected values for single events can offer a helpful guide for management decisions.

- A project with a positive EV should be accepted
- A project with a negative EV should be rejected
- When choosing between options the alternative which has the **highest EV of profit** (or the **lowest EV of cost**) should be selected.

Where probabilities are assigned to different outcomes, we can evaluate the worth of a decision as the **expected value**, or weighted average, of these outcomes. The principle is that when there are a number of alternative decisions, each with a range of possible outcomes, the optimum decision will be the one which gives the highest expected value.

Expected values can be built into decision trees in order to aid decision making. The amount of expected profit is likely to be conditional on the result of various decisions. We will look at this in more detail below. First, let us briefly consider some limitations of using expected values as a basis for decisions.

Therefore produce:

20 units of product B using	60 hours
22 units of product A using	88 hours
	148 hours

This leaves unsatisfied the market demand for a further three units of product A and 30 units of product C.

12.2.5 Make or buy decisions **6/11**

A common decision faced by businesses is whether to produce the product or service they sell themselves or whether to buy it from another business. Marginal costing can help with this by identifying the contribution of both options. As with accepting or rejecting contract decisions. However, there will be other factors that the organisation will have to take into account when making this decision. These other factors include loss of control of quality, potential unreliability of supply, and access to expertise and specialisation.

12.2.6 Example: Shark Ltd

Shark Ltd needs a component for one of its products. It can purchase the components from Ray Ltd, a subcontractor) for $20 each, or it can produce them internally for total variable costs of $15 per component. Shark Ltd has the spare capacity available.

Should the component be produced internally or subcontracted to Ray Ltd?

Solution

Shark Ltd should produce the component internally as this is $5 per unit cheaper than contracting out to Ray Ltd.

Question

Shark and Ray

How would the answer to the above differ if Shark Ltd had no spare capacity and could only produce the component internally by reducing its output of another of its products. Shark Ltd will lose contributions of $12 from the other product.

Answer

The relevant cost of internal production in this case would be

	$
Variable cost of production of the component	15
Opportunity cost of lost production of the other product	12
	27

In this case, Shark Ltd would subcontract the component to Ray Ltd as this would be $7 per unit cheaper than it would cost to produce the components internally.

12.2.7 Closing or continuation decisions

Many organisations produce separate financial statements for each department or section in order to attempt to assess the relative effectiveness of each one. By using these to look at the variable costs, the contribution for each can be determined. This means the organisation can determine the contribution to the overall organisation that the individual departments make. Departments that make a positive contribution should not be closed even if individually it makes a loss. This is because the fixed costs would still be incurred and the organisation would be worse off without it.

12.2.8 Example: MogTown

MogTown Ltd is a retail shop with three departments, all located in the same premises. The three departments occupy similar sized areas of the premises. The results for the year that has just ended are as follows:

	Total	*Cat Food*	*Cat Toys*	*Cat Furniture*
	$'000	$'000	$'000	$'000
Sales revenue	534	254	183	97
Costs	(482)	(213)	(163)	(106)
Profit/(loss)	**52**	**41**	**20**	**(9)**

This suggests that if the cat furniture department was closed, the company as a whole would be $9,000 more profitable per year.

However, when the fixed and variable costs are analysed, the contribution of each department can be determined. This gives the following results:

	Total	*Cat Food*	*Cat Toys*	*Cat Furniture*
	$'000	$'000	$'000	$'000
	534	254	183	97
Variable costs	(344)	(167)	(117)	(60)
Contribution	190	87	66	37
Fixed costs (eg rent)	(138)	(46)	(46)	(46)
Profit/(loss)	**52**	**41**	**20**	**(9)**

This shows the cat furniture department actually makes a **positive contribution** of $37,000 and should not be closed. (Closing this department would make the company as a whole $37,000 **worse** off per year). The fixed costs would continue to be incurred, whether or not the department is closed.

13 Full costing

FAST FORWARD

Full cost is the total amount sacrificed to achieve a particular objective. All running costs of a particular facility are part of the cost of output of that facility. Where there is more than one product, costs are split into direct and indirect costs. The direct costs are easily assigned to products. To determine the full cost a fair proportion of the indirect costs, or overheads, must also be allocated to each product.

Full cost is the total amount sacrificed to achieve a particular objective. It includes all amounts sacrificed, so all costs related to the production of the product or provision of the service would be included as part of the full cost.

Full costing works on the basis that all the costs of running a particular facility, eg a factory, are part of the cost of the output of that facility. For example, the rent is unlikely to change if we produce one more unit of the product. The cost per unit will therefore decrease as output increases and therefore is an important element of the cost of each unit of output.

Full costing is widely used in practice and can be a useful tool for assisting managers in decision making. It can be helpful in a number of ways, including:

Pricing and output decisions: full cost information allows managers to make decisions based on the price charged to the customer and the number of units required.

Exercising control: budgets are typically prepared on a full-cost basis and so actual performance based on full costs can be easily compared to the plans to identify, and take measures to address, any discrepancies between actual and planned performance.

international market. It therefore now appears difficult to justify the use of direct labour or direct material as the basis for absorbing overheads or to believe that errors made in attributing overheads will not be significant.

Traditional costing systems, which assume that all products consume all resources in proportion to their production volumes, tend to allocated too great a proportion of overheads to high volume products (which cause relatively little diversity and hence use fewer support services) and too small a proportion of overheads to low volume products (which cause greater diversity and use more support services). Activity based costing (ABC) attempts to overcome this problem.

