Internacional Master in Sustainle Development and CR 07-08

Module: Business Administration

SUBJECT: BUSINESS STRATEGY

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1. Business Strategy

1.1 Introduction, concepts, characteristics, need

Before defining the concept and characteristics of business strategy, we must first establish our starting-point. If you are to gain maximum benefit from all that follows, you must first consider a business as an open system, one that is constantly interacting with its environment. Within it, technical, productive, human, financial and organisational resources function together in relative harmony. Also, a business must be reasonably flexible in the use of its resources. When a business behaves as if it were frozen, with nothing being changed ever, then there is no point in even considering the subject of strategy.

Strategy is a Greek word used in a military context to define military tactics, or “the art of the general”. Alexander The Great of Macedon is said to have been the world’s first strategist on record. He dealt with subjects such as analysing the situation, ascertaining one’s own and the enemy’s capacity, how to find alternative ways of getting round the enemy’s defences and how to implement whatever option is decided to be the most appropriate with speed and precision. Before him, Sun Tzu from China (5th century before Christ) had already outlined basic aspects of the balance of forces amongst humans and leadership qualities in his “Art of Warfare”. Today, over 2000 years later, though there have been spectacular technical advances, the basic principles are still the same.

Also unchanged is the link between business strategy and military strategy. Essentially, what companies do is to fight against each other to gain a dominant position in the battle field—the market. We often use expressions such as “price war”, “fighting the competition”, “market entry manoeuvres”, etc. Karl von Clausewitz, a Prussian general (1780-1831), one of the classic strategists, said, “Rather than comparing warfare with other arts, it would be best to compare it with trade, which is also a conflict of interests and human activities”. If you are surprised at the use of the word “art” to describe a horrible conflict between people, the same writer also said, “It is obviously more appropriate to speak about warfare as an art than as a science. Science is mere knowledge. Art involves practical skill. Thinking is therefore an art. Where it is logic that draws the line, where the premises that result from knowledge end and judgment begins, that is where art begins".

In today's world and under normal conditions, companies have an array of management tools and huge amounts of information about their markets, their environments and their competitors. The difference lies in how they use it all (an art) to reach their objectives. Without a doubt, strategic business management is an art. Probably, when "official science" relates the events of recent years, Mr W (Bill) Gates will be recognised as one of the greatest strategists of all times (perhaps on a level with Alexander, Napoleon or Rommel). What he did was to imagine that we would all one day have a computer in our homes and offices and to realise that what mattered was not so much the keyboard but the skill of computers to communicate with each other and with those pressing the keys. By extrapolating from events of the past, he would never have reached this conclusion. Nor would he have become the richest man on the planet.

Between the classic writers and the most modern, a whole plethora of geniuses (from Taylor and Fayol to Ansoff, Porter, Mintzberg, Peters, Prahalad, Hamel) and of "practical geniuses" (Ford, Matsusita, Honda, Welch, Grove) have left their mark. (I have just made a serious strategic error. Never make lists because you are bound to forget someone.)

To find a simple definition of strategy is difficult. I recommend you look at any of the references in the bibliography. At the risk of leaving something out, business strategy could be defined as the set of actions that a business takes, interacting with its environment, in order to reach its objectives. If you prefer a more radical definition, even at the cost of neglecting many of the classic ones, K Ohmae says "I call strategy the creation of values for the customer that are better than those of the competition". (We shall discuss this in due course). Or you may prefer a straightforward, childish definition: "A strategy is a plan of attack" (John Darling to the lost boys in Peter Pan, before attacking the Indian camp).

The basic characteristics of strategy, to give another, personal definition, are:

- A strategy brings together and gives coherence to business decisions. (It is the "glue", or the "bike lane" along which the business travels).
- A strategy selects present and future deals in which the business wishes to be present. (In subject 2 you will see how a business is defined).

- A strategy lays down objectives in the long, medium and short term, as well as the means required to meet them, for all the functional areas of the business.

- A strategy defines the type of organisation needed in order to carry out the deals.

- A strategy is always determined by the situation of the business in its environment. (The environment conditions, and may determine, business progress).

- A strategy always aims to improve the competitive position.

A special comment is required on this last point. Whatever sector you work in, you will see how competition becomes increasingly intense. Competitiveness is key to business today and in the foreseeable future. It is a structural element, not just a passing situation. And today's passion for deregulation is based less on political motives than on competition ("the art of warfare"), as is the wave of mergers and acquisitions all over the planet. To see this from a European point of view, it is not a question of deployment but rather a reaction against the clear progress being made by North American companies and the North American economy over the last ten years, and preparation for the new competition to be expected from newly-developed countries.

If we consider the subject of business strategy from a more philosophical viewpoint, we could say that strategy is a plan of action, or a model or approach for business behaviour within the environment in question. It is important for you to understand that strategy is not a relative concept. What is strategic for the Chairman is not strategic for his chauffeur, and vice versa.

Just as there is a European, national, regional, sectoral, or company strategy, there is (or should be) a personal strategy. Your contribution to the former will be of little use if you fail in the latter (a relative, subjective concept).

Basically, under today's conditions of competition, deregulation, economic and market globalisation, companies have to know where they want to go, by what means and over what time frame (a strategy). They may still not be successful, but it is essential for them to be clear about these factors.

Do not forget that thinking is the prime strategic activity. Once you think, you will have started creating strategies.

1.2 CRITERIA FOR DRAWING UP AN EFFICIENT STRATEGY

If a strategy is to be efficient, it must be based on the following principles:

- The essential starting-point is to have clear objectives. If the company is not clear where it wants to go, then there is no point in considering how and when it will go.

- A company's strategy must always allow it to take the initiative (the surprise effect). In today's world, a company has to decide if it is going to work against its environment, or with or without its environment. (This also works the other way round. Do we want the world to work against us, or with or without us?) Although the capacity of an individual company, especially if it is a small one, to have a significant effect on mainstream trends is limited, we can and should be able to influence our immediate environment. (The future is built by us all, and is not an extrapolation of the past). It is essential to think slowly and act fast.

- It is important to concentrate efforts. Companies have to focus on resolving their greatest problems and taking advantage of their strengths. Dealing with a large number of problems is extremely wasteful of energy and rarely leads to positive results. Only if concentrated efforts are made will it be possible to beat the competition.

- In spite of the scope and matters of sovereignty involved (or deliberately created), strategies must be flexible. (We shall see this in detail in section 1.4).

- Leadership must be coordinated and committed. The strategist par excellence is the Chief Executive Officer. He is responsible not only for conceiving the strategy but also for implementing it. This is often the most difficult part. If a strategy is to be implemented, it must first be understood and accepted by the management and, as far as possible, by all the staff. This is why senior managers must be strong leaders. It is their job to motivate others, just as the captain of a sports team does.

In summary, a strategist is not the person who thinks most, like a Doctor in Philosophy, but the person who thinks, acts, measures, corrects, re-thinks, and so on. (We'll soon reach 1.4).

1.3 STRATEGY AND TACTICS

The classic doctrine refers to strategy as being capital, designed for the long term and directly related to basic objectives, whereas tactics are considered less essential, for the short term and related to secondary targets.

For example, if a company wants to enter a new market (a strategic action), it can choose between establishing branch offices or selling through independent distributors. The two options are tactics for applying the same strategy.

Many strategic decisions are taken in a question of days or weeks, and the long term is often mixed up with the short term. We could therefore say that a strategy affects the future of the business as a whole, and tactics affect everything else.

Considering this relativity of what is "strategic", this distinction between strategy and tactics is purely academic and should not concern you in practice. Strategy is on a higher level, but the tactic used is important because it may determine the success or failure of the strategy.

1.4 STRATEGIC MANAGEMENT: CONCEPT

The 1970s, and especially 1973, the year of the first oil crisis, were a period of change—from stability to turbulence, and from a system of strategic planning to strategic business management. (We shall discuss environmental factors in detail in the second part of the course).

Let us consider some historical factors. Planning techniques have been used in Public Administration since ancient times. In the 18th century, State Budgets were introduced in order to decide on taxation and control the civil service. In the 20th century, such techniques were more widely adopted and became more important. 3, 4 or 5 year plans were drawn up to guide political action in the field of industrial development. Centralised planning subsequently proved to be inefficient for managing a country's resources. It was seen to be more efficient to leave the initiative to individual entrepreneurs, allowing them to compete in a legislative environment that guarantees competition.

The business world has also applied planning and budgeting concepts, especially the large businesses that first grew up in the 20th century. During the Second World War, planning developed enormously to the extent that the US army was able to implement global logistics. This led to the concept of Strategic Planning, with a group of experts forecasting demand and aiming to cover it by increasing production capacity, human resources, funding, etc.

At the end of the Second World War, experts in Strategic Planning moved into private initiative, applying the same concepts of forecasting and planning, with great success. Some of the specialist consultancy firms were created, such as McKinsey, the Boston Consulting Group or Booz, Allen & Hamilton. At this point, I think we should mention the contribution made by Professor Igor Ansoff, who was trained in the Rand Corporation to resolve strategic problems for NATO. In a series of publications ("Corporate Strategy" (1965), "From Strategic Planning to Strategic Management" (1976) and "Strategic Management" (1979)), he laid the foundations for what today is known as Strategic Business Management. In particular, Ansoff is responsible for the "product/market" combinations in which companies compete (possibly requiring different strategies), and the decentralised preparation and implementation of plans by operating unit managers who act as agents for change.

Table 1 below shows the differences between the management approach of the seventies (strategic planning) and today's approach (strategic management).

In the strategic planning approach, the environment allowed objectives to be established and maintained throughout the period of the plan, with actions being taken in line with the plan. In strategic management, the company must be prepared to change its objectives, strategy and plan in line with developments in its environment, with the period of the plan (you may remember the famous "development plans") taking back seat.

TABLE 1: PLANNING VERSUS STRATEGIC MANAGEMENT

	STRATEGIC PLANNING	STRATEGIC MANAGEMENT
Environment	Stable - adaptive	Unstable - turbulent

Development	1960-1980	1980-
Management Process	Structured	Flexible - opportunistic
Time schedule	Long term	Medium cost
Formation of strategies	Centralised	De-centralised
Management style	Technocratic	Creative
External variables	Economic	Multi-disciplinary
Type of system	Planning	Planning - anticipation

Think of national accounts. The government establishes forecasts for economic growth (which is essential if its accounts are to tally), inflation, public deficit, public debt and job creation (resulting either directly or indirectly from its European commitments). At the end of the year, it recognises any deviations (either upward or downward), explains them as far as possible (oil prices, etc.) and draws up the accounts for the next year, taking into account the new situation. Meanwhile, but perhaps without saying so in public, it has been adopting corrective measures and preparing itself for the test. This is the philosophy. (Remember that a government is in power for a period of four years, which might affect its decisions). This limitation does not exist in private business, at least not under normal conditions.

Strategic planning was a structured process, based on forecasts, and was basically centralised. Strategic management, however, is a flexible process, one which looks for opportunities and which aims to be decentralised and to involve participation. (Participation by all in targets and strategies, however, exists only in books, and perhaps in small, professional companies).

The environment changes very fast and companies have to adapt constantly. At all costs, what must be avoided are what we might call “strategic surprises”. These always come from the environment and may lead to strategic problems. Remember that strategic problems may exist at different levels – national, regional, sectoral or entrepreneurial.

- Problems of size. Spain has a large surface area, but a medium-sized population and economic capacity. It cannot be compared with Germany or

France, Holland or Belgium. This places us in a difficult position for negotiating (so we cannot always complain about the results).

- Problems of location. Spain is on the periphery, and will be even more peripheral when the European Union expands eastwards. All the large countries are closer to the decision-making centres and the main markets than we are. (Think about who suffers most whenever there is a strike of any sort in France.)

- A problem of perception. For most of those who live north of the Pyrenees, Spain is a place for holidays, for “sun, sand and sex”. While tourism is our leading sector, this perception has very important connotations for the rest of our products. France is also a leading country for tourism (its tourism revenue exceeds ours) but its positioning is different and its products, technology, services and opinions are perceived as being those of a developed, industrial country. Although Spain exports 20 times more cars and spare parts than oranges, the majority of Europeans still think of Spain as an exporter of oranges and as a good place to spend a holiday.

We also have problems on a sectoral level.

- Our coal will never be competitive either nationally or internationally. We cannot close our mines because of the serious social problems that would aris as a result. (Is there a substitute industry?)

- Although Spain is the world’s fifth largest car manufacturer (after the US, Japan, Germany and France), none of the companies is Spanish (although this is not so important in a global business), and they all specialise in small models. What would happen if markets started to demand larger models? (It might be of interest to produce medium-sized vehicles but we are not competitive enough and would have to take the business from others.)

I shall resist the temptation of giving examples of problems on a business level, partly in order not to offend and partly because, by the time you read this, things might have changed. What is clear is that each of the problems mentioned above affects practically all of us and, in order to resolve—or mitigate—them, constant, determined action is required at the right level. A strategic problem requires strategic management. It cannot be resolved by raising salaries by 1% or by purchasing a new machine. What is required is a set of actions designed to meet the objective. You will by now have noted that in this subject we shall not be dealing with one per cents but with complex matters on a larger scale.

