Part III:
Strategy in Action

The focus of part 3: strategy in action

- Criteria and techniques that can be used to *evaluate* possible strategic options.
- How strategies *develop* in organisations; the processes that may give rise to intended strategies or to emergent strategies.
- The way in which *organisational structures* and systems of control are important in organising for strategic success.
- The leadership and management of *strategic change*.
- Who strategists are and what they do in practice.

Strategy in Action
11: Evaluating Strategies

Learning outcomes

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

The SAFe criteria

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

Table 11.1 The SAFe criteria and techniques of evaluation

Suitability

Suitability is concerned with assessing which proposed strategies address the key opportunities & constraints an organisation faces, through an understanding of the strategic position of an organisation.

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

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

Suitability of strategic options in relation to strategic position (1)

Concept	Figure/Table/ Illustration	Helps with understanding	Suitable strategies address (examples)
PESTEL	Ill. 2.1	Key environmental drivers Changes in industry structure	Industry cycles Industry convergence Major environmental changes
Scenarios	Ill. 2.2	Extent of uncertainty/risk Extent to which strategic options are mutually exclusive	Need for contingency plans or 'low-cost probes'
Five forces	Fig. 2.2 Ill. 2.3	Industry attractiveness Competitive forces	Reducing competitive intensity Development of barriers to new entrants
Strategic groups	Fig. 2.8	Attractiveness of groups Mobility barriers Strategic spaces	Need to reposition to a more attractive group or to an available strategic space

Table 11.2 Suitability of strategic options in relation to strategic position

Suitability of strategic options in relation to strategic position (2)

Concept	Figure/Table/ Illustration	Helps with understanding	Suitable strategies address (examples)
Strategic capabilities	Figs 3.2, 3.5 Ill. 3.5	Industry threshold standards Bases of competitive advantage	Eliminating weaknesses Exploiting strengths
Value chain	Figs 3.5, 3.6	Opportunities for vertical integration or outsourcing	Extent of vertical integration or possible outsourcing
Cultural web	Fig. 5.5 Ill. 5.4	The links between organisational culture and the current strategy	The strategic options most aligned with the prevailing culture

Table 11.2 Suitability of strategic options in relation to strategic position (Continued)

Some examples of suitability (1)

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

Table 11.3 Some examples of suitability

Some examples of suitability (2)

Strategic option	Why this option might be suitable in terms of:	
	Environment	Capability
Methods		
Organic development	Partners or acquisitions not available or not suitable	Building on own capabilities Learning and competence development
Merger/acquisition	Speed Supply/demand P/E ratios	Acquire capabilities Scale economies
Joint development	Speed Industry norm Required for market entry	Complementary capabilities Learning from partners

Table 11.3 Some examples of suitability (Continued)

Suitability – screening techniques

There are several useful techniques:

- *Ranking.*
- *Using scenarios.*
- *Screening for competitive advantage.*
- *Decision trees.*
- *Life cycle analysis.*

The life cycle/portfolio matrix

Competitive position	Stages of industry maturity			
	Embryonic/ Developing	Growth	Mature	Ageing/Decline
Dominant	Fast grow Start up	Fast grow Attain cost leadership Renew Defend position	Defend position Attain cost leadership Renew Fast grow	Defend position Focus Renew Grow with industry
Strong	Start up Differentiate Fast grow	Fast grow Catch up Attain cost leadership Differentiate	Attain cost leadership Renew, focus Differentiate Grow with industry	Find niche Hold niche Hang in Grow with industry Harvest
Favourable	Start up Differentiate Focus Fast grow	Differentiate, focus Catch up Grow with industry	Harvest, hang in Find niche, hold niche Renew, turnaround Differentiate, focus Grow with industry	Retrench Turnaround
Tenable	Start up Grow with industry Focus	Harvest, catch up Hold niche, hang in Find niche Turnaround Focus Grow with industry	Harvest Turnaround Find niche Retrench	Divest Retrench
Weak	Find niche Catch up Grow with industry	Turnaround Retrench	Withdraw Divest	Withdraw

Table 11.5 The industry life cycle/portfolio matrix
Source: Arthur D. Little

Competitive position within an industry

Competitive position within an industry can be:

- A *dominant* position which is rare in the private sector unless there is a quasi-monopoly position. In the public sector there can be a legalised monopoly status.
- A *strong* position where organisations can follow strategies of their own choice without too much concern for competition.
- A *favourable* position where no single competitor stands out, but leaders are better placed.
- A *tenable* position can be maintained by specialisation or focus.
- A *weak* position where competitors are too small to survive independently in the long run.