Key term

Activity based costing (ABC) involves the identification of the factors which cause the costs of an organisation's major activities. Support overheads are charged to products on the basis of their usage of the factor causing the overheads.

The major ideas behind activity based costing are as follows.

(a) **Activities cause costs**. Activities include ordering, materials handling, machining, assembly, production scheduling and despatching.

(b) **Producing products creates demand for the activities.**

(c) Costs are assigned to a product **on the basis of the product's consumption of the activities.**

The principal idea of ABC is to focus attention on **what causes costs to increase,** ie the **cost drivers**.

The **costs that vary with production volume**, such as power costs, should be traced to products using production **volume-related cost drivers**, such as direct labour hours or direct machine hours.

Overheads which do not vary with output but **with some other activity** should be traced to products using **transaction-based cost drivers**, such as number of production runs and number of orders received.

13.3.1 Cost Pools

ABC establishes separate cost pools for support activities such as despatching. As the costs of these activities are assigned directly to products through cost driver rates, reapportionment of service department costs is avoided.

Cost pools are similar to cost centres, except each cost pool is likely to relate to a particular **activity**, rather than being more general, as is the case with cost centres in traditional product costing.

13.3.2 ABC and service industries

ABC is perhaps even more relevant to the service industry than it is to manufacturing. This is because the lack of direct materials may mean an even greater proportion of costs are made up of overheads. Evidence suggests that ABC has been more widely adopted by service organisations rather than manufacturers.

13.3.3 ABC and decision making

Many of ABC's supporters claim that it can assist with decision making in a number of ways.

- Provides accurate and reliable cost information
- Establishes a long-run product cost
- Provides data which can be used to evaluate different ways of delivering business. It is therefore particularly suited to the following types of decision:
  - Pricing
  - Promoting or discontinuing products or parts of the business
  - Redesigning products and developing new products or new ways to do business

Note, however, that an ABC cost is **not a true cost** - it is **simply an average cost** because some costs, such as depreciation are still arbitrarily allocated to products. An ABC cost is therefore **not a relevant cost** for all decisions.

Answers to Quick Quiz

1 Managing for value; funding; financial expectations of stakeholders

2 Financial risk

3 By borrowing; by selling marketable investments; and by managing cash flows to payables and from receivables

4 Retained profits are flexible in that there is no specific schedule of repayments. Also, there is no change in the pattern of shareholdings

5 Debentures and other long-term loans to a business

6 Shareholders' funds plus current liabilities plus any long-term provisions for liabilities and charges

7 The proportion of total costs that is made up of fixed costs

8 Yes: the use of historic cost net of depreciation would be misleading.

Now try the question below from the Practice Question Bank

Number	Level	Marks	Time
Q15	Examination	25	45 mins

Study guide

		Intellectual level
	(Note that section H of the syllabus is underpinned directly by knowledge gained in F1, *Accountant in Business*. Students are expected to be familiar with the following Study Guide subject areas from that syllabus: A1, A2, B1-B3, D1, and D4-D6)	
H1	**Strategy and people: leadership**	
(a)	Explain the role of visionary leadership and identify the key leadership traits effective in the successful formulation and implementation of strategy and change management.	3
(b)	Apply and compare alternative classical and modern theories of leadership in the effective implementation of strategic objectives.	3
H2	**Strategy and people: job design**	
(a)	Assess the contribution of four different approaches to job design (scientific management, job enrichment, Japanese management and re-engineering)	3
(b)	Explain the human resource implications of knowledge work and post-industrial job design	2
(c)	Discuss the tensions and potential ethical issues related to job design	2
(d)	Advise on the relationship of job design to process re-design, project management and the harnessing of e-business opportunities	3
H3	**Strategy and people: staff development**	
(a)	Discuss the emergence and scope of human resource development, succession planning and their relationship to the strategy of the organisation	2
(b)	Advise and suggest different methods of establishing human resource development	3
(c)	Advise on the contribution of competency frameworks to human resource development	3
(d)	Discuss the meaning and contribution of workplace learning, the learning organisation, organisation learning and knowledge management	3

Exam guide

There is considerable practical detail in this chapter and it is easy to envisage a complete question covering these principles and how to embody them in a work situation.

You may also face a scenario where process redesign or information technology has an impact on job design. Be aware of the implications of different organisational structures for job design.

Models and theories

The Study Guide for this chapter indicates you need to be able to apply and compare alternative classical and modern theories of leadership in the effective implementation of strategic objectives. However, the guide does not explicitly reference any individual theories, so you will not be specifically required to use any single leadership theory to answer a question.

The Study Guide also refers explicitly to four approaches to job design – scientific management, job enrichment, Japanese management and re-engineering – so an assessment of any of these approaches could be specifically required in a question. However, remember that job design and staff development are also very practical (and examinable) topics, so make sure you cover the material in this chapter as a whole, rather than just focussing on the specific theories described in Section 1.

There are a number of expectations of modern leaders:

- To **change** organisations and systems from within.
- To drive forward adventurous, **visionary strategies**. Leaders need to have a clear vision for the future, and what needs to be done to get there, so that they can inspire others to aim for that future as well.
- To motivate others. Visionary leaders motivate others to work harder by making work seem as natural as play, and by making their teams see the value and purpose in what they do.
- To provide **clarity of purpose** and direction.
- To be good communicators, both to communicate their vision and purpose, but also to listen to others' points of view and to gain their trust.