Remember, in most cases, strategic efforts will aim to avoid “strategic surprises”, following changes in the environment or even anticipating them. Table 2 shows us some general characteristics of society today in the areas of interest to us.

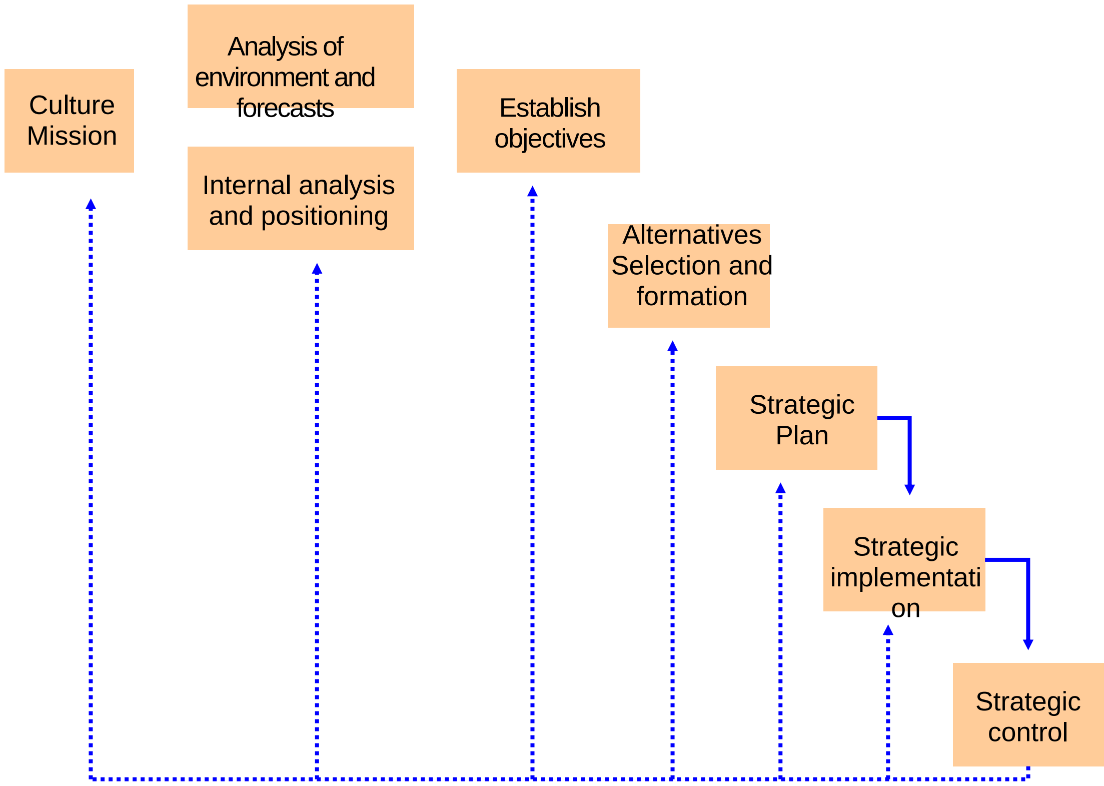
TABLE 2: SOCIETY TODAY

	OLD ECONOMY	NEW ECONOMY
Markets	Stable	Dynamic
Competition	National	Global
Organisational structure	Hierarchy	Matrix-based
Production	Mass	Flexible
Competitive advantages	Costs/economies of scale	Innovation, quality, timing
Action	Individual	Alliances and collaboration
Training	Qualification	On-going
Type of employment	Stable	Change and adaptation
Role of administration	Intervention and control	Creation of environment

1.5 THE PROCESS OF STRATEGIC MANAGEMENT

Having considered the philosophical aspect, we could summarise by saying that strategic business management advocates constant adaptation to the environment. We shall now go on to discuss practical aspects because strategic management is also a process which attempts to adapt a business (with all its complexity and problems) to turbulence in the environment. We shall now describe each of the steps shown in Table 3. These form the backbone of the whole subject.

TABLE 3: STRATEGIC MANAGEMENT



Organising the process. As with any other business process, there must be someone responsible for it (Managing Director), a basic frequency for repetition, certain variables must be monitored (we shall see these at the end of the section) and there must be a procedure for implementation. Although it has already been stated that strategic management is essentially an on-going activity, there are certain times (especially at the year-end) when businesses have to make special efforts to prepare and update plans for the following year.

Under normal conditions, it is the Strategic Planning Department which acts as facilitator, bearing much of the weight of this process although it receives support from all the others. All the line managers who are able to make a positive contribution should participate in the strategic deliberations because they will then be motivating elements in the organisation. They are also the main protagonists in strategic implementation, acting as “agents for change”. So, the Strategic Planning Department leads the process and provides the techniques and tools that we shall discuss below.

Now some comments about real life. Note the degree to which the Chairman or Managing Director of your company is involved in the strategic process. (This might indicate his or her capacity for adaptation and for generating a future for all of you). Also, where there is a single position called “Planning and Control” ,note whether the manager is more a “strategist”, or a “controller” or a “financier”. Note people’s attitudes and behaviour because they might be of use to you in the future.

Philosophy, purpose and mission. A company’s mission is what it does. When we talk about its philosophy (sometimes called “culture”), we are referring to the patterns of behaviour for shareholders, managers and staff. In section 2 we shall consider all the different aspects involved in detail and their importance for the definition, deployment and implementation of the company philosophy. (If you are interested, take a look at Section 2. It may be better to omit something than to repeat). Both philosophy and mission change over time.

Analysis of the environment and prognosis. When we talk about environment, (as you will see below) we refer to everything that surrounds the company. Analysis of the environment is carried out at two levels or in two categories (the specific environment and the general environment) and aims to discover opportunities and threats. A company’s environment involves suppliers, customers, competitors, possible new entrants and possible replacement products. The environment is characterised by political, economic, technological and social factors. (It can be said to have three areas—people, money and science/technology. You can decide for yourselves how to group them and how many factors are involved.)

The key for deciding how to divide the two environments lies in the fact that, in the general environment, the same factors affect companies in a single sector differently so may influence positions in the nearby environment. For example, the competitive edge of a company with a low level of borrowing will be reduced during periods of low interest rates. Also, a company with a good retail network will be affected if the sector is appropriate for sales via the Internet. Having carried out the analysis, we now come to:

- Opportunities
- Threats

The analysis will be of no use if the opportunities disappear fast, before we can take them up. Nor will there be any point in blocking threats if they are quick to disappear. We will have to consider how long they will remain and consider whether others might arise. This is why I have used the Greek word ‘prognosis’ (a subjective forecast, almost a guess, somewhere between a powerful computer and a crystal ball). “Guesstimate” would also be a good term. This is not easy but it is where the key to our success lies. Since the environment changes fast and competitors are always on the ready, it is best to try to anticipate changes in order gain an advantage over our competitors. This process is called “strategic intention”.

To give an example, “people carriers” were invented for the leisure society (to carry cases, bikes, etc.) rather than for large families. What matters is their spaciousness rather than the number of seats.

Internal analysis and determination of positioning. Internal analysis, to use the classic term, aims to discover a company’s strengths and weaknesses, in comparison with its main competitors. Since the main point of reference is the competitors’ position, it is obviously not a pure internal analysis. As before, it is essential to note the time frame of the strengths and weaknesses. Competitors are always on the prowl, aiming to reduce competitive advantages. (there is no such thing as a “sustainable competitive advantage in the medium and long term). “Time and tide wait for no man”.

So, having carried out the internal and external analyses, we have a starting-point to build up a strategy from two fairly different points of view:

- The company’s basic positioning. Every company has a basic position depending on its capabilities, human resources, cost structure and assets. If we define a company in this way, we can say it manufactures and sells a certain type of product within a specific price-quality band. Marketing techniques help to move products within this band.

An example can be seen in Daimler, a high-technology (or high added value) product company. Everything it manufactures (cars, trucks, buses, satellites, aircraft, electronic equipment, etc.) is of high quality and high priced. If it wants to "change lanes", it has to buy up other companies and manage them (e.g. Chrysler).

Another example is the Corporación Mondragón which can efficiently manufacture and sell refrigerators in the medium-to-top range (Fagor) and the medium-to-low range (Aspes). It would never attempt to enter the highest range markets (Liebherr or Siemens) or the low range (for reasons of cost).

- Main lines for strategic development. The company will have to consider any cross-effects arising from opportunities/threats and strengths/weaknesses. We shall have to use the strong points to take advantage of opportunities and, where possible, to block threats. Weak points will have to be eliminated or at least mitigated in order to avoid exposure to threats. In order to do this, we shall have to find the areas in the company with the highest potential utilities because there would be no use in being the best in a non-existent market, one in which nobody demands that type of product.

Definition of objectives. Having determined the company's current position in its environment and the prognosis, we shall be able to establish objectives. These have to be prioritised and integrated, and have to cover all the functional areas of the company. For example, we need to know if the priority is to sell more or to make more profit because under normal conditions growth will not be parallel.

Selection and formulation of strategies. Under normal conditions, the company will have to choose from several possible strategies in order to achieve the objectives it has defined. In real life, this process is not at all simple because the strategies with the greatest potential usually involve the greatest risk, while the most conservative, or those which are least vulnerable to changes in the environment, are likely to be less promising. In academic terms, this is known as the "Multi-criterion decision-making method". It compares strategies from many different points of view:

- Economic and financial (profitability, risk, exposure...).

- Strategic or from the point of view of the company's balance sheet (product portfolio, technology, distribution of sales, market presence, etc.)

- Organisational (implications for the company's current organisation, need for changes, etc.)

Also, it is important to consider the results of each of them in different environmental conditions (definition of scenarios as optimistic, neutral or pessimistic). The tools used to measure each of the above aspects and to decide between the various options may be very simple or very complicated. It makes no difference. However many measurements are made, at the end of the process a decision has to be taken and only in exceptional circumstances will it be clear which is the right decision. It is therefore essential that the reasons for taking the decision are noted down clearly and precisely, as well as any relevant conditions (trial and error, empirical learning).

Let us take an example. Imagine a company that wishes to enter a new market. First it has to decide whether to develop a new product range on its own, through a joint venture associating with one of its competitors or simply by buying up that part of a competitor's activity. Although there are a number of well-known factors (degree of maturity, concentration, entry barriers, technological intensity, necessary volume of investment, etc.) conditioning the decision, there is no universal solution. The decision taken will depend on many factors.

So, let us imagine we have taken the decision (after doing innumerable calculations, measuring risks, analysing actions in the past and their effects, etc.). We now have to formulate the decision.

A very clear, concise document will have to be drawn up containing the most important statements about the company's future orientation, describing its basic positioning, the activities and processes to be promoted or multiplied and any implications for functional areas. Except for exceptional cases in which the company's mission would change, the formulation of strategies will aim to support what are known as "core competencies", that is, the technology and know-how that allows the company to offer something unique to its customers. (We shall see this in much greater detail later on).

Drawing up the strategic plan. Once we have decided on the strategy and formulated it, we must draw up a plan. A strategic plan is a series of actions which affect every one of the company's functional areas and which cover a specific time period. Budgets and members of the organisation must be allocated to the actions. The plan must focus on the main guidelines laid down when formulating the strategy. The time frame for applying the plan depends on the length of the business cycle in question because it must allow us to observe the effects on the company of any actions taken.

For example, the strategic plan of a newspaper kiosk may have a time period of months or, at the most, one and a half years (for reasons of seasonality). But the plan for an aircraft manufacturer can be no less than 3-5 years to take into account a 5-year period of development, 2 years for production, a product life cycle of 20 years, maturity of the sales contract of 2 years, etc.

Let us now look at business time cycles. Most companies have a basic annual cycle, in line with the cycle of its components (people) and company and tax activity. We all celebrate our birthday once a year, not once a month or every day. Within this annual cycle (which is covered by the annual operating plan), companies may have monthly or quarterly planning and control targets. Under normal conditions, the annual operating plan covers the actions in the strategic plan for that year in detail.

The next cycle is determined by the time period of the strategic plan which, as already stated, is a multiple (or variable) of the annual cycle. It determines the basic planning cycle but not the control cycle. If we wish to go even further, we can go on to the cycle of analysis and prognosis of the environment. This covers several strategic plan time periods. As you can imagine, the longer the cycle, the less focused and less intense the actions will be in specific areas.

Strategic plans, the main value of which is that they integrate and coordinate different aspects, acting as a vehicle to transmit the strategy, are sometimes divided into functional areas (Strategic Plan for Sales, Strategic Plan for R&D, etc). This allows them to serve as a necessary point of reference for actions in the functional areas. Sometimes they are based on strategic guidelines (guideline for growth, for internationalisation, etc.) rather than on functional areas.

Implementing the strategy. Once the plan has been approved, it must be put into practice (deployment and implementation). The plan may be an excellent one but if it cannot be put into practice it will be of no use. (A strategist not only thinks, but acts, measures, corrects, etc.). Although the plan, with its actions, targets, persons in charge and budgets, is the main direct method for implementing the strategy, the company also has indirect tools and measures (information, training, incentives, etc.) to support the plan.