Acceptability (1)

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

Acceptability (2)

There are three key aspects of acceptability - the '3 R's':

- *Risk.*
- *Return.*
- *Reactions (of stakeholders).*

Risk

- ***Risk*** concerns the extent to which the outcomes of a strategy can be predicted.

- Risk can be assessed using:
  - *Sensitivity analysis.*
  - *Financial ratios – e.g. gearing and liquidity.*
  - *Break-even analysis.*

Sensitivity analysis

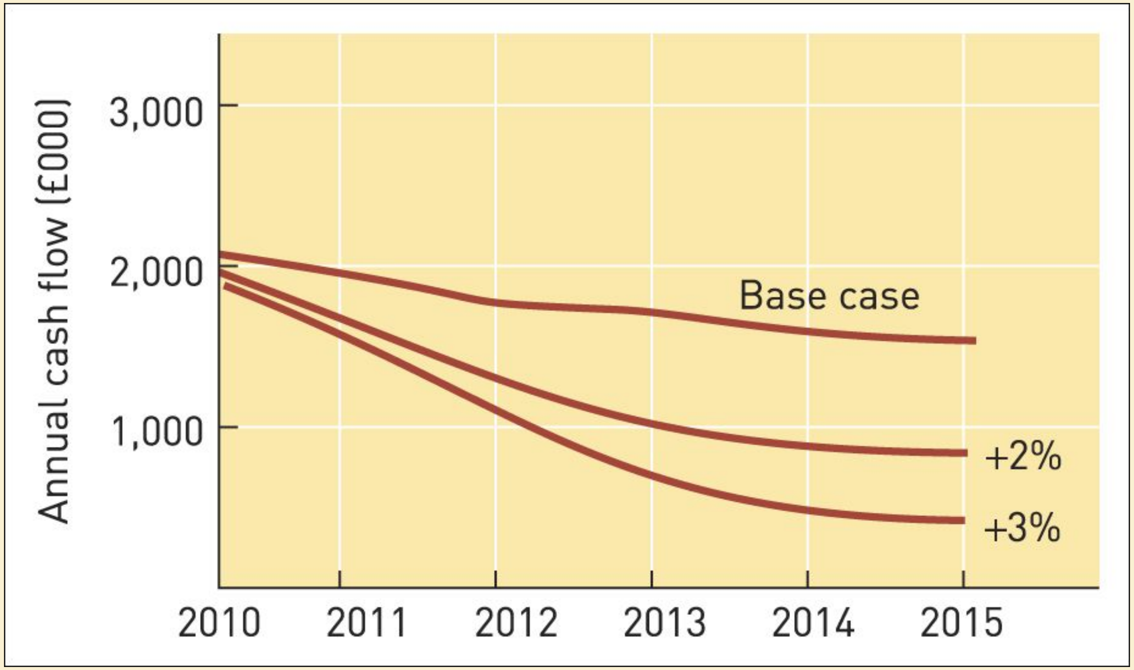


Illustration 11.3 A

Sensitivity analysis (Continued)