There are therefore three main themes within the transformational theories of leadership:

- Teams
- Vision
- Change

Case Study

Bill Gates and Microsoft

Bill Gates founded the Microsoft Corporation in 1975, with his childhood friend Paul Allen. Gates correctly identified that as computer hardware became increasingly powerful, there would be a gap in the market for computer software.

Microsoft is now the global leader in software, services and solutions that enables people and businesses to maximise the value of computers in their lives.

However, one of the major factors behind the growth and success of the company has been Gates' readiness to restructure to keep it innovative and ready for each new phase in the fast changing world of computer technology.

In April 2002, Microsoft announced its fourth major reorganisation in five years, before, in 2005, Gates announced a further realignment of the company into three distinct newly formed divisions, each headed up by its own president.

One of these divisions will be responsible for 'entertainment and devices'. The other two are the Platforms Products and Services Division; and the Business Division.

The Microsoft Platforms and Services Division includes the three operating segments of Client; Server and Tools; and the Online Services Group.

From the fiscal year 2007, Microsoft changed to operate its business in five operating segments: (i) Online Client, (Subsequently re-named Windows and Windows Live Division) (ii) Server and Tools, (iii) Online Services Group, (iv) Business Division and (v) Entertainment and Devices Division.

The creation of the entertainment and devices division illustrates how Microsoft has diversified away from its original core competencies in developing computer language programmes and software into new areas such as console games via the Xbox system.

The divisional structure is designed to support Microsoft's drive for innovation and growth for the future, increasing the number of new products and services it delivers.

Over the years since it was founded, Gates' foresight, vision and leadership have been drivers for change, development and success in the Microsoft Corporation. On the one hand, Gates has continually strived to advance software technology with a view to making computing more accessible and fun for people; on the other, he has strived to make Microsoft an attractive and exciting place to work.

(b) Describe the barriers to entry that FTL might face if it decided to enter the service centre business. **(6 marks)**

(c) Assess whether FTL's existing strategic capability gives it a good chance of success in the service centre business. **(8 marks)**

(Total = 20 marks)

6 Nadir Products: ethics — 36 mins

John Staples is the Finance Director of Nadir Products plc, a company which manufactures and sells bathroom products such as baths, sinks and toilets. These products are sold through a selection of specialist shops and through larger stores. Customers include professional plumbers and also ordinary householders who are renovating their houses themselves. The company operates at the lower end of the market and does not have a strong reputation for service. Sales have been slowly declining whereas those of competitors have been improving. In order to encourage increased sales the Board of Directors have decided to pay senior staff a bonus if certain targets are achieved. The two main targets are based on profit levels and annual sales. Two months before the end of the financial year the Finance Director asks one of his staff to check through the orders and accounts to assess the current situation. He is informed that without a sudden improvement in sales before the year end the important sales targets will not be met and so bonuses will be adversely affected.

The Finance Director has proposed to other senior staff that this shortfall in sales can be corrected by taking one of the following decisions.

1. A significant discount can be offered to any retail outlet which takes delivery of additional products prior to the end of the financial year.
2. Scheduled orders due to be delivered at the beginning of the next financial year can be brought forward and billed before the end of this year.
3. Distributors can be told that there is a risk of price increases in the future and that it will be advisable to order early so as to circumvent this possibility.

The Board is not sure of the implications associated with such decisions.

Required

(a) As a consultant, prepare a report for the Board of Nadir Products assessing the commercial and ethical implications associated with each of the proposed options mentioned above. **(8 marks)**

(b) Assess the significance of the corporate social responsibility model for Nadir Products. **(12 marks)**

(Total = 20 marks)

7 Arragon Antennas — 36 mins

Arragon Antennas Ltd is a company based in the country of Dragovia. It designs and manufactures antennas for airborne navigation and communication systems. The industry is characterised by dedication to high technical standards because of the demands of aircraft safety. There are three main parts to the business: design and integration of antennas for new aircraft; aftermarket spares for existing systems; and sub-contract manufacture of other firms' designs.

Design of new installations is highly technical and very time consuming since it depends on extensive tests, including test flying. Globally, there are only three other manufacturers capable of this work.

The aftermarket operation includes spares for Arragon's own products and for antennas the company has designed to replace the other three manufacturers' own proprietary designs. Sales of the latter are somewhat price sensitive, but the aircraft spares market generally is characterised by the high prices charged to captive customers for approved spares.

Demand for subcontracting work tends to be intermittent but forms a profitable supplement to the manufacture of the company's own designs. Nobody in the industry thinks it odd that Arragon should both manufacture for and compete with other firms.

are then stored ready for sale. All customer sales are from stock. Products that fail the inspection are returned to ISAS.

Currently 60% of sales are made to domestic customers and 40% to business customers. Most domestic customers pick up their products from DRB and set them up themselves. In contrast, most business customers ask DRB to set up the electronic equipment at their offices, for which DRB makes a small charge. DRB currently advertises its products in local and regional newspapers. DRB also has a website which provides product details. Potential customers can enquire about the specification and availability of products through an e-mail facility in the website. DRB then e-mails an appropriate response directly to the person making the enquiry. Payment for products cannot currently be made through the website.