An essential aspect is that the plan and indirect measures must take into account the company culture if they are to be successful. Although the traditional archetypes (ministry, public corporation, large national company, multinational, SME, etc.) are gradually disappearing, an aggressive plan cannot be applied in a “relaxed” company, and a “relaxed” plan would not work in a demanding company. You all know what I mean. The culture change cycle in a company is longer than a strategic plan.

Strategic control. Now we come to the last step in the process but it is by no means the least important. The purpose of strategic control is to check to what extent the objectives have been met. A series of index or reference variables are selected and target values are set for each of them, establishing margins for deviation that can be called the “orange zone” (poor) and the “red zone” (bad). The index variables work like traffic lights for the company’s strategy. If everything goes well (green), there is no need for special concern. If the orange zone is entered, then we must be cautious and prepare ourselves. If we enter the red zone, we must put on the brake and analyse the reasons why this has happened. Or procedures can be drawn up for when there is a large number of amber lights but no red lights.

The number of variables to be considered will vary depending on the type of company and its chain of value. But the variables must cover critical aspects of all the company’s functional areas and must not be too numerous. With ten or twelve parameters, it is possible to monitor the situation in a full-cycle company (with design, development, manufacture, sale and after-sales service), whereas five might be sufficient for a sales company.

What should be done if there are several red lights? It is easy to explain, but not at all easy to do. Table 2 showed that for each block there was a dotted line suggesting a feedback circuit. This means that if the result is not as expected (strategic control) we should check to see if implementation was correct, if the plan was properly conceived, if the objectives were “sufficiently reasonable” until we find where the mistake was made. In fact, the first thing to do is to check whether the environmental conditions are as forecast (which is hardly ever the case). Then we can analyse to what degree deviations in the environment were responsible for the situation and how we can restore things so that the initial objectives will be met or whatever objectives are considered valid in the new situation.

The whole process must be fast, and new decisions must be implemented immediately in order to ensure that the environment, which is never static, does not take over again

1.6 SCOPE OF APPLICATION

Having completed the process of strategic management, we shall now consider the scope of application. As stated above, companies may have one or several product/market combinations. Even a company that produces a single product, such as footwear, may serve several markets such as childrens', ladies', men's and sports shoes. These would be considered as four different product/market combinations. If each of them has specific characteristics such as life cycle, retail channels, price, technology, etc. they may require different strategies.

Each of these combinations gives rise to a strategic planning unit, or "Strategic Business Unit". This is a part of the company which:

- Has a quantifiable activity (annual accounts)
- Is able to decide for itself on most matters within its business area.
- Has a series of external customers allowing it to work in their markets.

The Strategic Business Unit is therefore a management unit, with an organisational structure and its own financial statements. The company's overall accounts are obtained by bringing together those of the different Units, plus expenses by the head office.

If we divide a company into strategic units (this would be a management criterion), the strategy would be divided into partial strategies, and each of the units may have a different strategy depending on its conditions (environment, market, competition, technology, etc.). The process therefore has to be carried out at the Business Unit level, adding results together for the company as a whole.

For example, a medium-sized hotel in a city centre could be decentralised into three Strategic Business Units:

- Accommodation
- Bar, restaurant and discotheque
- Assembly rooms and lecture halls

Clearly, the management skills required for each of these Strategic Business Units are different although they are all Inter-dependent and create important synergies.

I think it is easy to see that the main divisions of multinationals (such Lever Europe, Ford Europe, etc.) can be seen as strategic units. They are "quasi-independent" and report (and compete for funding) to their respective central corporations.

2. STRATEGIC OBJECTIVES

2.1 THE COMPANY MISSION

We have already defined the company mission as the activity to which the company is devoted. It is what lawyers call the company's purpose. For a strategist, the mission is much more than the company's present or future economic activity. Under normal conditions, the mission is related to what is sometimes called "vision" (the raison d'être of a company, the creative drive behind a business, etc.). The English-language literature talks at length about moving "from vision to mission", but I prefer to start with the mission.

When we talk about a company's mission, we are talking about its present and its future, about its basic business structure, about the type of product it plans to sell and its target customers. The academics give definitions that can be described as single-dimensional (by type of client, T. Levitt), two-dimensional (depending on the customer and the technology, I. Ansoff), three-dimensional (depending on the customer / type of need / technology, D. Abell, or profit / technology / customer, I. Ansoff). If we take this way of thinking to the extreme, we would even reach five dimensions – geographical, demographic, psychological, technological and utility sought.

One thing is clear. It is the entrepreneur who chooses his company's mission. This may be very specific. (For example, my company's mission is to sell rubber-soled shoes in the province of Albacete). Or it may be very vague. (For example, my company's mission is to sell hope.) In the first example, we have laid down all the basic parameters of the business: geographical area, type of product and customer, need to be met and technological level. In the second (Disney), we could say that everything is left open.

If I see my company as one that sells hope, then I must go beyond the means used (cartoons, films, songs, etc.) and focus on the reasons why a specific audience feels specific emotions when they see a Disney film. It may be more important to have a staff of outstanding psychologists and sociologists than to have the world's best cartoonists and graphic designers. In the same way, hope can be sold over a time scale of centuries or millennia even, provided there is a demand for the product sold (hope) and provided the means are adapted to the technology available at the time.

Sometimes, when it is difficult to define a mission, it may be defined by exclusion. People often say "that's not my business". We don't know what it is, but we do know what it is not.

A company's mission may change over time. It depends how it has been defined, and the speed at which its environment changes. A company that sees itself as "a passenger and goods transport company" would once have used coaches and railway carriages but now probably uses aircraft, trucks and coaches and in a hundred years time may use something like the "Enterprise". It makes no difference. It will still be a passenger and goods transport company.

Let us look at a different example. 3M, the well-known American company which sells thousands of different products (from cleaning cloths to adhesive tape), cannot be said to be a mining company, in spite of being called Minnesota Manufacturing and Mining. Clearly, its mission has changed during its long history. The large tobacco companies are another good example. For fifteen years now, in response to pressure from consumers and the administration, they are now becoming increasingly involved in the food business. What today is seen as diversification towards businesses involving less "social" risk may in fact be a change of mission for the medium term. Not only are such companies diversifying but they are extending their networks extremely fast all over the world and acquiring interests in other countries (Russia, India, etc.) where social pressure concerning smoking is non-existent (perhaps because they have other more important concerns).

In summary, what is important are not the words we use to define a mission, but the actual concept ("from vision to mission"). Only if the company understands its business fully will it be able to generate and develop competitive advantages, apply the concept of strategic business management and guarantee its future in the long term.

2.2 BUSINESS PHILOSOPHY

A company's philosophy, sometimess called company culture (although for many writers the concept of culture is broader than that of philosophy), is the set of patterns that govern the behaviour of its shareholders, managers and employees. It can also be defined as its set of values. According to the books, the philosophy or culture is stable over time. They give examples of very long-standing companies that have maintained their code of conduct throughout their history. But you all know that this is not entirely true in practice. I am sure you all know of people who can tell you how Seat has changed (before and after the German takeover), or Iberia, or IBM, or Telefónica, or any of the other companies taken over or involved in mergers in recent years. What is true is that culture changes are never fast. The balance sheets of two companies can be merged on paper in half an hour, but their cultures take years, or even decades, to merge. This is one of the most important challenges of a merger for any manager.

Below are some of the most practical aspects of business culture.

- Employee dedication. Some companies (especially consultancies or auditors) are governed by a meritocracy. This means that employees in all categories compete fiercely for promotion over a period of 5-15 years, without counting the hours worked or the holidays relinquished with the sole aim of gaining their reward (becoming a partner in the company). In such a race, normally the competitors who see they are unlikely to win will give up. There are also companies in which the employees do everything they can to work as little as possible, and others (almost all of them) in which the employees work as they are expected to, or more.

- Mobility. In some companies, mostly traditional or family-run ones, there is practically no job rotation and the key to the business is specialisation within the family. There is no geographical mobility for reasons of the company's business and location. Multinationals, however, require total availability to change jobs and place of residence from their staff. (This is the way to generate a company culture, by combining the contributions of employees of different nationalities). Rejection of a transfer (whatever the rules may say) generally puts a stop to the employee's rising career.

- A paternalistic relationship. Some companies give their employees a whole range of benefits (transport, meals, residences, discretionary use of the telephone, photocopies, etc.) obviously in exchange for a lower salary, whereas others prefer to offer a higher salary (and some even charge for private calls made during working hours). Employees tend to consider these benefits to be unalterable, to the extent that they may become a management problem, but one that is not linked to the company's mission.

- Creation of value. Creating value has become a catchword in recent years. Entrepreneurs no longer say they want profits but that they want to "create value for the shareholders" (and imply only for shareholders). Surely it would be better if companies created value for everyone involved and shared it out? No doubt things will improve!

We could also say that a company's culture is a set of positive values (regarding people, promotion of the best candidates, impeccable conduct by the senior management, compliance with internal rules and regulations, etc.) or negative values (authoritarianism, nepotism, secrecy, doubtful conduct by the management, etc.). A positive culture will help to motivate staff and will create a pleasant working atmosphere.

But that's enough for the time being. We could also talk about the relationship between the management and the employees, the influence of remuneration systems, information management within the company, the balance between the management and trade unions and many other facets of business philosophy or culture. It is important for you to understand how all these factors may affect the way in which a strategy should be drawn up because, unless the ground has been properly prepared, whatever we sow will not grow.

2.3 STRATEGIC OBJECTIVES

By laying down objectives, we establish what it is we wish to do and when, but now how. Objectives at a secondary level may be called goals, that is, each of the intermediate steps we need to climb if we are to reach the ultimate objective. Objectives are both the means and the end. By definition, they are an end, but they can also be seen as a means on which to build the objectives of the following year, or those of the unit immediately above.

In a company as a whole, we always find what we call “conflicting objectives”. Imagine a company in which the shareholders, managers and employees are all different people. The following will occur:

- The employees will want to earn more and work less.
- The managers will want to earn much more, especially if the company is profitable.
- The shareholders will want to increase short-term profitability without spoiling the long-term position too much.

Clearly, this is a difficult equation, one with no solution. Only if the three parties give way will it be possible to obtain a coherent set of objectives, which is essential from the strategic point of view.

Another version of conflicting objectives concerns timing. On a day-to-day basis, company decisions for the short term may have a pernicious effect in the long term, and vice versa. Imagine a company which owns its office but is having cash-flow problems. It will be tempted to sell the office to obtain the cash it needs in the short term but, if it does so, it will then have to pay ever-increasing rent or buy a new office in the future, which is bound to be more expensive. It will therefore need to find another way out of its cash-flow problem.

These problems—conflicting interests, and timing—do not exist in limited liability companies in which shareholders, managers and employees may be the same people (although they are likely to have other problems).

Let us now consider the basic conditions to be met by all objectives. They must be:

- Measurable so that they can be audited and checked.
- Appropriate. This is import both for those laying them down and for those receiving them.
- Achievable. If they are considered impossible to achieve by those receiving them, they will be demotivating and, if they are too easy, they will require no effort at all.
- Timed over a period rather than concentrated in a single milestone.
- Specific, clear and concrete.

From the strategic point of view, objectives must also be:

- Prioritised (see the table below). This is an essential condition for strategic objectives. The head of the company must be clear which of the objectives are the most important and which are of secondary importance. This is not always easy because, when things are not going well, it is difficult to know where to begin. ("It never rains but it pours".) But it is essential to establish priorities for action and improvement. For example, under normal conditions, increased sales will not tie in well with a cost reduction. It will therefore be necessary to decide which of the two is the most important and establish the objectives accordingly. In the same way, in complex business structures, priorities will depend on the organisational hierarchy. So, if the corporation's basic strategy is a conservative one (maintaining assets at all costs, with no growth, no investments, frozen salaries, staff reduction – does this sound familiar?), it will be very difficult for any of the divisions to successfully adopt a growth strategy (increased sales, assets, investment, staff, etc.).

Table 4 below shows the hierarchical pyramid of objectives, with their various steps. Having reached this point, I think we should clarify the word "goal" as used in strategy jargon. Strategic goals are the highest-level objectives in the planning horizon. One of the largest Spanish companies recently stated that its two strategic goals for the next five years were:

- To double sales by purchasing other companies and increasing local capability

- To double profits by increasing turnover and substantially increasing productivity.

In order to achieve these goals, it will be necessary to establish a set of objectives, such as the sale of assets that are not necessary for the main activity, capital enlargement in order to buy up other companies, identification of potential purchases, etc. In addition, each of them will have to be broken down into partial objectives for each of the five years of the planning period, and these objectives will lead to actions, giving a whole succession of actions for the company as a whole.

In these notes, I do not talk about “goals” because business today prefers the word “objective”.