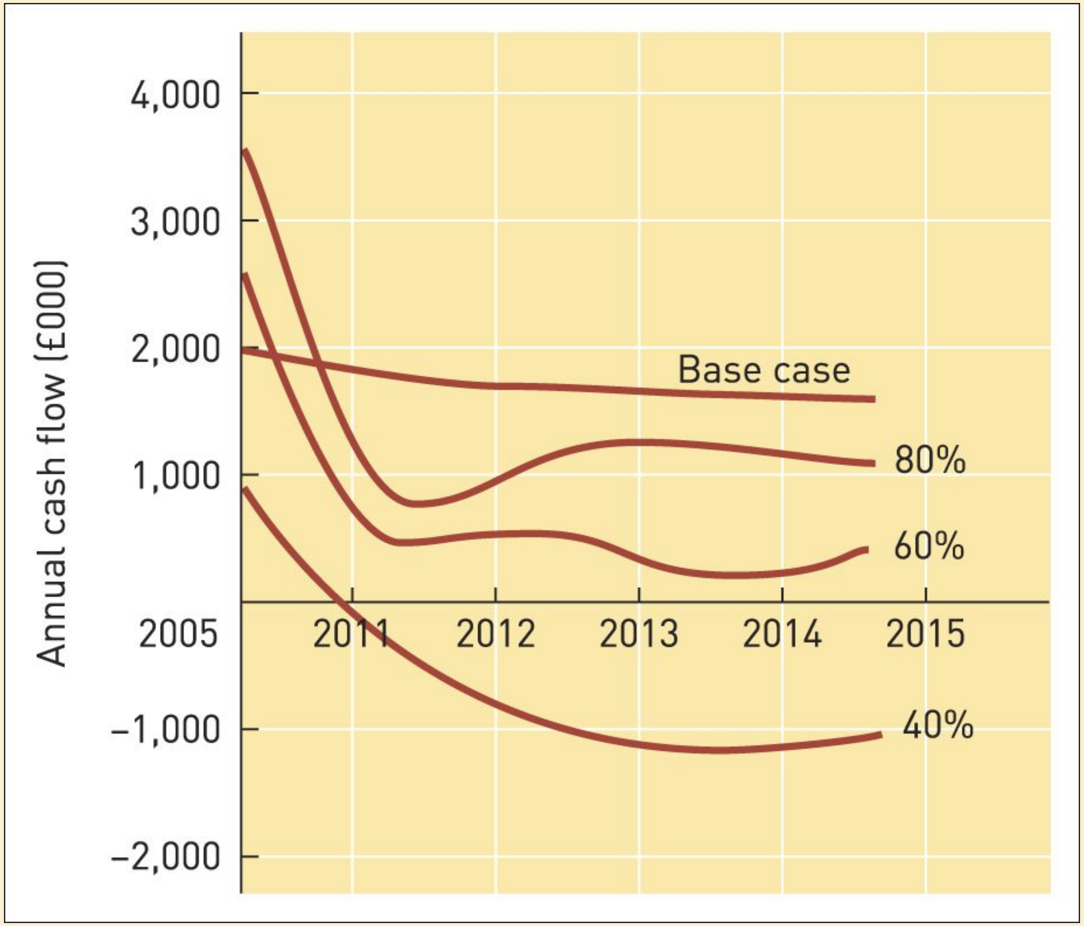


Illustration 11.3 B

Sensitivity analysis (Continued)