Feedback from existing customers suggests that they particularly value the installation and support offered by the company. The company employs specialist technicians who (for a fee) will install equipment in both homes and offices. They will also come out and troubleshoot problems with equipment that is still under warranty. DRB also offer a helpline and a back to base facility for customers whose products are out of warranty. Feedback from current customers suggests that this support is highly valued. One commented that 'it contrasts favourably with your large customers who offer support through impersonal off-shore call centres and a time-consuming returns policy'. Customers can also pay for technicians to come on-site to sort out problems with out-of-warranty equipment.

DRB now plans to increase their product range and market share. It plans to grow from its current turnover of $5m per annum to $12m per annum in two years time. Dilip Masood, the owner of DRB, believes that DRB must change its business model if it is to achieve this growth. He believes that these changes will also have to tackle problems associated with:

- Missing, or potentially missing shipments. Shipments can only be tracked through contacting the shipment account holder, ISAS, and on occasions they have been reluctant or unable to help. The trans-shipment to EIF has also caused problems and this has usually been identified as the point where goods have been lost. ISAS does not appear to be able to reliably track the relationship between the container shipment and the Waybills used in the EIF system.
- The likely delivery dates of orders, the progress of orders and the progress of shipments is poorly specified and monitored. Hence deliveries are relatively unpredictable and this can cause congestion problems in the delivery bay.

Dilip also recognises that growth will mean that the company has to sell more products outside its region and the technical installation and support so valued by local customers will be difficult to maintain. He is also adamant that DRB will continue to import only fully configured products. It is not interested in importing components and assembling them. DRB also does not wish to build or invest in assembly plants overseas or to commit to a long-term contract with one supplier.

Required

(a) Draw the primary activities of DRB on a value chain. Comment on the significance of each of these activities and the value that they offer to customers. **(9 marks)**

(b) Explain how DRB might re-structure its upstream supply chain to achieve the growth required by DRB and to tackle the problems that Dilip Masood has identified. **(10 marks)**

(c) Explain how DRB might re-structure its downstream supply chain to achieve the growth required. **(6 marks)**

(Total = 25 marks)

1 Bartok Fuel

Top tips. This is quite a simple question that offers a gentle introduction to the style of the examination. Part (b) is typical of the sort of question that usually forms one of the requirements of the Section A case study, being essentially a critical discussion of possible specific strategies. It is usually pretty clear what the overall worth of the proposals is, but not always. Discuss this sort of thing as rationally as you can, using simple models and pointing out any implications you can discern.

Part (a)

There would appear to be no real evidence of any formal strategic planning in the past. There is no mention of any mission statement or objectives for the company. The company seems to have moved from a garage and workshop into fuel distribution and glass manufacture almost by accident. These developments might have **emerged from patterns of behaviour** rather than any planning process and it could be argued that the company illustrates the emergent strategy model. However, there is also an element of **logical incrementalism** as the business has not strayed far from its origins but has taken small steps into new areas where it already has some knowledge and expertise.

It could also be argued that only a small number of strategic options were ever considered and the options that have been taken in the past have perhaps simply been accepted as satisfactory rather than embraced as ideal. This approach has been termed **bounded rationality** by *Herbert Simon*.

Part (b)

Each of the two strategies being considered requires very different considerations from the board.

If the Erewhon site is sold for its development potential, this will clearly be a boost to the company's cash flow. However, as we have no information about the company's current financial position, we cannot comment as to whether this is an element of the decision to sell. Nevertheless, the board must consider what use can be made of the funds received. It may be that the two options are related in David's mind and the funds from the sale of the Erewhon site are to be earmarked for investment in Arcadia. In any case, the sale should only be considered further if it seems likely that the income can be invested in a way that will **generate a higher return** than the garage business currently achieves.

If the Erewhon site is to be shut down there are also considerable **human resource issues** to be addressed. The division employs 50 people who must either be made redundant or be re-employed in other areas of the business. In either case, the cost of redundancy payments or of retraining must be taken into account. The car dealership appears to be a fairly stand-alone element of the business but it must also be considered whether its closure will have any **knock-on effects** on the other parts of the company.

The proposed expansion into Arcadia is fraught with potential problems. Bartok Fuel has always been an Oceania based business and therefore expansion abroad is a major issue. The results of a **PEST analysis** would be daunting. The company has no experience of doing business in Ardacia and it knows nothing of local business conditions or regulations. Language and culture are likely to present major difficulties.

All this is partially countered by the existence of a partner who knows the market and the culture of Arcadia, but Bartok Fuel will still be making something of a leap in the dark. In fact, they would be **wholly dependent** on the probity, efficiency and goodwill of their partner. It would appear that the company's only real contribution will be to provide risk capital and the brothers must ask themselves if they really see that as their area of expertise – they are not running a bank, after all.

2 National advantage

Porter notes that some nations' industries succeed more than other in terms of international competition. He does not suggest (as the D4D Prime Minister rightly notes) that countries as such are competitive, but that various factors support or inhibit the ability of the industries and firms **within** them to compete successfully on the international stage. Porter's 'diamond' model suggests that the degree of competitive advantage enjoyed by different nations results from the interaction of four basic factors.

Factor conditions

Factor conditions are a country's endowment of inputs to production. This includes **human resources, physical resources, knowledge, capital and infrastructure** (transport, communications etc). D4D appears to benefit from positive basic factor conditions (oil reserves and related revenues, a temperate climate, a young tertiary educated population and political stability) – but there are limitations (eg lack of local education institutions) and risks (eg dwindling oil reserves). D4D does not currently have advanced factors which are necessary to achieve high-order competitive advantages such as their own production technologies.