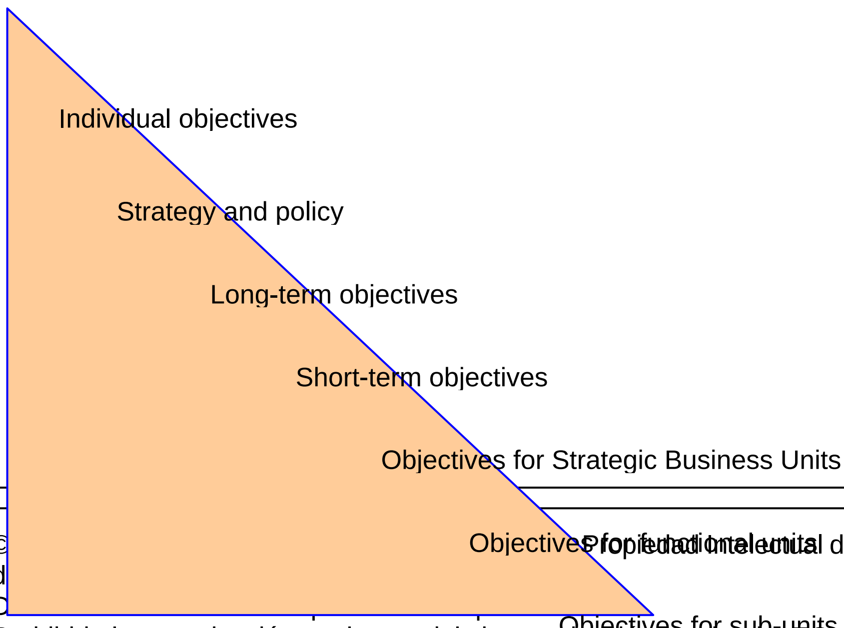


Table 4: Prioritisation of objectives

- It is also essential for objectives to be integrated. There are many actions in the day-to-day functioning of a company that may have opposing effects. These must be taken into account when establishing objectives. For example, if a company wishes to increase its sales by XX% and sales per employee by YY%, it will inevitably have to make large investments (to improve productivity, to increase sales actions, to motivate employees and perhaps to dismiss some of them). If no investments are made, it will not be possible to achieve the objectives, unless the starting situation was disastrous (which would indicate that the managers were at fault).

- Objectives must cover all the company's functional areas (Table 5). As I stated in the introduction, a company should be a unit in which the component parts work together in relative harmony. If the strategic objectives focus on a single functional area in the company, the others are likely to feel underrated by the management and the whole company will become unbalanced. This makes for a difficult situation at a time when the main aim of companies in the capital market is to "create value for the shareholder". We have to accept that profit (or dividends) is the best parameter for measuring a company. It is therefore bound to be one of the objectives but it must not rule out all the others. For example, a very large margin may lead to lower customer satisfaction which, in turn, would bring down future sales and reduce the long-term margin.

TABLE 5: POSSIBLE AREAS FOR OBJECTIVES
➢ Customer service ➢ Financial resources ➢ Human resources ➢ Presence and participation in markets

- ➢ Organisational structure
- ➢ Facilities
- ➢ Product development
- ➢ Social responsibility

- There must not be too many objectives. If every step on the list of priorities involves a large number of objectives, then probably the organisation as a whole will have no sense of direction. Every individual in the organisation—from the Chief Executive Officer to the non-skilled workers—should have a limited number of objectives that are appropriate to his or her position within the company.

- Everyone must participate in drawing up objectives. It is very important that the three 'powers' in the company participate, that is, the shareholders, the management and the trade unions (in representation of the workers), not only in actually establishing and accepting objectives, but in the effort required to achieve them. Only if everyone shares the objectives will the company function as a unit. (There is a growing trend towards making employees partners in their companies, and even towards remunerating them in accordance with the company value.)

- Objectives must be drawn up in line with the company philosophy or culture because this largely determines the company's attitudes and its reaction to changes in the environment. It is therefore necessary to take culture into account before establishing objectives in order to avoid unpleasant surprises, and to remember that to change a company culture (or the culture of a society) is always a long process (with regard to the company's planning horizon).

2.4 BUSINESS ETHICS

Ethics is basically the search for a correct way of living a human life. In our case, business ethics searches for the correct way of running a business. This is easy to say, but difficult to put into practice. For a start, we tend to treat the concept of what is ethical and what is not as a relative one. Some people even claim that it is impossible to find minimal ethics that can be applied to all human beings. Others adopt a utilitarian approach and define ethics as obtaining the greatest wellbeing for the largest number of people at the lowest cost.

Let us try to focus on our own socio-economic environment and on our own times but without attempting to establish standards for business ethics. You will all understand that working conditions in Spain today are not those of an under-developed country. Nor are they similar to those in Spain fifty years ago. For example, we might consider whether or not it is ethical to use company resources (telephone, fax, photocopies, etc.) for private purposes. Rather than an exceptional practice, these things are sometimes done as a matter of course. Workers in the third world would never even pose this question. Nor would they think of claiming five weeks' holiday, nor consider whether or not it is correct for them to cut down their trees.

Clearly, it is not easy to adapt ethical considerations to today's socio-economic circumstances. An entrepreneur not only has to consider whether an action is ethically correct but whether the competitor will do it if he decides not to. In such an environment, ethics has to be considered as a necessity and not as a management tool. It has to form part of the company culture and has to be an integral part of its market position. Customers, suppliers, competitors and other agents in the environment know (and appreciate) that the company behaves and will continue to behave according to certain standards.

From the point of view of strategic business management, ethics affects two main aspects—the company mission and its objectives. Concerning the former, it is clearly not ethically correct for the company to carry out damaging or illegal activities. It is as correct to run a bar as to "encourage responsible drinking" amongst one's customers. The same can be said of a gymnasium and doping, or any other example you can think of. Regarding objectives, we have already mentioned several times the need for everyone to participate in order to reduce and mitigate the conflict of objectives that is one of the components of business life.

From the point of view of day-to-day operations, there are two areas for business ethics—internal and external.

Externally, the company has to respect the basic rules for dealing with its suppliers and customers (cleanliness and hygiene) and in its advertising, leaflets and promotions. Also important is that managers and employees should not hold shares in competitors, suppliers and associated companies. In-house, of importance are compliance by both the company and the workers with labour legislation, and with the company's internal rules and regulations.

Before we close, I would just like to comment on one of the most delicate aspects of business ethics—management responsibility in times of crisis. Managers have to decide on the company's future and sometimes the competitive environment forces them to take extremely painful decisions (selective redundancies, mass staff transfers, etc.). Under such circumstances, they have to make clear what the company's ethics are, both for those who leave the company and for those who remain, for customers and for suppliers. Although obviously we cannot determine ethical standards, an unethical company will be recognised as such in its competitive environment and will soon find that its customers are also unethical and will make its life anything but easy.

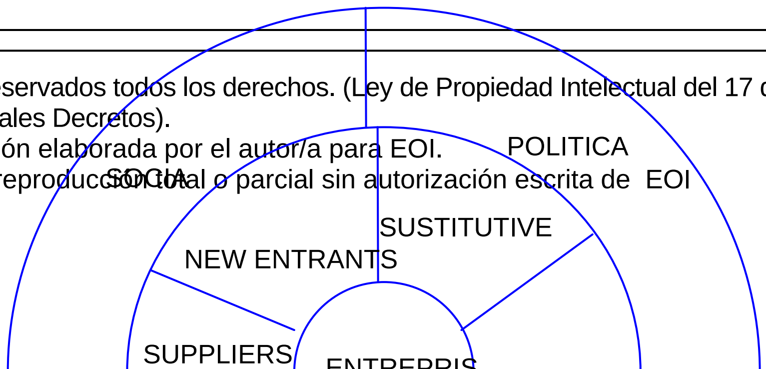
3. Strategic analysis

3.1 Business environment: definition and types

Generally speaking, an environment is what surrounds something. In the case of business science, it can be defined as "the set of social, cultural, political and economic conditions that affect our organisation". As already stated in connection with a company's strategic direction, we analyse the environment in order to identify opportunities and threats. Companies, which we always tend to look at from inside, obtain their resources (labour, supplies, services, finance) from the environment, and return profits to their shareholders via benefits obtained from the environment (market, customers), after winning the battle against their competitors (environment). This explanation should be sufficient to show that it is necessary to look outwards rather than focusing on what is going on internally.

Graph 6 shows the classic division of the business environment into two steps or categories: the nearby environment, also called the microenvironment or the specific environment, and the wider environment (macro-environment or non-specific environment).

Graph 6. The business environment



At the centre of the graph is the company, the central point of our activity. Then the first circle as we move outwards includes factors in the nearby environment—competitors, customers, suppliers and the threats of possible substitutes or of new entrants. These are the so-called competitive forces (M. Porter). In the outside circle are the factors in the general environment which are the political, social, economic and technological factors. This lesson will cover each of them in turn.

There are several reasons why the environment has been divided into two categories or steps. Firstly, physical proximity. Clearly, companies are in contact with their markets (customers) or competitors on a daily basis. They are not always, or have not always been, in contact with the social reality of their location or with the legal framework or with technological innovations in the sector. They automatically pay (or paid) more attention to one than to another.

There are also purely technical reasons. I have already said, but it is important to insist, that factors in the wider environment may affect a company and its competitors differently, so that advantages are different for each of them. Remember the examples given.

As a result, the traditional writers say that it is the nearby environment which holds the key to success or failure, whereas the wider environment determines progress for the companies in a sector. As you can imagine, I do not agree with this. I think they are both equally important.

Today's rapid process of globalisation blurs the frontiers between the two, but what is important is that you understand the concepts rather than the frontiers. I shall therefore refer from now on simply to the environment.

The basic characteristics to consider when defining an environment are stability, complexity, diversity and hostility.

An environment is said to be stable when it does not change over time. (Changes should not be measured in absolute terms but in relation to the basic cycle of our business). It is said to be dynamic when it changes over time.

An environment is simple when only a small number of parameters are required to define it, and complex when a large number of parameters are required.

An environment is integrated when changes in the parameters defining it are known or can be find out, and diverse when the parameters behave unpredictably or at random.

Finally, an environment is favourable when changes in it do not affect the company's future. Otherwise, it is described as hostile.

If we combine each of the possibilities we can obtain different types of environment (some of them will be ridiculous). The two extremes are what are known as the stable environment (stable, simple, integrated, favourable) and the turbulent environment (dynamic, complex, diverse, hostile). You now know that the famous turbulent environment, which receives so many mentions in publications of all types, is an environment which changes, which depends on many different parameters and which may create risks for the company.

What is most important is that the type of environment in which a company works has a great effect on its strategy, its type of management and the effort it has to make in drawing up an analysis and prognosis of the environment. (All the above theory has been given just to make you concentrate on these few lines). A company working in a stable environment may be conservative in its strategy, procedures, technology, etc. And it will not need to devote much effort to analysing its environment (an unusual, but fortunate situation). On the other hand, a company working in a turbulent environment must necessarily be creative in its strategy and flexible in its management and will have to use resources in order to understand and forecast the future of the world around it.

Let us look at some examples. A street-seller who sells sunflower seeds (or, to use a euphemism, a sunflower seed entrepreneur) lives in a stable environment. His basic business cycle is very short—market research, product design, development and standardisation, purchase of supplies, production, distribution, sale and collection in seven days. He does not need to pay much attention to his environment. He will just have to count the number of children entering school on 15 September every year since they probably account for 80% of his sales, and compare it with the number the previous year. He will then have to calculate per capita consumption over recent months. If there are no surprises, everything will run smoothly. But if the number of children decreases, or if sales decrease, then he will have to take action. He will have to start by checking the census in his district and the number of schools. He may even have to ask for a new licence and change his location. Unless his stand is blown away by a hurricane, he will see rises and falls in unemployment, in inflation, interest rates, and may see changing tastes in sweets or in stickers, but he is unlikely to have much reason for concern. His type of business, with a short cycle, few fixed assets and an almost captive clientele, will in principle defend him from changes in the environment.

Imagine what might happen to a person whose job it is to produce and sell nuclear power stations for the production of electricity, and you will see that he is at the other end of the scale.

3.2 BUSINESS ENVIRONMENT: PROGRAMME, FORECASTS, SCENARIOS

From the above examples, you can see the need for companies to have a programme for analysing their environment. This must include a systematic method for monitoring and forecasting changes in both the nearby and wider environment.

So there is no doubt that monitoring the environment is essential. We must not be caught unawares by a new law, or new technology or an alliance amongst our competitors. If the environment moves fast, so must we. It is also clear that this activity must be regulated and systematic. Even the sunflower seed seller knows that, every September, he has to note down the number of children at the school gates and do some calculations.

So where is the problem? The problem is that it costs money (yet again, conflicting objectives). Analysis of the environment is an activity that has to be funded and that, under normal conditions, will not provide short-term returns. It is not necessary to know everything—that is the job of the research institutes—but the company does need to know everything that may be of relevance. It is a question of finding out about any opportunities and threats rather than just collecting data.

Therefore, cost-effectiveness criteria need to be applied, to determine what is the minimum information required and to what extent funds are available. The scale factor is also of important. The sunflower seed seller may have to make a greater effort in proportion to that made by a multinational.

What is important is that no company, whatever its size, can turn its back on its environment. The intensity of the activity and whether it uses internal or external resources or combinations of them will form part of the company's strategy. Also defined in the strategy will be the involvement of the management and of the most highly-skilled staff, and the scope of reports on the environment and how they are used within the company. I personally believe that the information on the environment should reach all the staff so that they all feel involved in the process of collecting information.

As soon as we have understood what is going on in the environment, we face the challenge of determining what will happen in n days, months or years, in line with the company’s planning schedule. Environmental forecasting is difficult but essential because it provides the external reference for the strategic plan. Forecasts must be duly documented because they can be considered part of a quasi-empirical process in which experience is fundamental (we have to learn from our mistakes). Under normal conditions, companies use a combination of methods or techniques, such as Delphi, brainstorming and the impact-trend method.