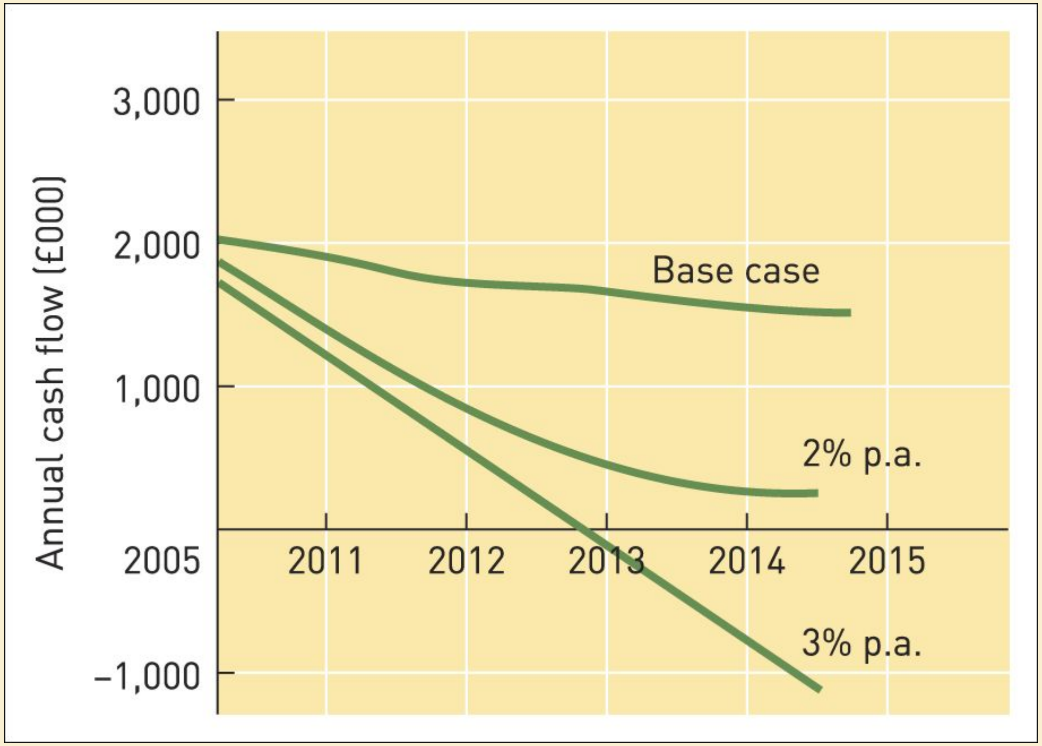


Illustration 11.3 C

Return

- ***Returns*** are the financial benefits which stakeholders are expected to receive from a strategy.
- Different approaches to assessing return:
  - *Financial analysis.*
  - *Shareholder value analysis.*
  - *Cost–benefit analysis.*
  - *Real options.*

Real options evaluation

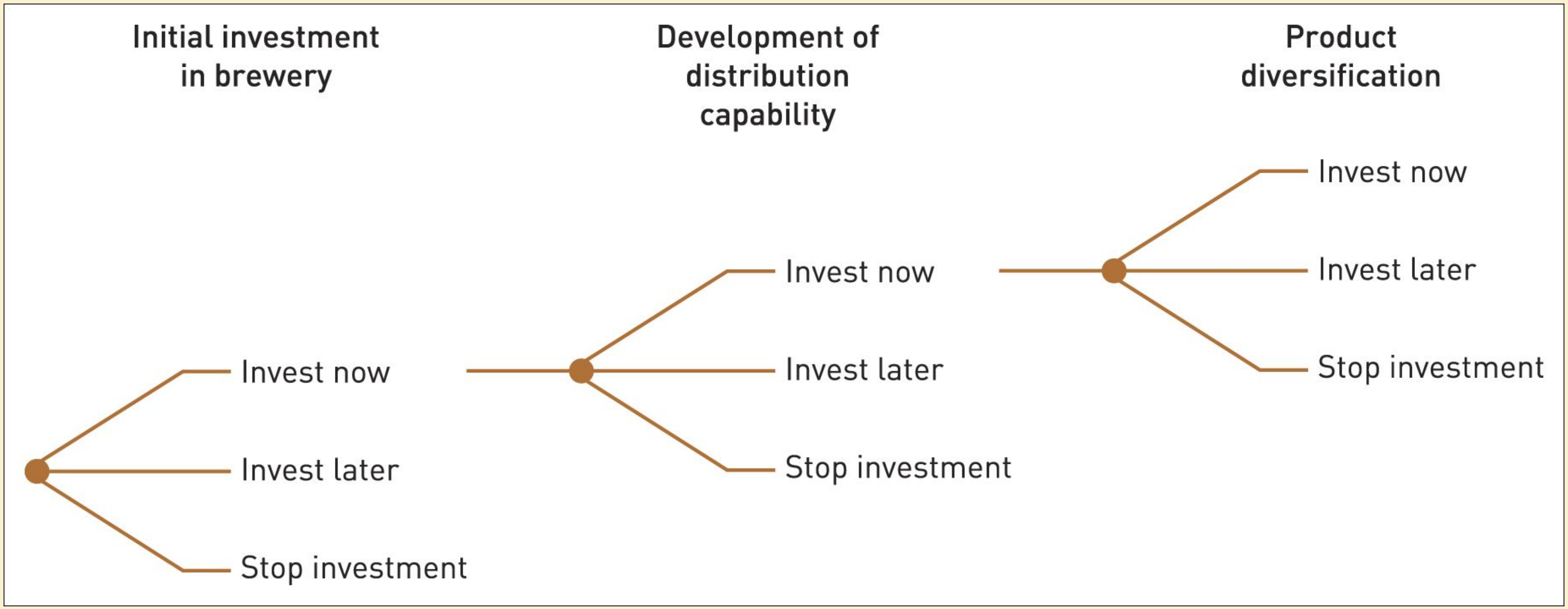


Illustration 11.6

Assessing profitability (1)

