Organisational Strategy

BMA6104

Strategic Choices (2): Corporate Strategies

Week 6

- BMA6104 Organisational Strategy

Learning outcomes (1)

- Identify alternative strategy options, including ***market penetration***, ***product development***, ***market development*** and ***diversification*.**

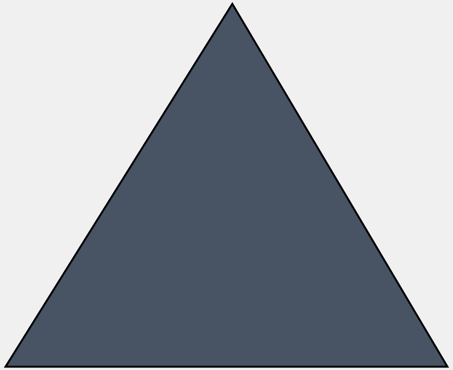
- Distinguish between different diversification strategies (***related*** and ***conglomerate diversification***) and evaluate ***diversification drivers*.**

Learning outcomes (2)

- Assess the relative benefits of ***vertical integration*** and ***outsourcing***.
- Analyse the ways in which a ***corporate parent*** can add or destroy value for its portfolio of business units.
- Analyse ***portfolios*** of business units and judge which to invest in and which to divest.

Strategic directions and corporate-level strategy

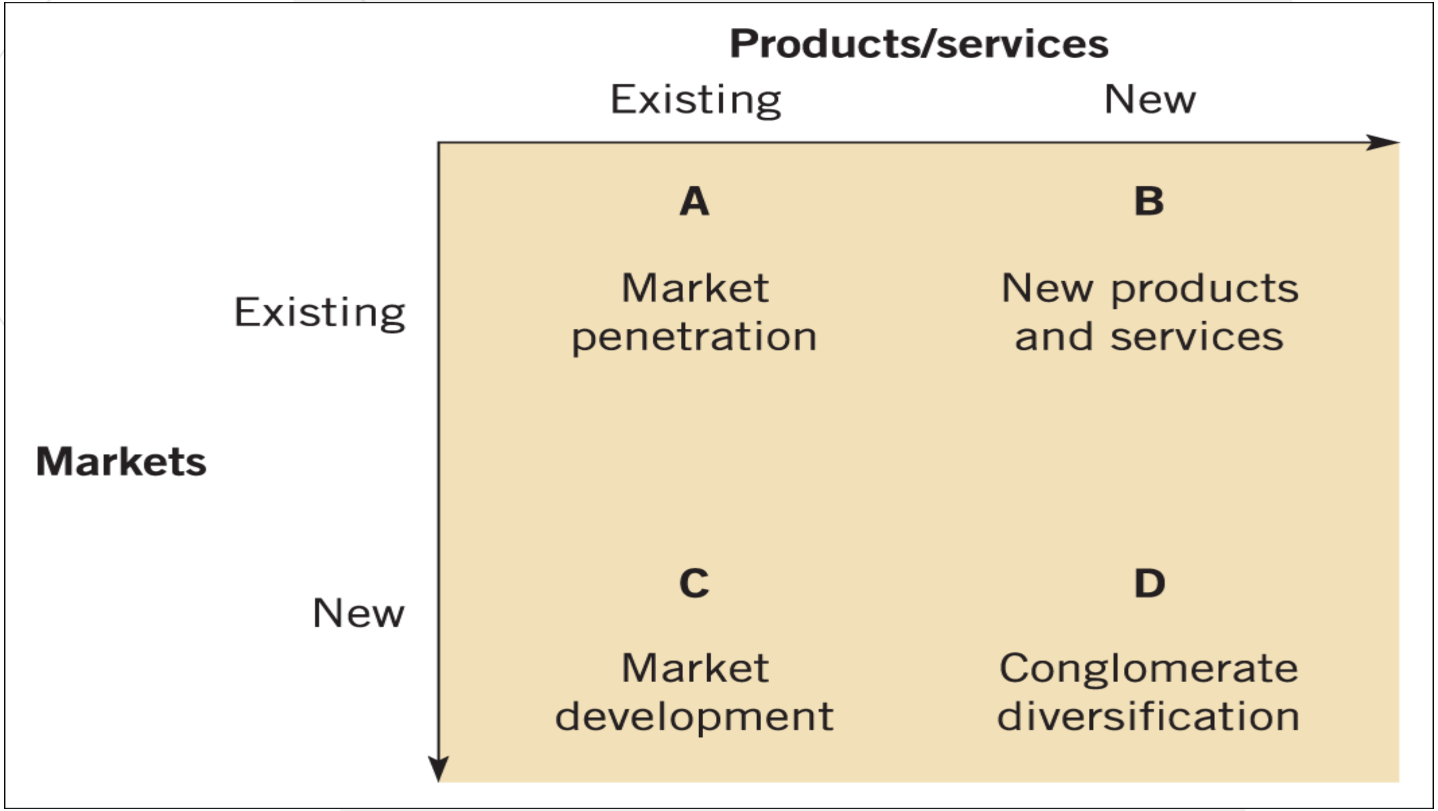
Scope
How broad to make the portfolio?