I shall now briefly describe the last of these three. The impact-trend method combines mathematical analysis (trends) with the effects produced by a series of external factors (impacts) on the variable in which we are interested. The value obtained, via historical extrapolation or regression, is corrected by the impacts (which may be specific, sustained, exponential, etc.). These impacts are caused by factors which may come from outside and have little connection with the day-to-day business of the company.

To take an example, imagine that it is 1988 and that we want to forecast traffic at Barcelona airport. Forecasts are normally made over twenty-year periods, so that development of the airport can be planned over two consecutive ten-year periods. Obviously, the historical series in traffic growth is known, as are the factors that are most appropriate for calculating regression (population, economic growth, foreign trade, etc.) as well as future trends in these variables. To depart momentarily from our subject, do you realise that these variables are general, not specific? And you must remember that, with annual growth of 5% (a long historical series), volume almost triples in twenty years (or quadruples, with 7%).

With all of this data and after a more or less complex process, the computer produces the estimate (trend, extrapolation, regression). We now have to take a series of factors into account (Olympic Games, European Union, saturation of Barajas airport, second gate to South America, etc.), which might involve impacts that are very relevant for our prediction. The values for each of them should be determined in collaboration with experts from the various relevant sectors (Olympic Committee, Ministries, Autonomous Government, etc.) in a Delphi session, for example.

Companies often devise different scenarios and carry out full planning for each of them. (Computers help enormously!). If we select an optimistic scenario, a neutral one and a pessimistic one, we can limit the sweep of key variables in the strategic planning process. In order to establish a scenario, first the factors or events that may affect our future to a greater or lesser extent have to be selected. Then we establish brackets for each of them and calculate the most probable values. Finally, a series of possible standard structures for the future are built up. (Note that some combinations might be ridiculous).

So, for the airport, we would have an outline as follows:

	Optimistic	Pessimistic
Growth	5	2
Type of society	leisure	work
Stability	high	low
Degree of competition	low	high
Air saturation	low	high

As you can imagine, figures can be allocated to each of the variables, although I felt it did not help in this example. Nor did I consider unlikely scenarios such as worsening conditions for tourism in the area, extensive consumer sales of flying saucers or lack of confidence in air transport.

3.3 Analysis of the general environment

As I have already stated several times, there are a variable number of factors that determine the wider environment. For simplicity, we have reduced them to four:

- Political and legal factors, such as:
  - Political and social stability
  - Government policy
  - Laws
  - Business control

- Economic factors, including:
  - Economic growth
  - Inflation rate
  - Interest rates
  - Balance of trade

- Technological factors
  - Degree of obsolescence
  - Technological intensity
  - R&D+i support policies

- Socio-cultural factors, including:
  - Demographic trends
  - Lobbies
  - Environmental awareness
  - Social consideration of work

We will have to analyse the situation and probable trends for each of these factors, bearing in mind that what we want to pinpoint are opportunities and threats for our company in its current business and in any business it might undertake in the future. The greatest danger in these cases is that of obtaining a huge amount of information but not knowing what to do with it. It is therefore necessary to make an effort to use only information that is relevant, especially for the purpose of presentation.

Factors in the wider environment usually change greatly in the long term, are often difficult to discern but may determine the company's future in the long term. (Remember the case of the sunflower seed seller. He might, for example, find his area is being pulled down and replaced by office blocks). Think of the future of companies making products for children in a society with such low birth rates as in Spain. There are thousands of examples. Consider the future of our society. Will it be run by computer, will we have genetically-modified animals or will immigration speed up, or will there be a combination of all these?

In the European environment and at least until the European Union process becomes standard for all purposes, political and legal factors (resulting from the transfer of power from national States to Brussels) may be dominant. I refer to processes for the approval of mergers, the monitoring of competition, large-scale privatisation processes, etc. The same will happen with R&D+i standardisation policies within the EU.

In many cases, the changes we note in the wider environment are little more than hints of a phenomenon that affects all the above-named factors and those in the nearby environment to be seen below.

Globalisation is a macro phenomenon. It is taking place on a planetary scale and basically brings standardisation of habits at end user level, which results in increased size of companies as they join forces to meet the demands of a gigantic market. Globalisation results in far-reaching change in market structure and competition so it needs to be analysed in detail from the point of view of its implications for business.

3.4 ANALYSIS OF THE NEARBY ENVIRONMENT

This comprises competitors, customers, suppliers, substitutes and the threat of new entrants, what Michael Porter described over twenty years ago as competitive forces.

Mr Porter defined competitors as “anyone who might erode my margins” (as opposed to “anyone who sells in my place”). His model of the five forces reflects the fact that competition in any sector is not only activity by competitors (the most obvious form of pressure) but also interaction between the five forces. Together they determine the intensity of competition, profitability in the sector and, consequently, its future prospects. For example, if a sector is obtaining limited returns, it is unlikely to be able to fund the development of substitute products in the same sector.

Competition operates continuously and is balanced by the pressure that investors apply in that they will not allow their returns to drop below a certain level, which will depend on the perceived level of risk in the business. If profits fall below this threshold, investors will take their capital elsewhere in search of better investment opportunities. (Take a look at the comings and goings in the Dow and Nasdaq indices).

Let us look briefly at how each of the five forces works:

- Threat of new entrants. The appearance of new companies in the sector will bring increased resources and capability and, in principle, will involve an attempt to obtain participation in the market at the cost of those already in it. They upset the balance and make it necessary for existing companies to adopt defence mechanisms (reducing prices and/or enhancing quality and service).

  The possibility of entering a sector basically depends on two factors: the capacity for reaction of existing companies (through technology, finance, production, etc.), and any entry barriers. The most characteristic of such barriers are:

  - Economies of scale. These make it possible to reduce unit costs because of volume of production (and sometimes because of the experience effect). Note, however, that economies of scale may also be an exit barrier for those already in the market, as in the case of automobile or aircraft production.
  - Product/service differentiation. Customer loyalty makes it necessary to make very large (and risky) investments in order to dislodge the traditional supplier. This is critical in markets in which confidence is essential (banks, pharmaceutical companies, etc.).
  - Capital requirements, especially when capital outlays have to be made initially or when it is difficult to recover capital (as in the automobile or steel-making industries).
  - The cost of change. There are many products and services in which the purchaser has to fund additional costs if he wishes to change supplier, mainly because of logistic aspects (training, spares, warehouses, etc.).
  - Access to retail channels. These may be controlled, making access very difficult. Channels may raise their prices or competitors may lower theirs.
  - Other factors, including patents, privileged access to raw materials, location, government aid, etc.

- Competitor rivalry. This occurs when one or more competitors feel pressured or note an opportunity for improvement. The degree of rivalry will depend on a series of structural factors, including:

  - A large number of competitors, or very balanced competitors.
  - Slow market growth. When markets become stagnant, the only way of improving results is to increase one’s market share at the cost of one’s competitors.

- High overheads or storage costs. When this occurs, it is necessary to make great efforts to operate at peak capacity, or at least above breakeven.
- Low price differentiation. Consumers are attracted by the price, so competitors will tend to lower their prices.
- Strategic interests. In certain markets, it may happen that several important companies simultaneously attempt to consolidate their positions by using disproportionate amounts of resources.
- Exit barriers. When competitors find it difficult to leave a market that is no longer of interest, their competition will be intense, especially if there are exit barriers such as specialised assets, fixed exit costs, social restrictions or emotional barriers.

As you can imagine, from the point of view of barriers the best sector to be in is one in which entry barriers are high and exit barriers are low, but unfortunately such situations hardly exist in real life.

Pressure from substitute products. The price/quality ratio of substitute products may limits price levels in their sector. Substitute products can be manufactured by companies that belong to the sector or by others from outside it, a potentially risky situation. Companies in the sector may react all together, or they may not react at all or they may meet customer demands by adapting the product. For example, a cruise ship cannot compete with an aircraft as a means of passenger transport, but it is still an excellent means for taking a luxury holiday.

From the strategy point of view, it is important to pay attention to products that at first sight would not be considered substitutes. An example would be videoconferences as against the use of air travel plus hotel accommodation.

- Purchasers' negotiating power. Purchasers may force prices down and quality up, affecting profits for the sector. Their power will increase if:
  - They are concentrated, or they buy large relative volumes
  - Raw materials are costly
  - There is no product differentiation
  - The cost of changing supplier is low
  - There is no threat of integration
  - They have complete information
  - Quality is not an important consideration

I am sure you can think of examples for each although, fortunately for suppliers, no example will fit all the above categories.

- Suppliers' negotiating power. Powerful suppliers may threaten to raise prices and/or to reduce quality. Companies in the sector may see a fall in their profits if they are not able to pass on such increased prices to the end consumer. Their power will increase if:
  - They are more concentrated than the sector which purchases
  - They are not forced to compete with substitute products
  - The purchaser is not an important customer
  - The product is important for the purchaser
  - The product is differentiated
  - They represent a threat of integration

All these forces interact and change constantly.

Our objective is to place our company in a position in which it can defend itself from the threats posed by competitive forces.

3.5 INTERNAL ANALYSIS

Once the external analysis has been completed, we have to analyse the company internally. Though this is called 'internal analysis', what it really does is to analyse the company in relation to its main competitors, in order to find aspects in which the company is better than others (strong points) and in which it is worse (weak points). This is sometimes called 'benchmarking'. In a football match, the 'bench' is where the substitute players wait, watching how the others do things and waiting for their opportunity to do things better than they do. This is similar.

The greatest problem is that we have to be impartial in assessing both our own capabilities and those of our competitors. Either the classic method can be used or analysis of the chain of value.

- The classic method is considered by many writers to be the prime tool for strategic diagnosis. It aims to build up what is called a strategic profile (See graph 7).

GRAPH 7. STRATEGIC PROFILE

Sales capacity

- Products
- Retail network
- etc.

Production capacity

- Modern facilities
- Suppliers

R&D capacity

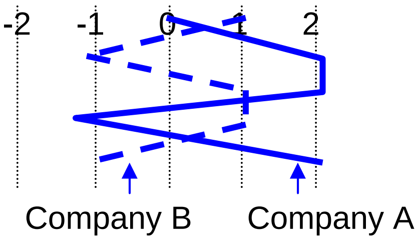
- Quality and number of patents

Economic and financial capacity

- Equity
- Cash flow
- etc.

Management capacity

- Management style
- Quality of human resources



The procedure building up a strategic profile is as follows:

- First, the key factors for success in the business must be determined. Normally they are grouped by functional area. Remember that the key is to use just four, five or six key concepts. If we have twenty or so, they will have to be placed in groups.
- Assess the company's capability regarding the key factors. This is usually done on a scale from –2 to +2 (very bad, bad, normal, good, very good). But if this complicates things, a scale from –3 to +3 can be used, or any other you feel is reasonable. The sector's standard is implicitly represented by '0' (normal).

- The profile obtained should be drawn graphically and compared with that of the main competitor(s). In the areas on the graph in which I am to the right of the competitor, these will be my strong points, and in areas in which I am to the left, these will be my weak points. Sometimes comparisons are made with the market leader (benchmarking) to see how far we are from him and in which business areas.
- Analyse the time frame for the profile and compare with that of the competitors.

Graph 2 shows the classic examples of a new company A, which has modern facilities, staff and management techniques but has limited presence on the market and a limited financial position in comparison with company B which has greater presence on the market and more money, but older facilities, staff, and management methods.

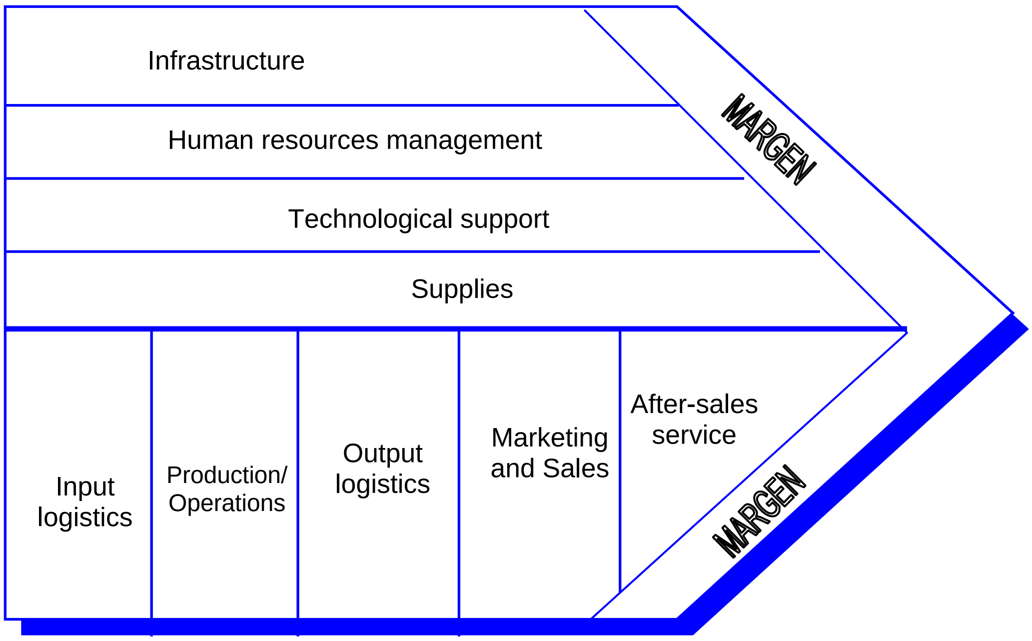
A example of a strategic profile, but for a product rather than a company, can be seen in weekly automobile magazines when they talk about ‘comparative trials’. They rank factors from 1 to 10 to make things easier for readers and in order to distinguish between options which are very similar. Sometimes these are shown graphically. You can also see how factors are grouped together: acceleration, braking and speed all come under ‘performance’; materials and finish come under ‘quality’.