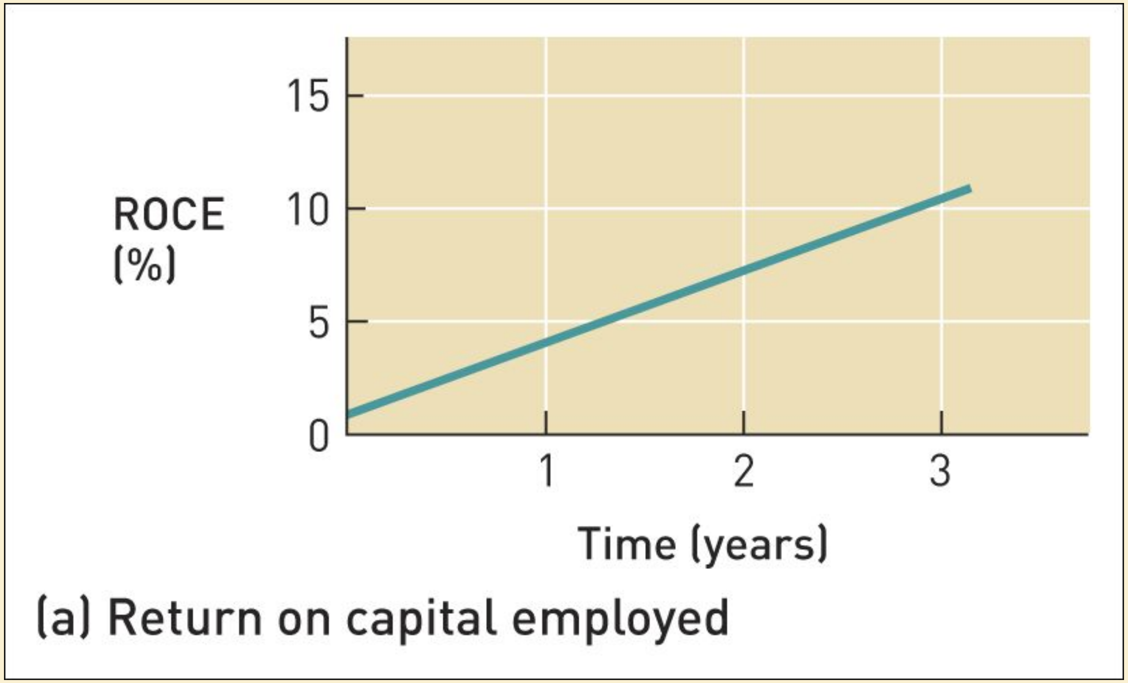


Figure 11.1 Assessing profitability

Assessing profitability (2)