Demand conditions

The home market determines how firms perceive, interpret and respond to buyer needs. Strong and sophisticated demand encourages **growth, high quality, innovation and economies of scale**: all these build competences for competing more effectively abroad. Given the recent revenue D4D has earned from oil, it is possible that it has not been focusing on demand conditions very closely. If that is the case, then the short-term benefits from oil could potentially be weakening its competitive advantage in the longer term.

Firm strategy, structure and rivalry

Capital markets, ownership structures, attitude to time horizons, degree of **innovation and entrepreneurship** vary from country to country. National cultures have been shown to orient business towards certain industries: in D4D's case, agriculture and light manufacturing.

Meanwhile, **domestic rivalry makes exporting attractive** and keeps firms on their toes, while the opposite is also true: as in D4D's case, lack of domestic rivalry stunts competitive development and encourages firms to rely on the home market. The government could be more pro-active in fostering innovation and entrepreneurship among firms to encourage them to become more successful, but it appears to be happy to support the uneconomic local industry.

Related and supporting industries

Competitive success in one industry is linked to success in related industries, by creating a pool of managerial and technical talent, the exchange of information for organisational/industry learning and benchmarking, and a robust supply market for parts and components.

Clustering

A cluster is a linking of industries through network relationships which are either vertical (within the supply chain) or horizontal (common customers, technology or skills). Porter believes clustering to be a key to national competitive advantage: firms will be more likely to succeed internationally if there is a supporting cluster that supports lower costs, infrastructure development, transfer of expertise and so on.

3 EMS

The decline in the number of people taking the qualification appears to be a reflection of the maturity of the marketplace. The large pool of unqualified environmental managers and auditors that existed when the qualification was launched has now been exploited. There are now fewer candidates taking the examinations and fewer members joining the EMS. The organisation's response to this has been to look for international markets where it can promote the qualifications it currently offers. It hopes to find large pools of unqualified environmental managers and auditors in these markets.

The scenario suggests that EMS currently has relatively limited strategic ambitions. There is no evidence that EMS plans to develop new qualifications outside its current portfolio. Indeed, attempts to look at complementary qualifications (such as soil and water conservation) have been rejected by Council. Hence, expansion into new strategic business markets does not appear to be an option.

Strategy Development

Internal development

Internal development takes place when strategies are developed by building on or developing the organisation's own capabilities. It is often termed organic growth. This is how EMS has operated up to now. The original certificates were developed by the founders of the Society. Since then, additional certificates have been added and the Diploma programme developed at the instigation of members and officers of the Society.

In many ways this type of organic growth is particularly suited to the configuration of the organisation, one where there is a risk-averse and cautious culture. The organic approach spreads cost and risk over time and growth is much easier to control and manage. However, growth can be slow and indeed, as in the case of EMS, may have ceased altogether. Growth is also restricted by the breadth of the organisation's capabilities. For example, EMS has not been able to develop (or indeed even consider developing) any products outside of its fairly restricted product range. Furthermore, although internal development may be a reasonable strategy for developing a home market it maybe an inappropriate strategy for breaking into new market places and territories. This is particularly true when, as it appears in the case of the EMS, internal resources have no previous experience of developing products in overseas markets.

In summary, internal growth has been the method of strategy development at EMS up to now, based on a strategic direction of consolidation and market penetration. There is no evidence that EMS is considering developing new products to arrest the fall in qualification numbers. However, the Board has suggested developing new markets for the current qualification range and India, China and Russia have been identified as potential targets. It seems unlikely that internal development will be an appropriate method of pursuing this strategic direction.

4 Natalia Norman

Part (a)

> **Top tips.** The great advantage of careful market segmentation is that it permits a precise determination of the marketing mix variables. This saves money and allows the firm to make best use of its competences.
>
> However, make sure you apply your knowledge of market segmentation to the specific problems represented by the scenario rather than simply suggesting generic bases which can be used for market segmentation.
>
> **Easy marks.** Part (a) is about segmentation methods and is worth fifteen marks overall, which can be expected to break down into seven for suggesting the bases and eight for saying why segmentation is a good idea. Thus we might expect three marks for proposing three bases and saying a little about the relevance of each, with another three (or possibly four) for deeper discussion. Our discussion of each of the bases we have chosen illustrates this approach, progressing from the name of the base through its relevance to its wider implications or applications.

Segmentation would be Natalia's first step towards a more active relationship with her existing and potential customers. If she knew who they were in more detail she could design her market offering in a way that would improve her own **efficiency** while also providing increased **customer satisfaction**.

The simplest form of segmentation is probably **geographical**. Natalia's potential market could be very simply split into domestic and overseas, for instance. Indeed, she probably does this already, in a sense, since she must make appropriate arrangements for the extra complications of shipping to foreign customers. Geographical segmentation would be necessary if Natalia wished to sell in other ways than via the internet, perhaps by issuing catalogues, since the styles of knitwear offered would have to appeal to varying local tastes.

Geographical segmentation becomes much more useful when it is combined with demographic information. This **geo-demographic** segmentation would enable Natalia to target segments defined by such variables as place, age, sex, income and social class. A consideration of these variables might for instance lead her to concentrate her marketing effort on older, affluent people in specific metropolitan areas. This would have immediate implications for design, quality, promotion, price and distribution.

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Natalia could attempt to do this by exploiting the originality of her designs, thus effectively differentiating her market offering and justifying higher prices. The development of her **brand image** will be a necessary precondition for success with this strategy.