It may seem that not all the information is available for drawing up a strategic profile. But a profile is the simplest tool and if I am unable to build one, then I am unlikely to be able to decide between two strategic alternatives or to implement a new one.

Before we close, it is important that you remember that the key to correct use of a strategic profile is to be neutral in the self-assessment.

- Value chain. This is the way in which the company gradually adds value to the products and services it sells, as it completes the successive stages involved in converting raw materials into a finished product and then places this in the hands of the end consumer. Figure 8 shows the traditional concept of chain of value.

GRAPH 8: VALUE CHAIN



However, if we dare to be more radical, we could say that companies generally buy, transport, manufacture, store, transport, sell and post-sell, using R&D, administration, finance and human resources (the key is always in the line). And it is not difficult to argue that at each of these steps the company only adds cost, not value. Only at the end of the chain does the product or service pass to the customer (or market) and it is then that the product is recognised as having a value. Depending on the extent to which the value is greater or less than the added costs, the company will have a profit or a loss. Obviously, if it obtains a profit, this will have to be calculated on a pro rata basis for each of the steps in the chain. Otherwise we would be giving all the merit for the operation to the salesperson.

So, what is the objective? It is to analyse how efficient our company is at each of the steps of the value chain, comparing it with the sector standards. This process has many advantages:

- It allows for analysis from outside in.

- It allows for identification of the aspects that are most relevant from the point of view of competition, relegating others
- It allows us to see our strengths and weaknesses against the importance of each of the steps (the strategic centre of gravity and key factors for success).
- It allows us to measure our resources and what options we have to relocating them.

However, it is not always easy to obtain the information we need to continue the analysis right the way through, especially regarding comparison with our competitors.

Let us look at two examples to illustrate the two main concepts.

Imagine you are in a business in which purchases account for 50% of sales (for example, in automobile manufacturing). Your strategic centre of gravity will have moved to the left (purchases), so the company should therefore use its best resources at that stage. It would be silly to make a great effort to improve transport costs, which are negligeable in comparison with purchases. If you think about it, you will realise that revolutions in this sector in the last twenty years have always taken place at the purchasing step, and that the purchasing managers are usually the number 2 in their companies.

Now imagine that a manufacturing company, which has seen substantial cost increases in its factories, carries out a comparative analyses and finds that its competitors are much more efficient that it is at that stage and that internal and external conditions are not going to allow it to get over this. The strategic decision is clear. The company will have to outsource components for the end product to other suppliers who can offer the goods at prices lower than its costs (the centre of gravity moves towards purchases). The speed of this change will depend on conditions in the company (again, flexibility is vital):

These two examples illustrate situations in which there is apparently no problem at the level of sales, or at least there is no problem in reaching the sales objective. We can easily imagine the opposite case. Think of a company that sells its products through agents, but that is noting—and beginning to worry about—a decrease in sales volume. It is likely to take on sales staff (probably increasing cost per unit sold) in order to recover its previous volume (and continue being competitive).

Essentially, we have to find a way of determining our company's weak and strong points and comparing them with its competitors.

Sometimes, however, there is not much point in carrying out external and internal analysis because things change too fast.

3.6 GLOBALISATION

Although this chapter is getting too long, I feel we must discuss the inescapable subject of globalisation.

Globalisation is the process whereby much of the world's economic activity takes place irrespective of national frontiers. People started talking about it in 1984 and today it is a household word. There are a number of factors, such as free movement of capital, cultural dissemination, ease of travel, the elimination of trade barriers, etc. which indicate that the tendency towards a more global economy is unstoppable, and that the former 'multidomestic' model will become a thing of the past, at least in much of what we call the developed world.

Before going into greater detail, I think I am morally obliged to say that, in my opinion, globalisation favours, first, large countries and, second, large companies. This means that those gaining the greatest benefits are large companies in large countries. (Consider Spain's position). This indicates what future trends are likely to be.

From the strategic point of view, and with regard to the environment (leaving other aspects to subsequent lessons) we see the following effects:

- Generalisation of the inter-linked economy. Since all countries are more or less related, with foreign trade growing at three times the rate of the economy, when one country goes through a bad patch, these effects spread to other.
- Legal, fiscal and labour conditions gradually become standardised in large geographical areas.
- The role of the State in the economy and in business life is gradually changing. The State is no longer able to maintain exchange rates nor to defend its currency.

- Standardisation of life styles in developed countries leads to the appearance of segments (which can be measured, are stable and similar, etc.) in countries separated by large distances. Only large companies can respond to their needs. But here we need to make a comment. Although at one extreme of globalisation it is true that, wherever you are, you can find Coca-Cola, globalisation does not necessarily mean that products will be standard for a standard market and will necessarily be manufactured by a gigantic multinational. The fact is that the life of a newly-married couple in a Madrid suburb is very similar to that of a similar couple in a Paris, Munich or Roman suburb, but not to that of a couple in Escarabajosa de Cuéllar (Segovia) or Bollullos del Condado (Huelva). In order to serve those in the former group, you will agree that size is necessary.

- Competition makes it necessary to constantly improve products and processes in terms of added value. Management of the chain of value becomes critical. Technologies and products are moved around in line with added value and unit costs. For example, almost nobody sews in Spain any longer, nor is coal mined, and soon only specialist ships will be built. It is preferable for sewing to be done in Morocco at 100 a month and then to transport the ready-made garments than to sew them in Galicia at 500 a month.

- Domestic competition and competitiveness are essentially a micro phenomenon—accrued competitiveness of the companies in a specific region or country—rather than a macro phenomenon associated with social conditions. No nation, not even the USA, is competitive in everything.

- ‘Value migration’ processes make it necessary for strategies to be more flexible than ever. Fifteen years ago it was important to build a computer. Now what is important is the software that allows us to operate correctly both in isolation and in association with others. Fifteen years ago, Spain was full of small, family-run garages, and we all knew how to do basic repairs on our Pandas, R-5s or Minis. Today, it is not possible for a private person or poorly-equipped garage to carry out programmed vehicle maintenance, however simple. The large manufacturing companies have now taken over the chain of value and it is they that now carry out these tasks.

We could go on talking about this subject throughout the course if we wanted. But it is important for you to note the degree of globalisation in the sectors in which you work because it will, to a large extent, determine your companies’ attitudes to their markets and competitors, and will most certainly condition your own future.

4. Strategic alternatives

4.1 Growth strategies

Growth is the basic option in business life. It is a natural movement and much has been written about the different types of growth. In this section, we shall discuss competitive strategies, diversification and what are called growth styles.

4.1.1 General competitive strategies

Professor M Porter described competitive strategy as “taking offensive or defensive actions to create a portion in the sector that can be defended in order to successfully face competitive forces and thus boost returns”. Competitive strategies are tactics which serve to gain the upper hand over our competitors.

Although Porter never stated that he was talking about growth strategies, clearly all actions aim to keep us on the growth track, whatever the size of the company or its profits.

In order to deal with the five competitive forces, there are three potential strategies for success that should help companies to operate better than their competitors: general leadership in costs, differentiation and approach, or high segmentation.

General leadership in costs

This strategy was fashionable in the 1970s because of popularisation of the experience curve concept. It was based on aggressive construction of large facilities that could produce large volumes efficiently, rigorous cost reductions using the experience curve, strict controls on indirect costs and minimisation of R&D costs, customer service, advertising, etc.

Today, I would say that the strategic option for cost leadership is based on good management of the chain of value, which leads companies to outsource activities in which they are not competitive from the cost point of view, maintaining only those which are necessary from the point of view of perceived quality and customer service. Even today, the low cost option usually requires a large market share, large investments in industrial equipment, extensive product lines and high productivity. I think priority access to raw materials, which used to be fundamental, is no longer relevant (at least from this point of view), whereas purchasing capablity in international markets and access to distribution are essential.

When a company leads in costs, it can defend itself against its competitors because it is able to obtain profits when they cannot even if it prices are reduced. It can also defend itself against powerful purchasers because they will only be able to bring their prices down to the level of the competitor which is second best in efficiency. Also against suppliers, because the company will be more flexible than others in a situation of price rises. The same reasoning can also be applied to new entrants and substitute products.

A cost leadership strategy, however, may expose us to the risk of technological change because we would be tied to machines using previous technology. Think of the revolution in clock-making (quartz as opposed to mechanical working), or computers (valves as opposed to chips) or, much more recently, diesel engines as against petrol engines.

Now let us consider two basic aspects.

- First, the cost leadership position is still valid for competing, as it was thirty years ago. The resources and techniques required to reach such a position have changed and will continue to change. This is a general comment that can be applied to practically all the theory on competition and competitiveness.

- Second, if we use the chain of value concept, you will realise that, previously, the cost leadership position implied a certain domination of the production system (a centred chain) whereas today it centres more on purchases and on distributors (with the weight at either end of the chain).

Differentiation

The second strategy is to differentiate the company's product or service, creating something that the market (our customers) perceive as unique. There are many methods of differentiation—brand image, technology, customer service, distribution, or any other factor considered relevant by our current or potential customers.

Differentiation defends us against our competitors because of customer loyalty and their theoretical lower price sensitivity. Customer loyalty is also an important entry barrier. Differentiation leads to higher margins for negotiating with suppliers, and clearly mitigates the power of purchasers as they have no comparable alternatives and are therefore less price sensitive. Finally, a company that has managed to differentiate its products or services and has achieved high levels of customer loyalty will be able to defend itself against substitution products than its competitors.

Although the differentiation option has implications for the whole of the chain of value, it basically depends on the company's marketing capability in the broadest sense (control of the company's image and products). It is easier to differentiate in services, because of their intrinsic nature (production is simultaneous with consumption, uniqueness, etc.) than in products, especially those that are of low value or that have no brand.

Sometimes differentiation makes it difficult to achieve a large market share. It often implies a perception of exclusiveness which is incompatible with high levels of participation. However, what usually happens is that differentiation implies an exchange with the cost position because the activities required to create it are necessarily costly. Although customers recognise a company's superiority in its sector, not all of them will be prepared to pay higher prices. Customer sophistication may lead us to a dead end, and competitors may be tempted to imitate us.

Focus or high segmentation

The last competitive strategy is to form a group of purchasers, or niche, based on their preferences, tastes, geographical area or product demand.

As with differentiation, there are a number of possible approaches. Unlike the two previous alternatives which aim to reach their objectives throughout the sector, the approach strategy aims to serve just one part of the market very well, and all functional policies are drawn up with this in mind. The strategy is based on the premise that the company can serve its limited target audience more efficiently than its competitors who compete in a more general way. Even when the approach strategy does not achieve lower costs or differentiation from the point of view of the market as a whole, it does achieve one, or perhaps even several, advantages in a market which is limited in size.

A company which achieves a high degree of segmentation also has a defence against competitive forces and will therefore achieve high returns. Its approach implies that it is either a cost leader or a differentiated company for its audience, and it will therefore have the advantages mentioned above for each of the other two strategic options.

The approach strategy always involves limitations regarding the market share that can be reached, at the complete market level. It means that profitability will be exchanged for sales volume, and the greatest risk will be the appearance of sub-segments.

Considerations on “half-way positioning”

Classic theory maintains that companies in the half-way position will have lower profits than any of their competitors and will find it difficult to survive. Companies decide naturally on one of the possible options, depending on a series of factors ranging from tradition to standard of living in their location. If we imagine the three competitive options as forming the three sides of a triangle, companies will always be closer to one of the sides than to the other two. Only exceptionally will companies be above one of the sides (Ferrari). In almost all cases, they will form part of larger groups working in diverse business environments.

4.1.2 DIVERSIFICATION STRATEGIES

As an intellectual option, diversification is attractive. Human beings do not like to always do the same thing and to start something new is almost always appealing. This is a well-known phenomenon in both psychology and economics. The Gossen law states that, when a need is constantly satisfied, after a certain period it fades away, eventually disappearing altogether. The more a pleasant sensation is repeated, the faster the degree of intensity of the pleasure and its duration decrease. But the problem is that, at least in theory, companies exist to make money and we work to earn our living and not to have fun. Why, then, do companies diversify? Apart from the obvious reason of not putting all their eggs in one basket, the following are some other reasons:

- A company may not be able to reach its objectives (growth, profits, market presence, social recognition, etc.) through its current activity.
- Financial surpluses exceed the resources needed for expansion in the current business.
- The profits expected from diversification opportunities exceed those expected from expansion opportunities (taking into account any risks associated with both).
- The economic information available does not allow a choice between growth and diversification strategies. (You will understand this better when you have assimilated the problem of comparing and selecting strategies):

When a company diversifies, it increases its expected profits and tries to guarantee its development:

- It may carry out risk dispersion studies, based on its product portfolio.
- The strategy may be divided into partial strategies.
- Any synergies arising out of horizontal, vertical or concentric developments can be utilised. (We shall see this in greater detail below).