Corporate parenting
How should the ‘parent’ add value?

Portfolio matrices
Which SBUs to invest in?

Corporate strategy directions



Source: Adapted from H.I. Ansoff, *Corporate Strategy*, Penguin, 1988, Chapter 6 . Ansoff originally had a matrix with four separate boxes, but in practice strategic directions involve more continuous axes. The Ansoff matrix itself was later developed – see Reference 1.

Diversification

- ***Diversification*** involves increasing the range of products or markets served by an organisation.
- ***Related diversification*** involves diversifying into products or services with relationships to the existing business.
- ***Conglomerate (unrelated) diversification*** involves diversifying into products or services with no relationships to the existing businesses.

Market penetration

Market penetration implies increasing share of current markets with the current product range.

This strategy:

- builds on established ***strategic capabilities***
- means the organisation's ***scope is unchanged***
- leads to greater market share and ***increased power*** vis-à-vis buyers and suppliers
- provides greater ***economies of scale*** and experience curve benefits.

Constraints on market penetration

Retaliation from competitors
e.g. price wars

Legal constraints
e.g. restrictions imposed by regulators

Consolidation and retrenchment

- ***Consolidation*** refers to a strategy by which an organisation focuses defensively on their current markets with current products.

- ***Retrenchment*** refers to a strategy of withdrawal from marginal activities in order to concentrate on the most valuable segments and products within their existing business.

Product development

Product development is where an organisation delivers modified or new products (or services) to existing markets.

This strategy:

- involves varying degrees of ***related diversification*** (in terms of products)
- can be ***expensive*** and ***high risk***
- may require new ***strategic capabilities***
- typically involves ***project management risks***.

Market development

Market development involves offering existing products to new markets.

This strategy involves:

- *product development* (e.g. packaging or service)
- *new users* (e.g. extending the use of aluminium to the automobile industry)
- *new geographies* (e.g. extending the market to new areas – international markets being the most important)
- meeting the *critical success factors* of the market
- *new strategic capabilities* (e.g. in marketing).

Conglomerate diversification

Conglomerate (or unrelated) diversification takes the organisation beyond both its existing markets and its existing products and radically increases the organisation’s scope.

Potential benefits to an acquired business is that it gains from the reputation of the group and potentially lowers financing costs.

Potential costs arise because there are no obvious ways to generate additional value.

Drivers for diversification

- ***Exploiting economies of scope*** – efficiency gains through applying the organisation's existing resources or competences to new markets or services.
- ***Stretching corporate management competences*** – 'dominant logics' i.e. applying these competences across a portfolio of businesses.
- Exploiting ***superior internal processes***.
- Increasing ***market power*** via ***mutual forbearance*** or ***cross subsidisation***.

Synergy

Synergy refers to the benefits gained where activities or assets complement each other so that their combined effect is greater than the sum of the parts.