Natalia is unlikely to have sufficient resources to become an overall market leader, but her products seem to be relatively innovative and unique. This is likely to mean she is not merely an imitator, recycling ideas from the leader. Therefore, with appropriate marketing mix strategies supporting the business, Natalia's company could become a **strong niche market player**.

The option of developing a market niche is particularly important where the niche is of a viable size and has growth potential, yet is not seen as threatening to major competitors so as to attract their interest and attention. In this case, if Natalia can **develop the core competences** of design, branding, quality and image they should enable her to develop and expand her business from being merely a low cost supplier of non-branded goods to having a more differentiated product with a brand value of their own.

An important problem for the market follower is that it may constitute an **attractive target** for market challengers seeking growth by acquisition, or indeed for the market leader seeking to extend control over the market.

An agreed takeover may, in due course, be a suitable way for Natalia to realise the equity in her business; however, assuming that she wishes to maintain her independence of operations for the foreseeable future she must control her costs and exploit appropriate opportunities to achieve differentiation. Otherwise, cash flow difficulties may force her to sell out.

5 Firebridge Tyres Ltd

Top tips. This is a fairly straightforward question on the environment and strategic capability. Part (a) may look very wide ranging and therefore rather daunting. This is a good example of the way in which the use of a model (such as PEST) can help you to organise your thoughts. You will see from our answer that a detailed knowledge of the motor industry is not required to answer this question.

Part (a)

Main factors in the external environment

The environment of an organisation is everything outside the boundaries of the organisation. Organisations are by definition open to the environment: it is the source of their inputs; it is the destination of their outputs; and it sets constraints over what the organisation can do. Some argue that the environment is increasingly a source of uncertainty for organisations, and that it is becoming harder to read. The degree of uncertainty it causes results from its complexity and the rate of change.

Hofer and Schendel argue that the very purpose of strategy is to secure some sort of environmental fit. This might be an extreme position, as it implies reaction to the environment rather than activity to shape environmental forces. However, any formal strategic planning process takes the environment into account.

As far as the general environment is concerned, we can analyse PEST and competitive factors.

Political and legal factors

Firebridge Tyres Ltd (FTL) operates in a stable political environment. Agreements between governments have opened up international markets, not only to FTL but to its competitors: however GTC does not want FTL to increase its exports outside Europe. There is no shortage of car service stations, a fragmented industry, so political interference is unlikely. Local government might determine the siting of certain activities. FTL is indirectly affected by government transport policy, if this affects the demand for and use of cars.

Economic factors

In the UK, tyres must be checked annually, as part of the MOT testing process. The overall level of economic activity determines transport use, which influences wear and tear of tyres. However, in times of hardship, people will be less likely to buy the premium brand range preferring to go for the lower cost Freeway range, cheaper overseas tyres, or even retreads. The general level of prosperity also influences

Distribution

The chain is basically a distribution outlet for FTL's tyres. The importance of choosing the right sites for distributing the service was identified above. Existing service providers know the market, but otherwise they have no special advantages.

Conclusion

Barriers to entry are fairly low. This will make it easy to set up business, but hard to make a profit perhaps, unless some unique lessons can be transferred from GTC, operating in a very different transport infrastructure.

Part (c)

Strategic capability and critical success factors

Strategic capabilities have four essential qualities**.**

- They produce effects that are valuable to buyers.
- They are **rare**.
- They are **robust** in that they are difficult for competitors to imitate.
- They are **non-substitutable**.

Critical success factors, on the other hand, are product features that are particularly valued by a group of customers. Organisations must get these things right if they are to succeed. Some of these factors relate to physical products, but many depend on internal processes and the basic infrastructure of the business.

FTL is a manufacturing business, producing what is essentially a commodity product, tyres, and making a stab at product differentiation. This competence is not truly distinctive, as there are other tyre manufacturers in the world, but FTL has built up a market presence in Europe. The strategic capabilities that led to this position probably look something like those shown below.

(a) Building a **brand** that consumers recognise, and preventing its erosion by competition
(b) Good commercial relations with the distributors, who are the **strategic customers**
(c) Making **incremental technical innovations** in order to encourage new sales

How do these relate to the proposed service centre business? A key problem is that services are a very different proposition to products. There are several possible resources and competences for the proposed servicing business.

(a) A brand that customers recognise and choose, having realistic and satisfied expectations of what it offers
(b) Well-chosen sites that are easily accessible, offer plenty of parking and are comfortable to wait in.
(c) Well-trained staff who not only know how to change wheels and tyres, and do other repairs but who are able to demonstrate high standards of customer care
(d) To be seen as preferable to the local garage in terms of the processes by which the service is provided

FTL's existing competences, at best, cover brand building. It has no experience in choosing and managing properties or customer service staff: US conditions are different, so a transfer of skills between the US and the UK firm may be hard to achieve. FTL runs a manufacturing business; a service business, based on a variety of intangibles such as staff courtesy, is a different proposition. The required cultures of the two businesses might conflict.

The firm might have to spend a lot of money on training, both technically and in terms of customer care. Also money would have to be spent on building the brand. However, GTC should be able to provide some expertise in building the service aspects.

In short, FTL's current strategic capability is not suited to this plan, given the fragmented nature of the industry. GTC may be able to provide some help, but GTC might end up investing more money and making short term losses, rather than the profits it is looking for.