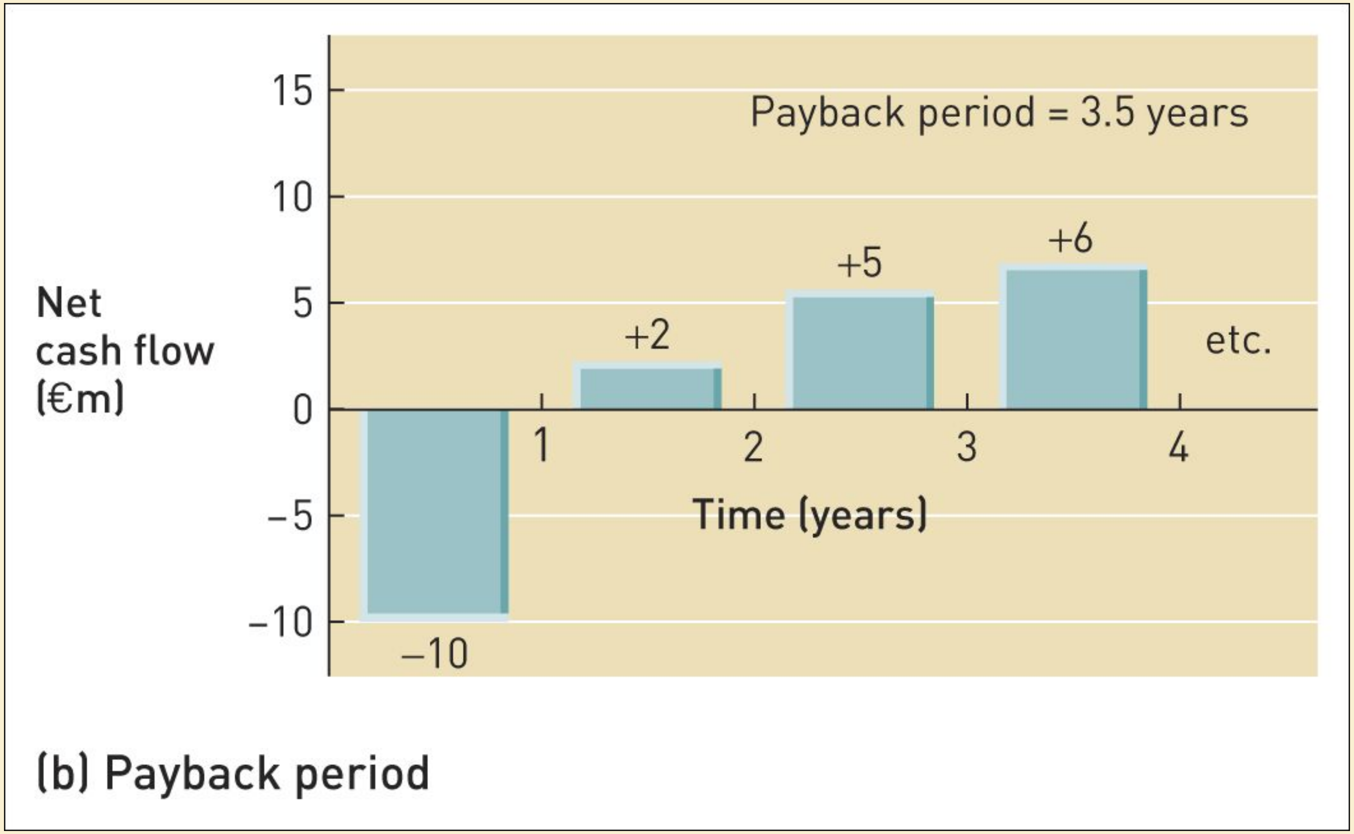
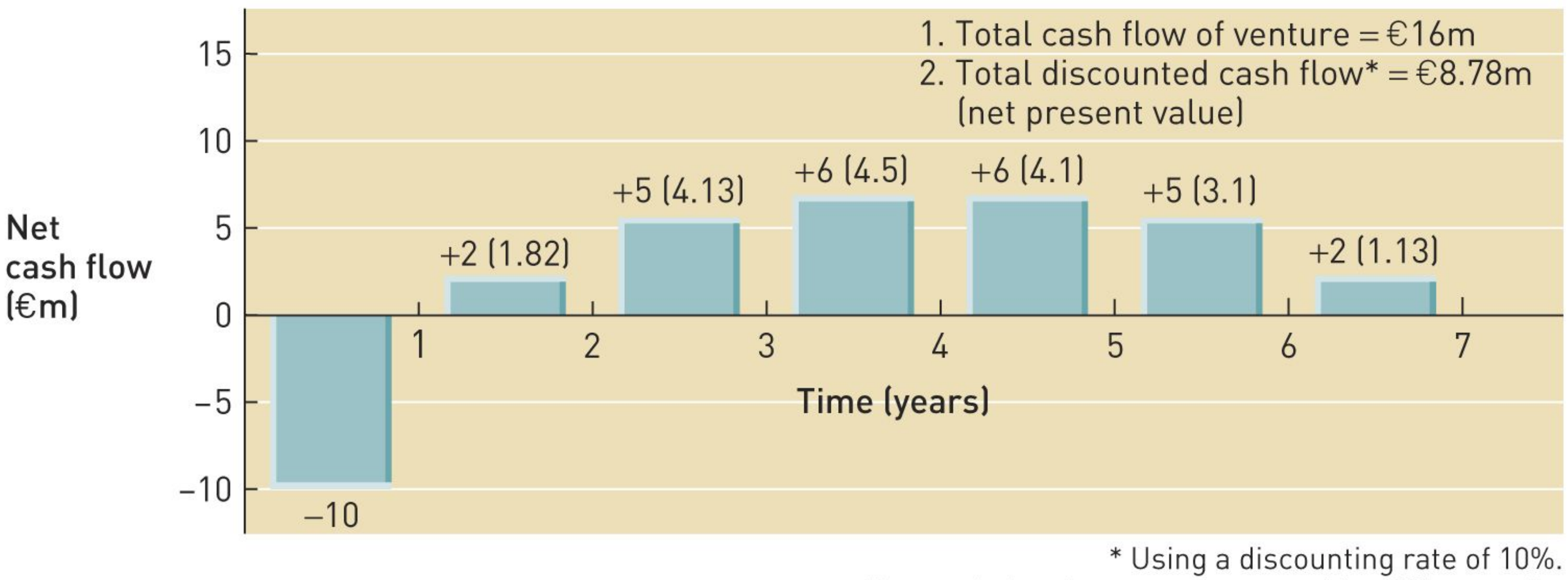