N.B. Synergy is often referred to as the

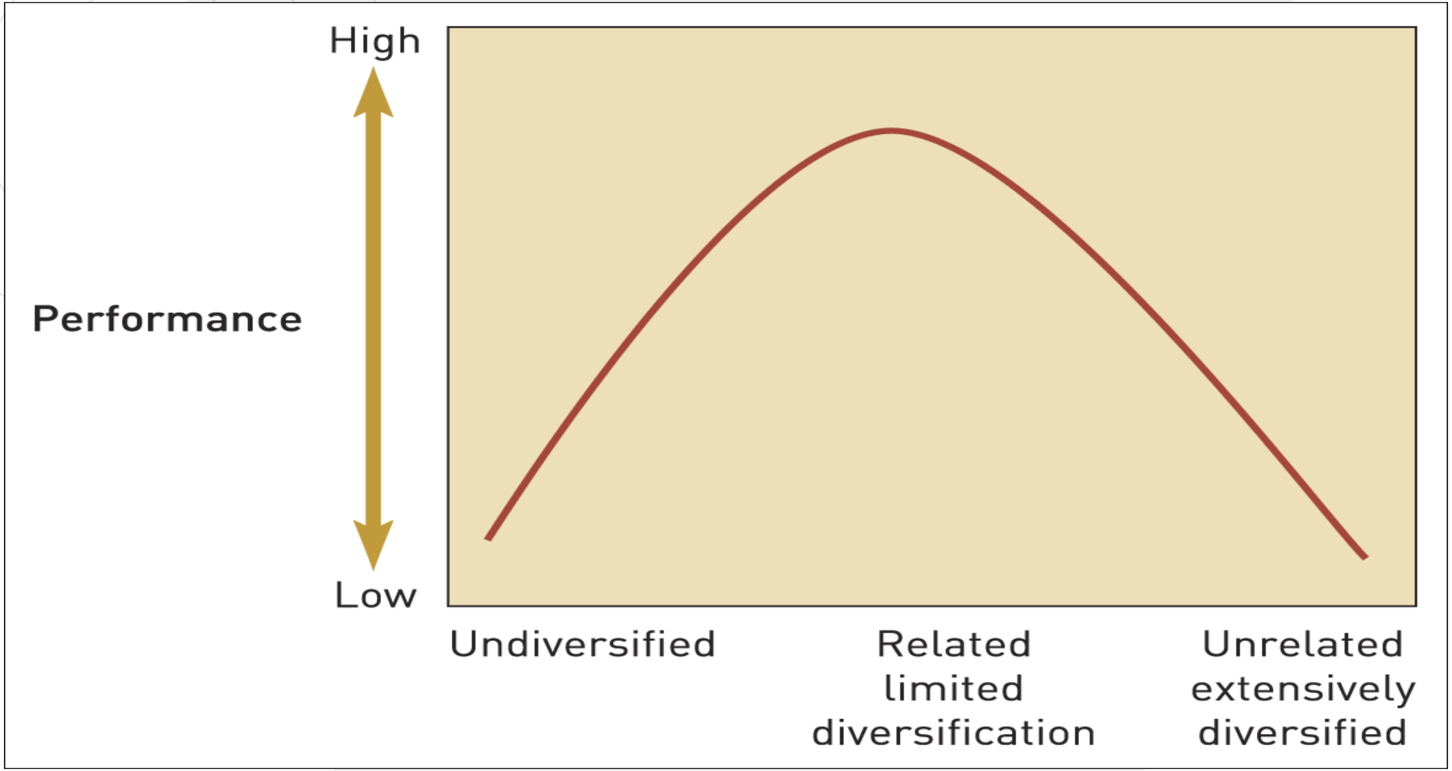
'2 + 2 = 5' effect.

Value-destroying diversification drivers

Some, often quoted drivers for diversification may actually involve value destruction (negative synergies):

Responding to market decline
Spreading risk
Managerial ambition.