But, as you can imagine, diversification also involves a number of risks:

- Economic risks, especially relating to a different environment (which will have to be analysed).
- Commercial risks, resulting from different competition, different distribution channels, etc.
- Technological risks, associated with the innovation needed to start up new business.

- Financial risks, because liquidity is needed for investments.
- Organisational risks, because in many cases it will be necessary to adapt the business structure to the new strategy.

Above all, it will be necessary to apply the concept of strategic management to each of the businesses. This will obviously require an effort, especially to get to know the new sectors as well as we know our own. Managing a large number of different activities and businesses is hard work, and this may weaken the company's strategic position in its traditional businesses.

These are the reasons (as well as turbulence in the current environment) which have drastically changed the way in which professional, sophisticated companies deal with the problem of diversification. Thirty years ago, it was perfectly normal to start up relatively different businesses as soon as a company reached a medium size. What companies do today is to take out shares in companies in other sectors, or they form aliances. This allows them to adopt a strategic position in businesses different from their own while they delegate day-to-day operations to those who know them best and are specialists.

There are four main types of diversification:

1. Horizontal development. This is the process whereby a company brings out new products, or products deriving from existing ones, and sells them on its traditional markets. For example, the dairy company Pascual started out by packing and distributing a single type of milk but gradually introduced other types, then milkshakes, etc.

2. Vertical development. Normally, for a strategic reason and even at the cost of losing overall efficiency, a company takes over one of its distributors (forward integration) or suppliers (backward integration). For example, Japanese automobile manufactures took control of their dealers in many European countries in order to comply with a policy of quotas in the markets they were promoting, the theory being that if they could only sell cars, then they would do so without offering any type of discount. Another example can be seen in food companies (of which Heinz was the first) which provide their

own raw materials in order to guarantee quality and/or purity throughout the process.

3. Concentric diversification, also called proximity diversification. This is when a company exploits its know-how, technology and distribution channels to sell similar products in markets that are similar to its current ones. Pascual again serves to exemplify this. Using its sales channels and image, it now sells juices or yoghurt-type desserts to its traditional customers, adopting whatever brand policies it considers most appropriate.

4. Total diversification. The company enters radically different businesses. This is unusual (except for shareholdings). A few years ago, a Spanish group had about two hundred companies, with a total of 8,000 employees, and it claimed it was neither trying to deceive the tax office nor that it was involved in financial engineering. They said that when they had a new idea, they just set up a new company.

I think any diversification should be firmly based on current products/markets/technologies. Otherwise, it is best to grow through alliances or shareholdings.

4.1.3 TYPES OF GROWTH

Whether pure or diversified growth is chosen, it can be achieved in one of two ways – internal and external growth.

- Internal growth is the process by which a company, through profits obtained and retained, invests in assets in order to expand its business. This is the traditional type of growth, and in it the company has full control of the whole process. The rate of growth will depend on the maturation of the different productive, technological and commercial resources. The competitors will note the growth and try to counter it.

- External growth is the process by which a company uses its own or borrowed resources, or a combination of the two, to participate—or even control— one or several of its competitors or related companies. The degree of “participation” can range from a straightforward takeover (with the purchase of assets) to a minority shareholding, including mergers (with the provision of assets in order to form a new entity), mergers with partial provision of assets (from an existing company or to form a new one) or majority holdings or control. Considered more broadly, external growth might take the form of an alliance or joint venture amongst companies for specific purposes. In this case, the speed of growth will depend on the speed at which the management resources can mature. Two balance sheets can be combined in half an hour, but it takes companies years or even decades to achieve a real merger.

I am sure you all have friends or relations who have been through processes of this type (in banking, automobiles, pharmaceuticals, consultancies, etc.). Many of them will have told you stories about how the advantages or synergies achieved are the result of eliminating indirect personnel or of economies of scale in purchases (depending on the type of company or sector). It takes many years to identify real synergies like those described in books and learn to reap maximum benefit from them. We need to see who does what best then share the benefits amongst the two sides, with each position being occupied by the most suitable person.

GRAPH 9. COMPARISON OF GROWTH ALTERNATIVES

	EXTERNAL	INTERNAL
PROS	Immediate availability Fast growth Use of synergies	Purchase of technology Industrial optimisation/Location Management optimisation
CONS	Resistance / human problems Technology / Mature products Legal difficulties	Maturation period Financing growth Competitors' response

Graph 9 shows the pros and cons of the two types of growth. Basically, internal growth is more conservative, it allows better control of the process and is suitable for growing sectors and for objectives that can be controlled within the company (bearing in mind competitors' reactions). External growth has the added advantage of the surprise effect and the fact that total supply in the sector does not change. However, it has the drawback that the whole parcel has to be accepted. It is proving to be the most popular option for large companies in mature sectors.

The key question—but one for which there is no answer—is whether it is more difficult to expand the market by 10 units (and keep them) or to buy the company which now sells 10 units. If you can answer it, you will be sure to find a good job in a multinational, preferably an American one.

4.2 MAINTAINING THE POSITION

The strategic option for maintaining the position is valid from an intellectual point of view but is not practical. A company that does nothing special will not maintain its position. It will collapse under the pressure of its competitors.

So, if I want to maintain my current position, I shall have to use the same competitive pressure as my main competitors or the average for the sector (normally, maintaining my current strategic line).

This is the option adopted by companies which do not want to improve their position in certain markets because it is already good and in order to avoid being accused of reaching a dominant position. I am sure you can think of examples of this in the past.

4.3 DOWNSIZING STRATEGIES

To reduce the size of a company is always difficult, painful and exceptional but unfortunately necessary. Sometimes, companies are surprised by factors in the environment (unfavourable economy, legal requirements, competition, technological revolutions that have by-passed them, etc.), or they find they are unable to control internal factors (poor management, incorrect investments, trade union pressure, etc.) to the extent that the situation becomes untenable. This means that radical decisions have to be taken in a hurry, based on a consensus. (Do not forget that the competition is always on the prowl, especially in such situations). The aim will be to save part of the company before it is too late and nothing can be saved. “Shrink fast, but shrink smart”.

The magnitude of the problem will depend on whether the company is diversified, or produces a single product or has a single market (both of which would be extreme cases). Let us first deal with diversified companies.

When a diversified company faces problems, it has two basic options – either to concentrate or to change its mission. A diversified company has as many chains of value as activities, whatever the structures used. The normal decision would be to break off one of the chains of value, preferably one that is profitable in order to obtain a good price and one that is related as little as possible to the company's main activity. This process is called concentration or "going back to the core business". The funds obtained from the transaction are used (normally together with a contribution from the partners) to improve the core business. For example, an airline that owns hotels will sell the hotels in order to obtain fresh funds and renew its fleet of aircraft. It may be able to establish an alliance with the purchaser of the hotels in order to fill the hotels with its passengers, thus obtaining benefits for both.

If the core business is considered to be in a desperate state, for technical, social or financial reasons (or for a combination of reasons), or if there is no reasonable buyer for the profitable business, the company may decide to carry on with that business and give up the former core business. From the strategic point of view, this requires a change of mission. From the organisational point of view, it requires segregation and, from the labour point of view, many jobs will be lost. In most cases, in spite of what you might read, employees are tied to their respective activities and they are likely to run the same fate as the company. If we go back to the example given above, if the company sells its aircraft and buys more hotels, what would be likely to happen to the aircraft personnel?

If the company is a highly concentrated one (with a single product, technology, market or distributor) and reaches a desperate situation, it will have to carry out realignment. This will require the agreement of all those involved in the company (shareholders, management, employees) and in the environment (creditors, suppliers, customers) and the administration. It will be necessary to act at each of the steps in the chain of value, both horizontally and vertically, trying to find places where cutbacks can be made efficiently. We must not forget that what is left should be in a much better condition than previously and that the final result should be a new social, industrial and financial structure on a smaller scale.

This is what the theory says. In practice, you all know that the solutions will depend on the type of company in question. A multinational that does not have many strategic interests will restructure its foreign subsidiary as soon as it sees that the objectives have not been met for two years running. Some would consider this to be a sort of tyranny. A family-run company with a low degree of professionalisation will only realise the danger it faces when it is too late. Companies will prefer to adopt what are euphemistically known as "non-traumatic" solutions, offering early retirements all round. And managers are more likely to be treated generously than the members of a production line (with the exception of the head of the medical service). During bad times, a company's philosophy and culture will become apparent. Companies with an immaculate reputation will offer redundancies (which they will have to pay for), rather than unfair dismissals, thus avoiding legal problems.

I don't wish to tire you further. As far as I know, not much has been written on this subject. (Those "in the know" keep quiet so that they can charge for their revelations). I apologise for making the section so long and so serious.

4.4 Business implications: "Company Policy"

Throughout the lesson, in order to maintain the basic structure of classic theory as on other occasions, we have dealt with business options from the point of view of definition of the business. This means that I have left out two subjects which I consider essential – internationalisation, and the internal definition of alternatives. We shall now go into these in some detail.

Let us begin with internationalisation which can be a real challenge for a business. It brings a number of advantages:

- Higher volume of production, automation, efficiency
- Opportunity for reducing the problem of order seasonality
- Contacts with more markets (and competitors)
- It allows us to get to know of technical advances on a worldwide level
- It places us in a better situation for competing with foreign companies in the local market.

There are also a number of important drawbacks:

- Selling in a foreign country may be less beneficial than selling at home
- The investments required are greater

- Competition may be greater in both quality and quantity
- Analysis of the environment and communication with the target market may be difficult and costly.

As a result, when the local market is sufficiently large, the trend is to continue in it, basically because it is easier (language, a more certain environment, products do not have to be redesigned or adapted, etc.). But in today's environment of increasing globalisation, fierce competition and no tariff barriers, no local market is sufficiently large, nor is local competition sufficiently small. Entry into foreign markets is a strategic decision, one which requires a study of the risk involved and the commitment of the whole company. But sometimes the decision may be speeded up or taken because of factors such as:

- A wish to counter-attack when global competitors enter the local market with better products at lower prices
- Opportunities to improve margins in foreign markets
- A desire to reduce dependency on a single market (in large companies)
- To prevent customers from going to foreign markets for international services.
- To accompany other companies, which are regular customers of ours, in their ventures in other countries.

In order to classify internationalisation within one of the above strategic alternatives, al least two options should be considered. For a small company, or one which has only limited foreign activity, it would be best to consider interantionalisation as an alternative in itself, as a growth strategy. (It is reasonable to assume that what a company wants is to grow, which is why it is interested in internalising its activities). For a large company, with multiple products and multiple markets, one which already has fairly extensive foreign activities, internationalisation is not a strategic option in itself. It is more a part of a growth strategy (either pure or diversified), or part of a strategy for maintaining its position.

An internationalisation strategy may take one of several forms (indirect exports, direct exports, franchising, joint ventures, etc.). These require different degrees of commitment towards the company's international activities.

So, having considered internationalisation in sufficient detail to cover all the possible “outward” alternatives, we now need to look inwards.

Without trying to be too scientific (what a euphemism “business science” is), let us try to cover all the functional areas within the company to see some of the possible options:

- In the economic-financial area and administration:
  - In-house financing rather than borrowed funds
  - High borrowing rather than low indebtedness
  - Banks rather than securities
  - Margin rather than rotation

- In production and operations:
  - Labour intensive rather than capital intensive
  - Localised or disperse
  - Product specialisation as opposed to technology specialisation
  - Conventional rather than sophisticated materials
  - Shift work or regular working hours

- In sales and marketing
  - Geographical coverage of markets
  - Type of need being met
  - Broad range rather than narrow range
  - High prices (skimming) rather than low prices (penetrating)
  - Intensive rather than exclusive distribution
  - Mass communication rather than promotions

- In R&D+i (the fashionable term!)
  - In-house developments rather than external patents
  - Product rather than process

- Technological sovereignty rather than joint ventures
- Product-oriented engineering rather than life cycle cost

- In human resources
  - Management with participation rather than authoritarian management
  - Meritocracy as opposed to promotion by seniority
  - Loyalty rather than rotation
  - Permanent rather than temporary staff
  - Rigidity as opposed to flexibility

As you can see for yourselves when you read the business press, all these parameters (and others I may have forgotten) are not altogether independent. They are related and stem from the company strategy and culture. So it will be almost normal for a company using rotation to also apply the strategy for penetration, to have low costs, limited, process-oriented engineering and permanent staff earning low wages. The opposite happens with a company that focuses on its margins. It will always try to apply high prices, will be technology-intensive, its employees will be stable and loyal, with good wages and good promotion possibilities. (Please note, it is very rash of me to make such a statement. It is just a paradigm, and I am sure you can find examples where the situation is exactly the opposite. Please take it only as an illustration).