Figure 11.1 Assessing profitability (Continued)

Assessing profitability (3)



(c) Discounted cash flow (DCF)

Figure 11.1 Assessing profitability (Continued)

Measures of shareholder value

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

Table 11.6 Measures of shareholder value

Advantages of real options

There are four main benefits:

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

Reaction of stakeholders

- Stakeholder mapping and the power/interest matrix can be used to:
   - *understand the political context of strategies.*
   - *understand the political agenda.*
   - *gauge the likely reaction of stakeholders to specific strategies.*
- If key stakeholders find a strategy to be unacceptable then it is likely to fail

Feasibility

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

Two key questions:

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

Financial feasibility

Need to consider:

- The *funding* required.
- *Cash flow* analysis and forecasting.
- *Financial strategies* needed for the different ‘phases’ of the life cycle of a business.

Financial strategy and the business life cycle

Life cycle phase	Funding requirement	Cost of capital	Business risk	Likely funding source(s)	Dividends
Development/ launch	High	High	High	Equity (venture capital)	Zero
Growth	High	Low/medium	High	Debentures and equity (growth investors)	Nominal
Maturity	Low/medium	Medium	Medium	Debt, equity and retained earnings	High
Decline	Low/negative	Medium/high	Low	Debt	High

Table 11.7 Financial strategy and the business life cycle

People and skills (1)

Three questions arise:

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

People and skills (2)

Critical issues that need to be considered:

- *Work organisation* – will this need to change?
- *Rewards* – are the incentives appropriate?
- *Relationships* – will people interact differently?
- *Training and development* – are current systems appropriate?
- *Staffing* – are the levels and skills of the staff appropriate?

Integrating resources

- The success of a strategy depends on the management of many resource areas, for example:
  - *people,*
  - *finance,*
  - *physical resources,*
  - *information,*
  - *technology and*
  - *resources provided by suppliers and partners.*
- It is essential to integrate resources – inside the organisation and in the wider value network.

Evaluation criteria

Four qualifications:

- *Conflicting conclusions* and the need for management judgement.
- *Consistency* between the different elements of a strategy is essential.
- The *implementation and development* of strategies might reveal unanticipated problems.
- Strategy development in *practice* – it isn't always a logical or even rational process.

Summary

- Proposed strategies may be evaluated using the three SAFe criteria.
- *Suitability* is concerned with assessing which proposed strategies address the key *opportunities and constraints* an organisation faces. It is about the *rationale* of a strategy.
- The *acceptability* of a strategy relates to three issues: the level of *risk* of a strategy, the expected *return* from a strategy and the likely *reaction of stakeholders*.
- *Feasibility* is concerned with whether an organisation has or can obtain the capabilities to deliver a strategy.