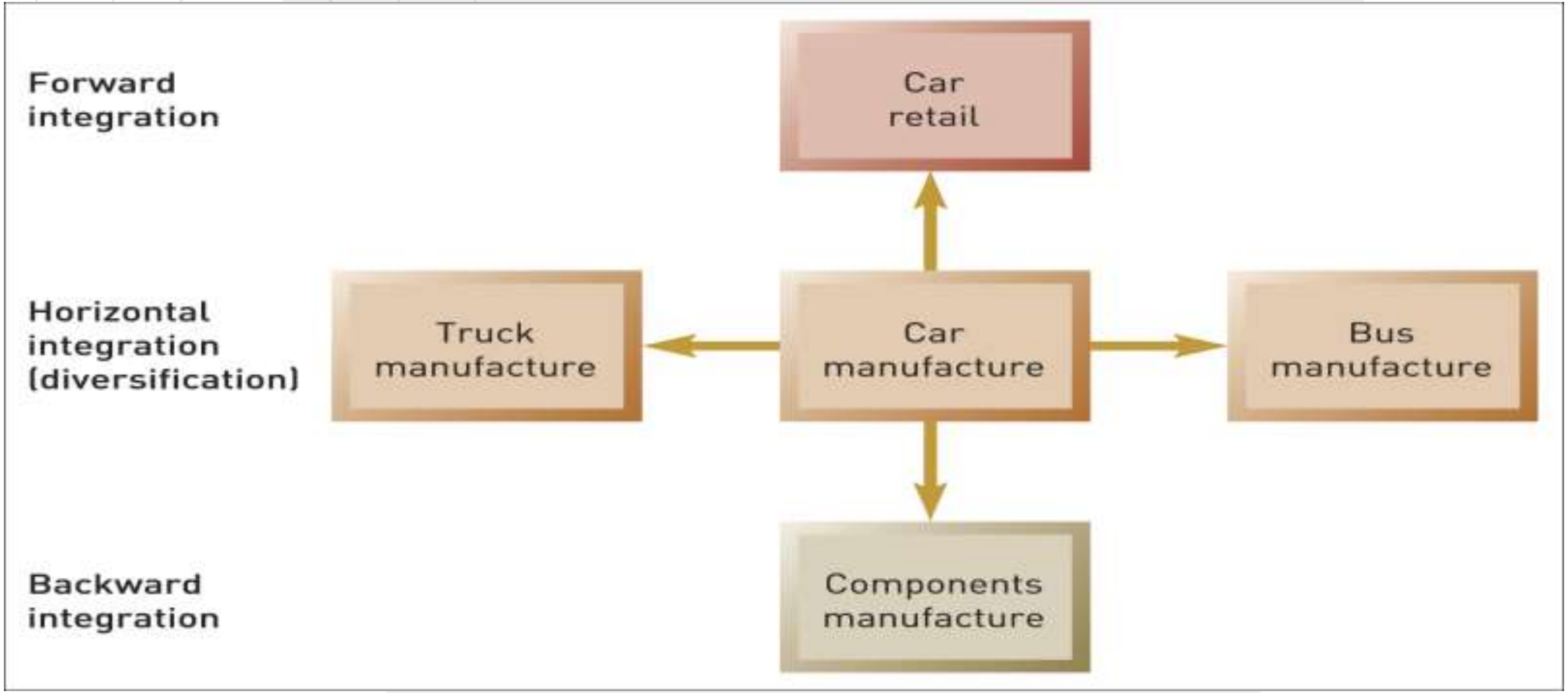
Diversification and performance



Vertical integration

- ***Vertical integration*** means entering activities where the organisation is its own supplier or customer.
- ***Backward integration*** refers to development into activities concerned with the inputs into the company's current business.
- ***Forward integration*** refers to development into activities concerned with the outputs of a company's current business.

Diversification and integration options



Outsourcing

Outsourcing is the process by which activities previously carried out internally are subcontracted to external suppliers.

Examples include:

- Subcontracting the manufacture of components to a specialist supplier
- Outsourcing non-core activities to a cheaper location (e.g. call centres)
- Outsourcing to a specialist supplier (e.g. IT).

To outsource or not?

The decision to integrate or subcontract rests on the balance between two distinct factors:

- ***Relative strategic capabilities***:
- Does the subcontractor have the potential to do the work significantly better?
- ***Risk of opportunism:***
- Is the subcontractor likely to take advantage of the relationship over time?

Value-adding activities

- Envisioning
- Facilitating synergies
- Coaching
- Providing central services
- Intervening