FTL is in a difficult situation, because its managers are tied by the priorities of the US parent.

certainly be required. The aim of BPR is to provide radical improvements in efficiency and cost savings of up to 90%. Amending the supply chain as noted above will help to these benefits.

11 Fashion retailer

Top tips. Fashion retailing is a fairly specialised job. However, we all have some experience of it from the customer's side of the counter. Don't be afraid to make some educated deductions about, for instance, the need for careful inventory control when a wide range of goods is moving rather quickly.

An organisation's value-creating activities must be mutually supporting.

Part (a)

Paul's business is in the fashion clothing industry with 20 retail stores but little integration between the stores. This part of the fashion industry operates with very slim margins and with profitability not keeping pace with the increase in turnover, Paul realises that he must operate in a more cost-conscious manner. The computer system is currently underused and is operating in a passive manner, simply providing basic information rather than contributing to the business' competitive advantage in any way.

We can use **Porter's value chain model** to consider how the IS function can be applied to help provide Paul with a competitive edge in his business.

Paul's firm will only be as strong as the weakest link in its value chain. The IS investment will be worthwhile if it can be used to reduce costs or to differentiate Paul's business from the others in the industry sector.

Primary activities

Inbound logistics

This relates to the purchasing function and the storage of inventory and distribution to the stores. An IS system can help with inventory control levels, economic ordering and efficient distribution routings.

Operations

IS can be used to monitor the performance of each store with details being provided about profitability, inventory levels, inventory turnover, expense levels, staff absences and so on. IS could also be used to analyse the different consumer demand profile in different locations in order to help each store ensure that it has sufficient inventories of the type of sales made in its store.

Outbound logistics

This element of the chain concerns distribution to customers and is more relevant in a manufacturing industry. In Paul's business there will not be much distribution to customers but the system may be able to produce a customer database to assist with marketing and promotions.

Marketing and sales

Paul could use IS to indicate customer purchasing patterns for different stores and to develop databases for promotions. Internet retailing is a possibility, though it would create a fulfilment problem.

Service

This area of the chain is to do with the provision of service to the customers and it is not likely that IS can be of much use here although it could be used to monitor, control and facilitate transfers between stores.

Support activities

Firm's infrastructure

In this area IS can be used to help with the budgeting, finance and management information in order to improve the Paul's company's performance compared to that of his competitors.

same range of goods. This should be easy to find out using market research and a search of competitor sites.

Such customer involvement however could provide a mechanism for **increasing customer loyalty**, for example by targeting particular groups and finding out more about their sports activity and spending habits. This can be done via online questionnaires or surveys, and could lead to the identification of new niche markets, currently not served by any competitors, that can be developed (such as new types of sports equipment to be included in the product range; new services).

As indicated in the answer to part (a), Good Sports needs to go back to basics and consider all the costs and benefits that could be associated with offering such enhanced online capability to its chosen niche market.

13 DRB

(a) A simple value chain of the primary activities of DRB is shown below.

Handling and storing inbound fully configured equipment Quality inspection	Re-branding of products Re-packaging of products	Customer collection Technician delivery and installation	Local advertising Web based enquiries support	On-site technical support Back to base
Inbound logistics	**Operations**	**Outbound Logistics**	**Marketing and sales**	**Service**

Comments about value might include:

Inbound logistics: Excellent quality assurance is required in inbound logistics. This is essential for pre-configured equipment where customers have high expectations of reliability. As well as contributing to customer satisfaction, high quality also reduces service costs.

Operations: This is a relatively small component in the DRB value chain and actually adds little value to the customer. It is also being undertaken in a relatively high cost country. DRB might wish to re-visit the current arrangement.

Outbound logistics: Customer feedback shows that this is greatly valued. Products can be picked up from stock and delivery and installation is provided if required. Most of the company's larger competitors cannot offer this service. However, it is unlikely that this value can be retained when DRB begins to increasingly supply outside the geographical region it is in.

Marketing and sales: This is very low-key at DRB and will have to be developed if the company is to deliver the proposed growth. The limited functionality of the website offers little value to customers.

Service: Customer feedback shows that this is greatly valued. Most of the company's competitors cannot offer this level of service. They offer support from off-shore call centres and a returns policy that is both time consuming to undertake and slow in rectification. However, it is unlikely that this value can be retained when DRB begins to increasingly supply outside the geographical region it is in.

(b) DRB has already gained efficiencies by procuring products through the supplier's web-site. However, the website has restricted functionality. When DRB places the order it is not informed of the expected delivery date until it receives the confirmation email from ISAS. It is also unable to track the status of their order and so it is only when it receives a despatch email from ISAS that it knows that it is on its way. Because DRB is not the owner of the shipment, it is unable to track the delivery and so the physical arrival of the goods cannot be easily predicted. On occasions where shipments have appeared to have been lost, DRB has had to ask ISAS to track the shipment and report on its status. This has not been very satisfactory and the problem has been exacerbated by having two shippers involved. ISAS has not been able to reliably track the transhipment of goods from their shipper to EIF, the logistics company used to distribute their products in the country. Some shipments have been lost and it is time-consuming to track and follow-up shipments which

Profitability measures can also influence the **range** and **frequency** of courses run, with the **most profitable** courses being run more often. However past profits may not be the **best indication** of future prospects, and focusing on the performance of individual courses may **not highlight** the **links** between them.

Return on investment

Return on investment is calculated by **dividing profits** by the **value of assets used**.