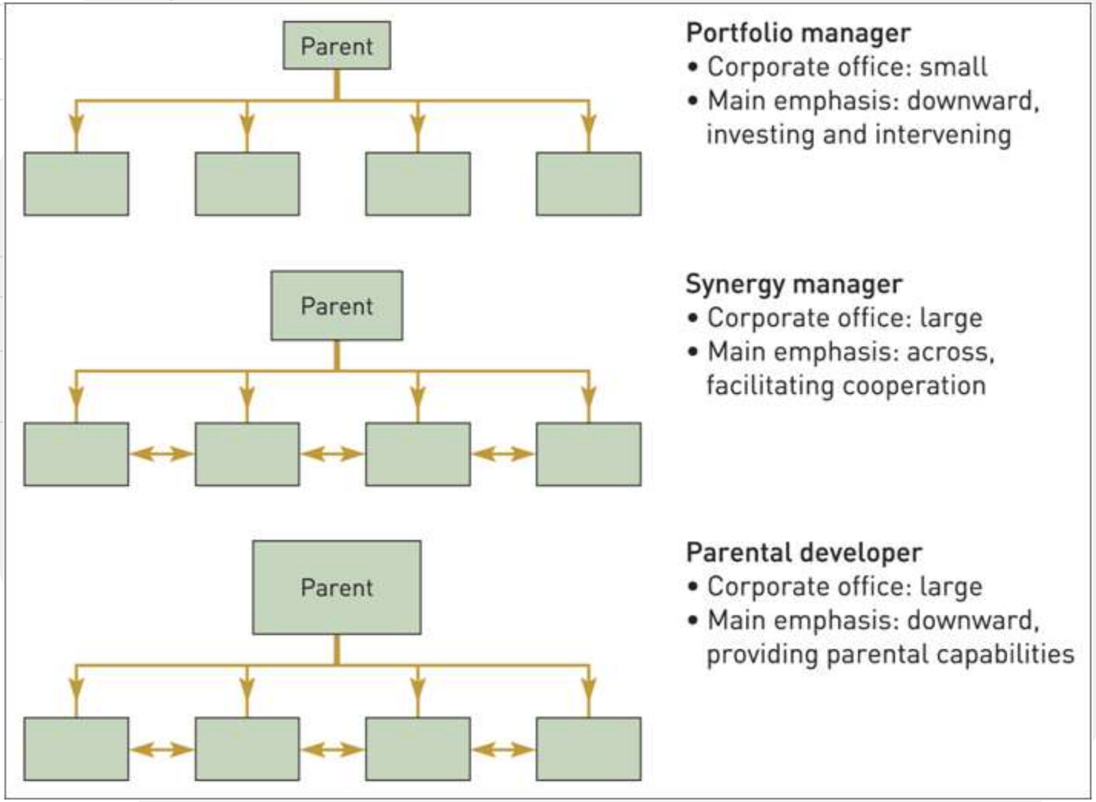
Value-destroying activities

Adding management costs

Adding bureaucratic complexity

Obscuring financial performance

Corporate rationales (1)



Source: Adapted from M. Goold, A. Campbell and M. Alexander, *Corporate Level Strategy*, Wiley, 1994.

Corporate rationales (2)

- ***The portfolio manager*** operates as an active investor in a way that shareholders in the stock market are either too dispersed or too inexpert to be able to do.
- ***The synergy manager*** is a corporate parent seeking to enhance value for business units by managing synergies across business units.
- ***The parental developer*** seeks to employ its own central capabilities to add value to its businesses.

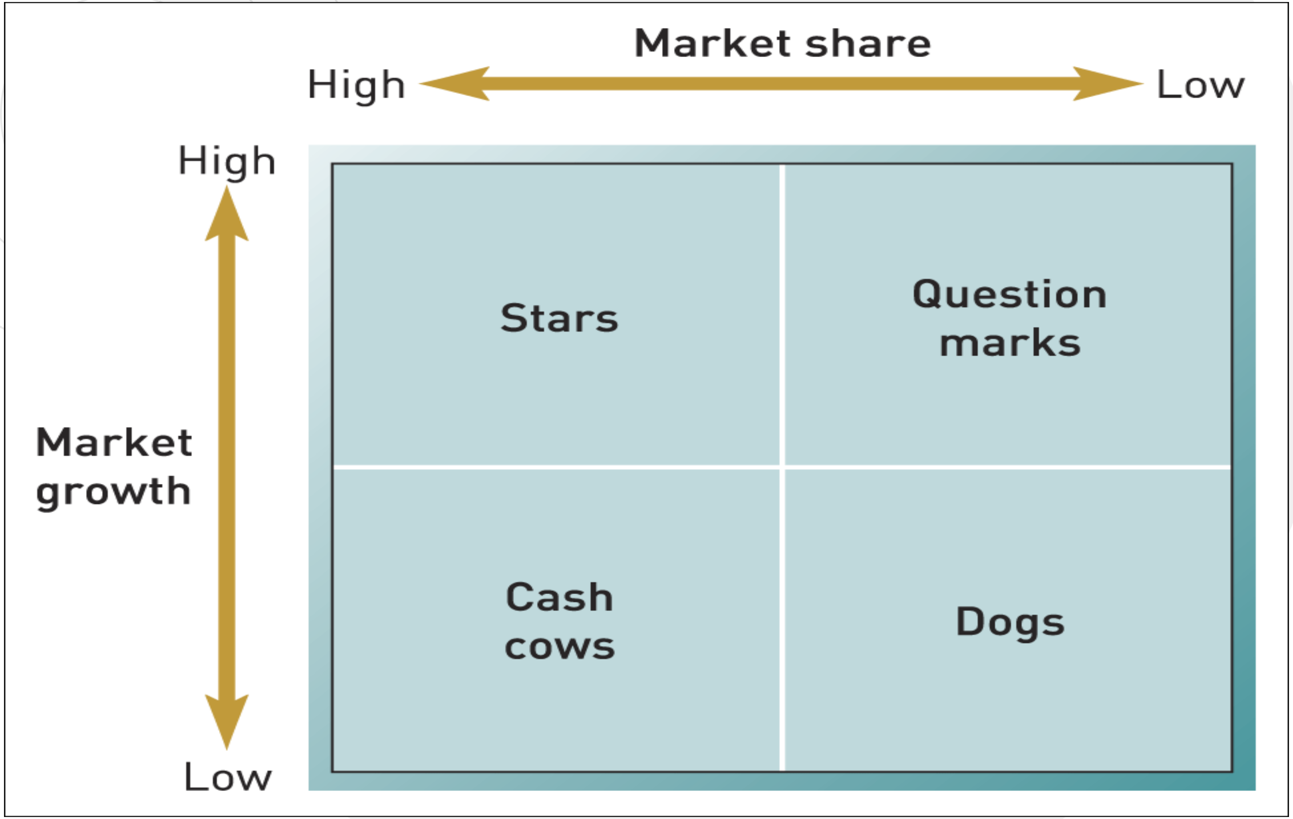
Portfolio matrices

BCG (or growth/share) matrix

Directional policy (GE–McKinsey) matrix

Parenting matrix

The BCG or growth/share matrix (1)



The BCG or growth/share matrix (2)

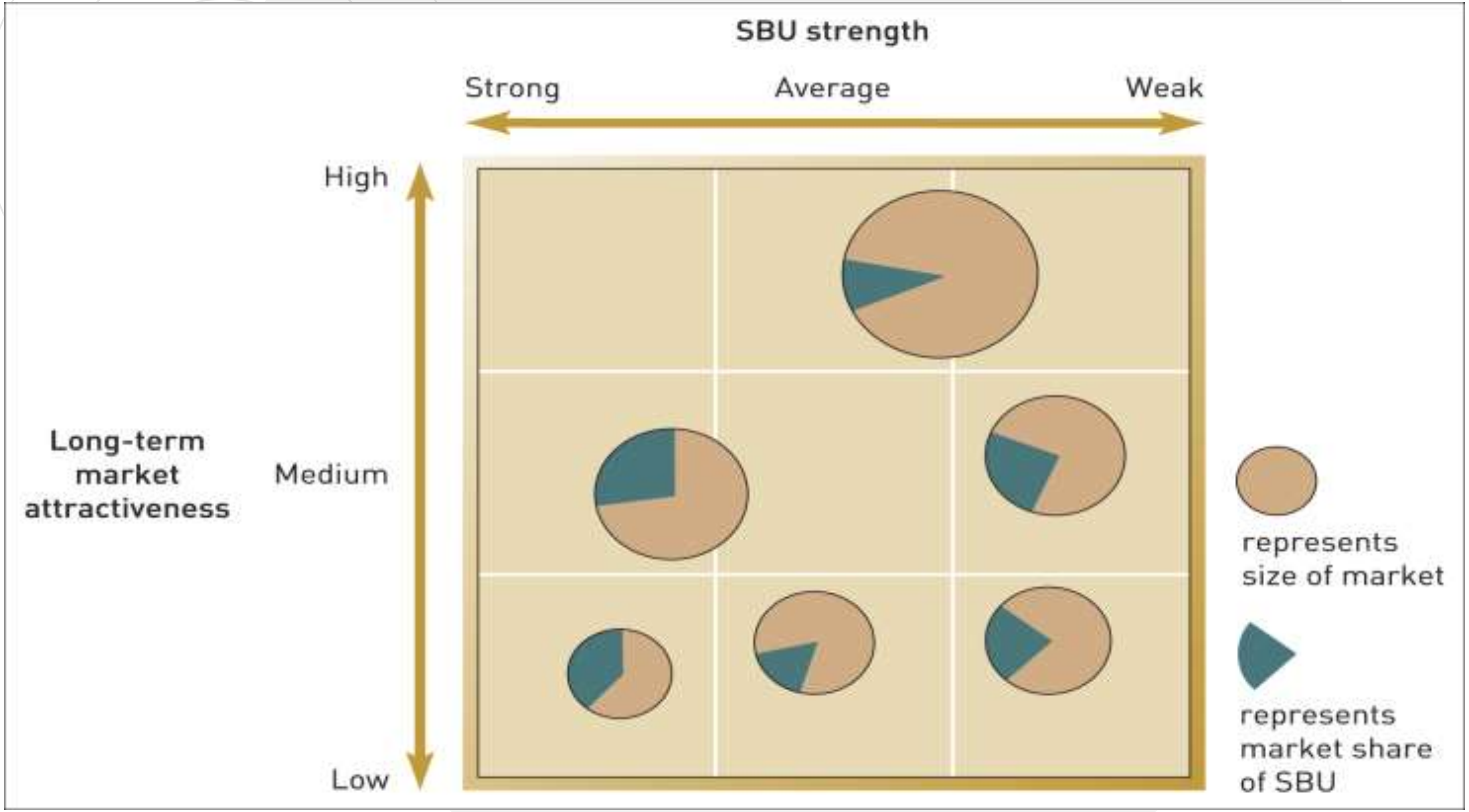
- ***A star*** is a business unit which has a high market share in a growing market.
- ***A question mark (or problem child)*** is a business unit in a growing market, but it does not yet have a high market share.
- ***A cash cow*** is a business unit that has a high market share in a mature market.
- ***A dog*** is a business unit that has a low market share in a static or declining market.