Use of return on investment

Again the profit figures used may be subject to distortion, but return on investment does at least take into account the **resources needed** to generate profits. However the figures might be distorted by the methods used to **allocate assets**. Provided though the methods used are consistent, return on investment can be used as an indication of changing efficiency levels over time. Its use may however **restrict investment**, as managers seek to keep down levels of capital employed; this may not be in the Institution's best interests as it is trying to expand its courses programme.

Competitive position

There are various measures of competitive position that may be valuable to the Institution. These include the **number and variety of courses** offered by competitors, also the extent to which competitors are introducing **new courses,** the **standard of courses** offered and the **pricing structure** of courses.

Use of competitive position

The Institution can **benchmark** competitors by sending its **staff** on **competitors' courses**, and getting them to report on the standards of teaching, material and facilities. The feedback provided should indicate to the Institution in what areas its **own courses** need to be **improved** to match those offered by competitors. Benchmarking may also highlight **strengths** of the Institution's courses compared with its competitors, and these **strengths** can be **emphasised** in **marketing literature.**

Customer satisfaction

Customer satisfaction is likely to be a key measure for the Institution. If customers are satisfied with the courses provided, they are likely to **book further courses** and also **recommend the courses** to others.

Use of customer satisfaction

The Institution can obtain feedback from customers **by review forms** at the end of every class. These should allow participants to **rank different aspects** of the courses (quality of teaching, quality of material, facilities provided). **Targets** could be set for the marks that should be achieved. These targets could be increased over time, and also improvements made to courses that failed to reach the targets. Alternative methods of assessing how customers' needs have been met include **internal peer reviews**, **quality audits**, and obtaining **feedback** from **private sector participants' employers**.

Another way of measuring satisfaction is to track the **level of bookings** from **previous participants** on Institution courses. In a competitive market, customers will only book again if they are happy with what they have received in the past.

Market share

Market share measures the **percentage share** that an organisation has in the **total market** for a good or service. It measures the **success** of the **sales performance**, **pricing strategy** and **product quality**.

Use of market share

The Institution will need to research who offers similar courses and **ascertain numbers** who go. The courses offered by others need to be tracked over time. In order to achieve its growth targets, it may be better for the Institution to concentrate on expanding courses in areas in which it currently has **low market share**, since there may be potential to attract customers away from competitors. **Market share targets** may be set as **subsidiary targets** to **growth targets**.

16 Coxford Doors

> **Top tips**. This rather unrealistic scenario turns the situation in the typical UK family run business on its head: one would normally find such a business falling behind because its autocratic management style and **power culture** were unsuited to a rapidly changing environment. Nevertheless, this question is a gift to the reasonably well prepared candidate. It is *almost* an invitation to write down all you know about participation and change management. Almost – but not quite: you must *always* relate your answer to the scenario!

This company seems to have operated more like a soviet than a business. No doubt there has been much job-satisfaction, but the company's ability to compete and add value has deteriorated.

A participatory style of management has been shown in many studies to enhance personal **motivation** and **commitment** to the organisation's mission. This occurs via the process of **internalisation**, whereby the members of the workforce adopt the corporate goal as their personal goal. This can lead to better industrial relations, higher quality and better service. However, there is no conclusive evidence that such an approach necessarily leads to improved overall performance. This is borne out by the situation at Coxford Doors.

Andrew Smith's style of management is likely to bring the focus that has been missing in the past. He will no doubt speed up the decision making process (probably by making most decisions himself) plan effectively and issue clear instructions. Confusion and delay should be reduced and control enhanced. This will improve the business's responsiveness and ability to satisfy customers.

However, Andrew Smith is likely to encounter resistance from a work force used to proceeding according to its own ideas of what is appropriate. Morale and loyalty are both likely to suffer from the loss of autonomy. There is likely to be a lack of co-operation and, possibly, active resistance to the new order. The commercial position might deteriorate further as a result.

Even if there is acceptance that the trading position demands change it is unlikely to be wholehearted. A strong undercurrent of resentment may be created, resurfacing at some time in the future, perhaps when the commercial situation has improved.

Routine changes are harder to sell than **transformational** ones if they are perceived to be unimportant and not survival-based.

Culture change is perhaps hardest of all, especially if it involves basic assumptions. This is certainly the case at Coxford Doors. However, the necessary preconditions for change are in place. Andrew Smith is himself an **outsider**, prepared to challenge and expose, in a visible way, the existing behaviour pattern; his appointment will act as a **trigger**; and **alterations to the power structure** will be an inherent part of his actions.

The unfreeze stage is likely to include extensive **communication** and **consultation processes**, but the objective must be kept in sight; concern for proper treatment of employees must not be allowed to subvert the overall aim.

Change is the second stage of the process and is mainly concerned with introducing the new, desirable behaviours and approaches. This will involve retraining and practice to build up familiarity and experience. Individuals must be encouraged to take ownership of the new ways of doing things. For this to happen they must be shown to work.

Refreeze is the final stage, involving consolidation and reinforcement of the new behaviour. Positive or negative reinforcement may be used, with praise, reward and sanctions applied as necessary.

It will be important for Andrew Smith to retain **control of the process** at all times, since the company's history of participative management will tend to undermine his move towards a firmer style. He must make it clear from the outset that change must take place, while remaining flexible on the detail and the style of its introduction. It would be advisable to aim for an intermediate style of management, in which the workforce retain a voice. Operational control must be improved, but it should not be necessary to move to a completely autocratic way of doing things.

Review Form – Paper P3 Business Analysis (4/15)

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