The BCG or growth/share matrix (3)

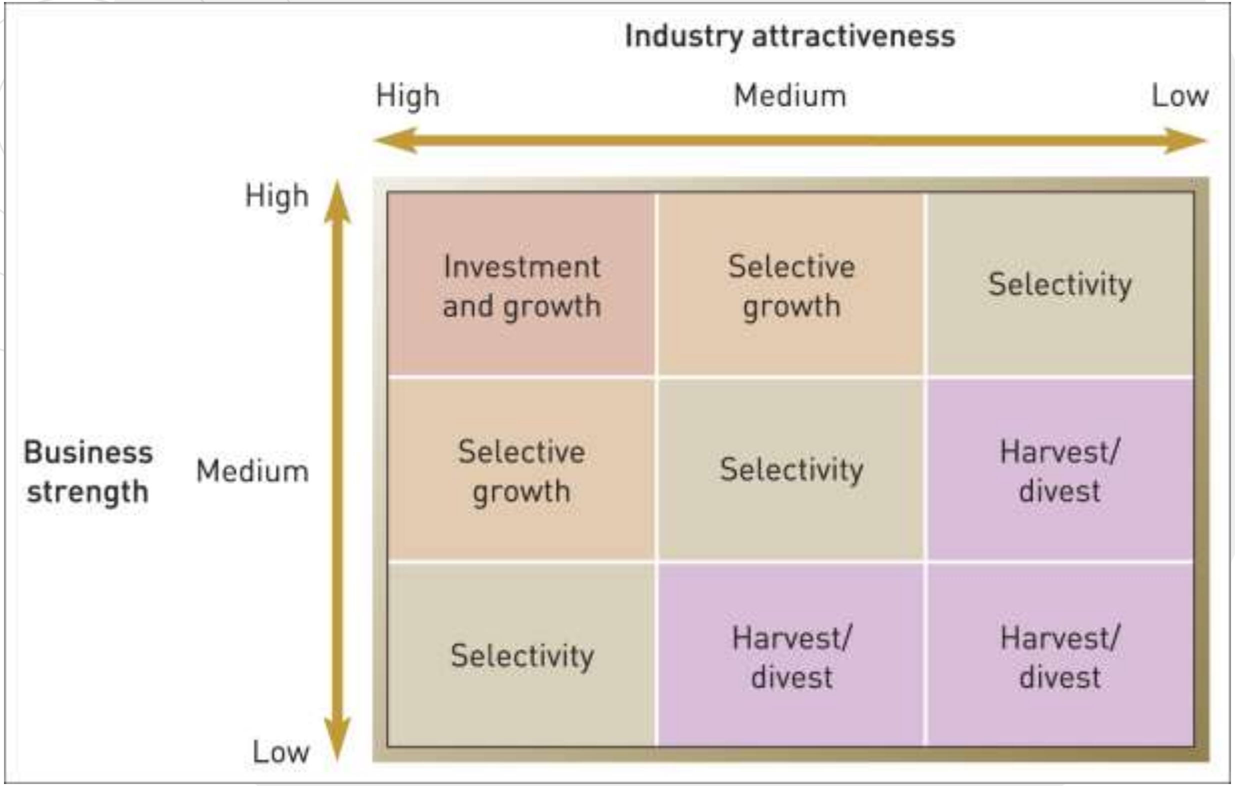
Problems with the BCG matrix:

- ***Definitional vagueness***
- ***Capital market assumptions***
- ***Motivation problems (in ‘dogs’)***
- ***Self-fulfilling prophecies***
- ***Ignores commercial linkages.***

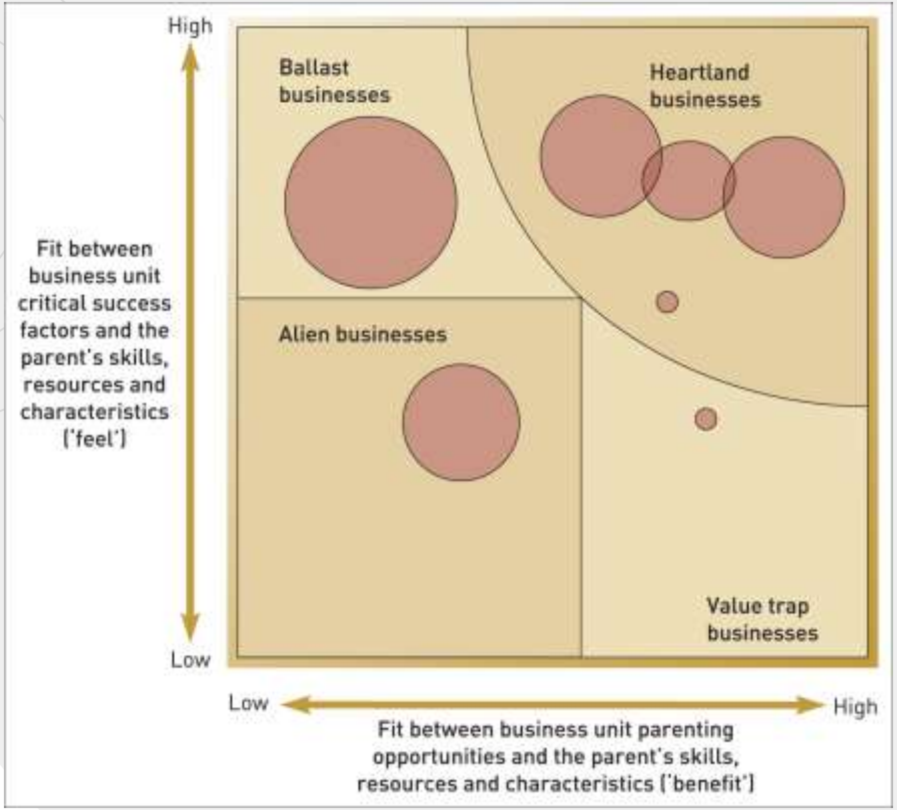
The directional policy (GE–McKinsey) matrix (1)



The directional policy (GE–McKinsey) matrix (2)



The parenting matrix (1)



Source: Adapted from M. Goold, A. Campbell and M. Alexander, *Corporate Level Strategy*, Wiley, 1994.

The par matrix (2) enting

1. ***Heartland*** business units – the parent understands these well and can add value. The core of future strategy.
2. ***Ballast*** business units – the parent understands these well but can do little for them. They could be just as successful as independent companies. If not divested need to avoid corporate bureaucracy.
3. ***Value-trap*** business units are dangerous. There are attractive opportunities to add value but the parent's lack of feel will result in more harm than good The parent needs new capabilities to move value-trap businesses into the heartland. It is easier to divest to another corporate parent which could add value.
4. ***Alien*** business units are misfits. They offer little or no opportunity to add value and the parent does not understand them. Exit is the best strategy.

Summary (1)

- Many corporations comprise several, sometimes many, ***business units***. ***Corporate strategy*** involves the decisions and activities above the level of business units. It is concerned with the scope of the organisation.
- Organisational ***scope*** is often considered in terms of ***related*** and ***unrelated diversification***.
- Corporate parents may seek to add value by adopting different parenting roles: the ***portfolio manager***, the ***synergy manager*** or the ***parental developer***.

Summary (2)

- There are several portfolio models to help corporate parents manage their businesses, of which the most common are: the ***BCG matrix***, the ***directional policy matrix*** and the ***parenting matrix***.
- ***Divestment*** and ***outsourcing*** should be considered as well as diversification, particularly in the light of relative strategic capabilities and the transaction costs of ***opportunism***.

Thanks!