If we try to bring together, at least mentally, all the different external and internal alternatives, we shall obtain a huge number indicating all the possible paths available for a company. People talk about "Company Policy" when considering the set of attitudes and patterns open to a company. So, for example, a company may say it is not its policy to enter emerging markets, to employ temporary staff or to work with dangerous materials. Or it may say its policy is for its managers to come from within the company, or that it does not like to employ people who are related, etc.

As you all know, there are companies that jump at every opportunity, while others are very conservative. The results, which we can see for ourselves in the business press, are just a reflection of the different policies applied by companies.

5. Techniques and tools for strategic decision-making

5.1 Quality tools: I – SWOT analysis

SWOT analysis (strengths, weaknesses, opportunities, threats) [known in Spanish as DAFO – *debilidades, amenazas, fortalezas, oportunidades*] is a simple diagnostic tool that shows how the various strategic options considered fit together. Although most of the literature just lists all the relevant factors, I have preferred to give them in chart form.

GRAPH 10. SWOT ANALYSIS

	O1. EU market	O2. Economic growth	O3. New product lines	A1. New Ind. Countries	A2. Substitute materials	A3. EU competitiveness	A4. Competitiveness row
F1. Modern facilities	+2	0	+2	+2	+1	+1	+2
F2. Position in the Spanish market	0	+1	+1	+1	0	+1	0
F3. Commercial network	+1	+1	+1	+1	+1	+1	0
F4. EU protection against others	0	+1	0	+1	0	0	0
D1. Staff surpluses	-2	-1	+1	-2	-1	-2	-1
D2. Low productivity	–2	0	–2	0	–2	–2	–1
D3. Production costs	–2	0	–1	–1	–1	–1	–2
D4. Trade union and social aspects	–2	–1	0	–1	–1	–1	0
Total	-3	+1	+2	+2	-3	-3	-2

On one axis are the strong and weak points (of the company in comparison with its competitors) and, on the other, are the opportunities and threats in the environment. When we fill in the table, we gradually see the effect of each of them (using a scale of –2 to 2, for example, or any other scale), as follows:

- When a strong point serves to take advantage of the opportunity, insert +, 0 if the effect is neutral, and – if the effect is the opposite.

- If a strong point can serve to counter a threat, insert +, 0 if it is neutral and – if it gives greater exposure to the threat.
- When a weak point prevents me from taking advantage of the opportunity, insert -, 0 if it is neutral and + if it helps me to take advantage of it.
- When a weak point exposes me to a threat, insert -, 0 if it is neutral and + when it helps me to avoid it.

One by one, we can fill in all the boxes on the chart. For practical reasons, it is best not to use a large number of factors. If it is difficult to limit them, form groups, or prioritise. In addition, they should be selected in a balanced way. There is no point in taking 5 opportunities and 5 strong points, and only one threat and one weak point. That would be cheating!

It is also important to make fair judgments because, otherwise, the diagnosis will be irrelevant for a real situation. As you can imagine, the upper part of the chart is usually full of plus signs and the low part of minus signs. But there will always be exceptions. In the example given, a weak point (labour surpluses), when compared with an opportunity (new product lines) gives a positive value (suggesting that, in principle we can use the labour surplus on the new product line).

So, what is the result of using the chart?

- If we add the results horizontally, we can see how strong each of the strong points is under that environmental condition . (And the same for the weak points).
- If we add the results vertically, we see how beneficial each of the opportunities may be (for that definition of the company), and likewise for the threats.
- If we add the results at the corner, we get a reference for the overall situation (they are all relative).

Do not forget, as we saw in the first chapter, that a situation in the environment may have very different effects on each of the competitors in a sector, depending on their business structure.

SWOT analysis allows for a simple comparison of the original situation with any situation that can be imagined if the strategic alternatives are applied, each of them with different scenarios. It also helps in identifying the strategic line (or development vector) and priorities for action (the highest values in the chart).

5.2 QUALITY TOOLS II: MATRIX ANALYSIS

Matrix analysis is the use of a set of graphs representing the company's products, functional areas, divisions or technologies to note how they develop in order to be able to take decisions on them. They can be used with different degrees of detail or aggregation. They are all based on the relation between the company's basic parameters (profits, cash flow, etc.) with the positions of the various products (technologies, etc.) on the chart. There are many matrices. They are usually named after their inventor or the company that invented them, and there is no universal rule for knowing when to use which. It is important to gradually discover how they can be used in our particular business. Sometimes several are used simultaneously and complementarily. They are used more in large companies than in small ones because they need large volumes of information, and are especially useful for considering the addition or elimination of activities (at corporation, division or business area level, etc.)

The procedure for using them is always the same, and involves a set of perfectly clear steps:

- Analysis of the current situation (in the year).
- Analysis of developments over time
- Comparison with the competition (historical series)
- Design of target portfolio or position

We shall here consider two samples of matrices—those of the Boston Consulting Group and of General Electric/McKinsay.

But, as I have already stated, every author or consultant has his or her own type of matrix, and the key lies not so much in the type as in knowing how to apply the technique.

5.2.1 Boston Consulting Group Matrices

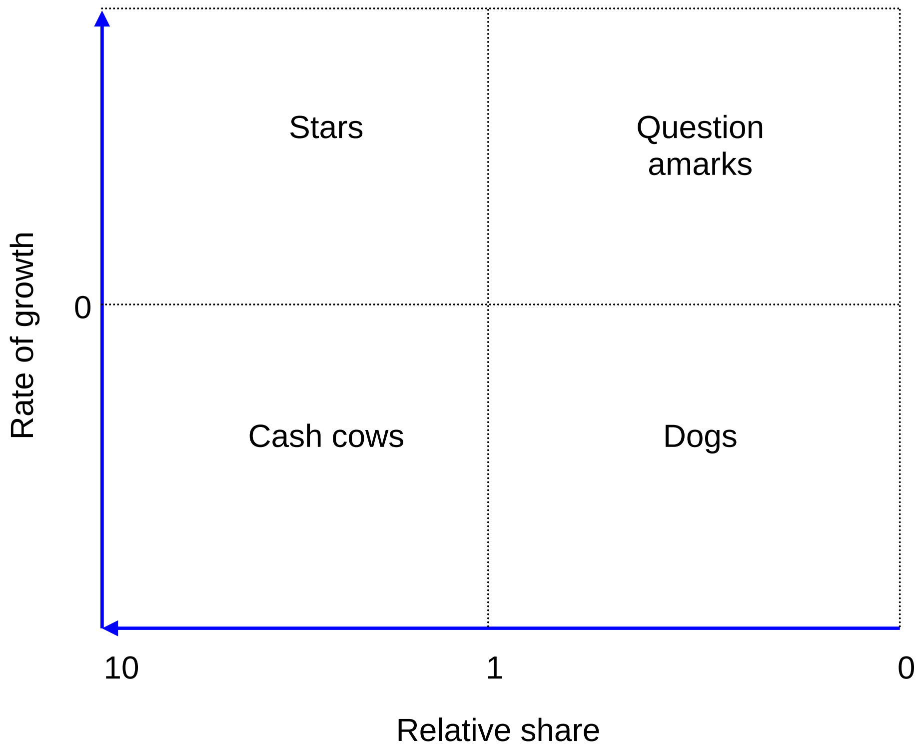
The BCG devised this type of matrix in the 1970s. It is easy to build and to use, and its main advantage is that it is completely numerical. No value judgments need to be made to build it. It can therefore be used by a person who does not have even basic knowledge of a sector (competition, key factors for success, etc.), provided they have the necessary data to build it.

The BCG matrix has the advantage of having extrapolated the learning effect, discovered during the Second World War and used until then only in factories, for business activities as a whole. The BCG matrix centres its analysis on cash-flow which is considered the variable which determines a product's strategic role. Companies make money with some products and lose it with other, and the trick is to make as much as possible, investing in other new products so that we never have all our products at the end of their life cycle or in decreasing markets. The starting hypotheses, which are hard to accept but generally valid, are:

- The money a product produces (cash-out) is just a function of its relative share (high share = leading product = high sales = low costs (economy of scale plus experience curve) = greater margin). The leader, unless there are very great differences, makes more with each unit sold, and also sells more units than anyone else.
- The money a product needs (cash-in) depends on the rate of growth in the segment (provided the aim is to maintain the competitive position). Growth in the segment = increased sales = increased production and purchases = need for more money.

The BCG matrix is a grid on which the horizontal axis shows the relative share (increasing to the left and, in theory, on a logarithmic scale), and the vertical axis (increasing upwards) shows growth (in the market /segments).

GRAPH 11. BCG MATRIX(1)

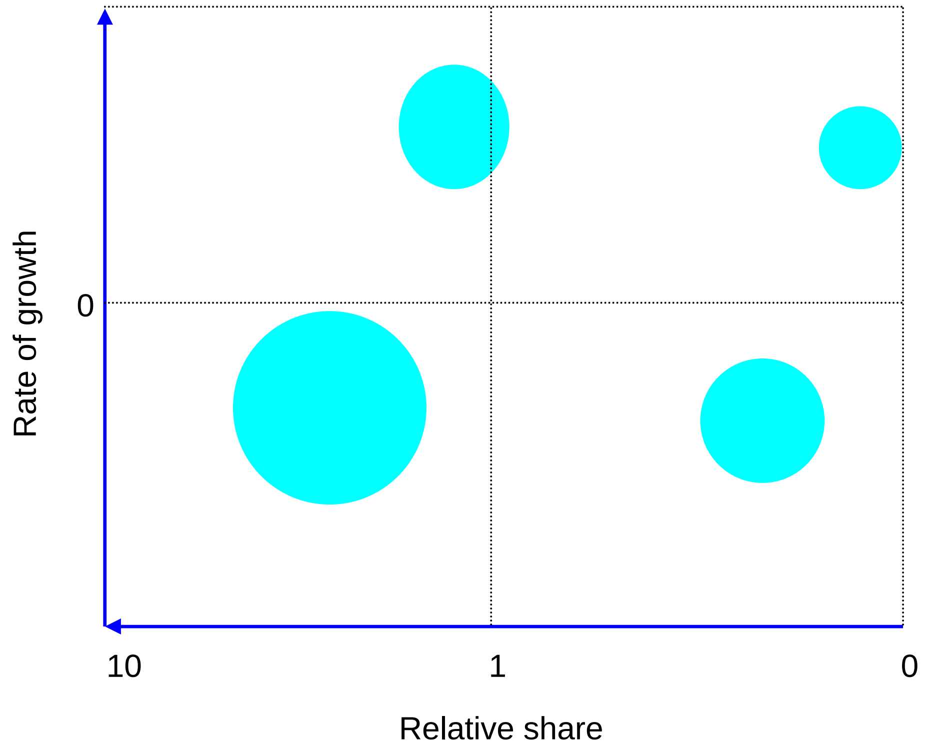


When the hypotheses are applied, the graph shows four zones:

- One with a relative low share (producing a low level of cash) and a high growth rate (needing a lot of cash), therefore a negative cash-flow: question-mark products.
- One with a relatively high share (producing a lot) and a very high rate of growth (needing a lot), therefore a positive or negative cash flow (depending on relative sizes): star products.
- One with a relatively high share (producing a lot) and a low growth rate (needing a little), therefore a positive cash-flow: cash cows.
- One with a relatively low share (producing a little) and a low growth rate (needing a little), therefore a small, positive or negative cash-flow: dog products.

Two axes divide the four areas. A vertical one, at value 1 of the relative share which means the leading products are located on the left, and those which are not leading products, on the right. A horizontal one, indicating average market growth in the long term, which separates the segments that grow less from those that grow more (every year).

GRAPH 12. BCG MATRIX(2)



Throughout their life cycles, products (and technologies and services, etc.) go through each of the quadrants. (Note that in order for them to pass into the left-hand quadrants they have to be leaders in their respective segments, which is by no means easy). This means they start out as question-marks, then become stars, then cash cows and finally dogs. The ideal is for a product to become a leader when the segment is stationary (cow) and remain there as long as possible.

The products are represented by circles (known as "Boston balls"). The centre of the circle is easy to calculate: the horizontal axis is the relative share (my sales divided by the leader's sales), and the vertical axis is growth in the segment (total sales in the segment this year, divided by those for the previous year). The area of the circle is proportional to the volume of sales of the product (expressed in monetary, not physical units):

The circles move every year, showing the overall development of the company and of each of its products. The balls can have a different outline or colour to represent different years. The same can be done with competitors' products so that a visual comparison can be made.

Note the amount of practical information given by the balls, their movements, their relative positions and the overall positions.

- The size of the ball indicates sales of the product and, when compared with the others, relative sales in comparison with the company's total sales. The number of balls, and their sizes, indicate the way in which sales are distributed (risks, comparison with competitors, etc.).
- Movement along the horizontal axis indicates competitive behaviour of the product in the segment.
- Vertical movement indicates behaviour of the segment in comparison with the market average. (Note that it is no good being king of an island if it is sinking!)
- Radial movement indicates trends in sales of the product (from more to less).

The position at which a product is located on the matrix determines the basic strategy to be applied with each of them. So, an unknown product needs support to make it become a star product. Once it has become a star, it will continue to need support (but less) in order to enter the cow position with the highest possible income. When it becomes a cash cow, it should stay there as long as possible and, when it is a dog, it should be liquidated (unless there are strategic reasons for not doing so).

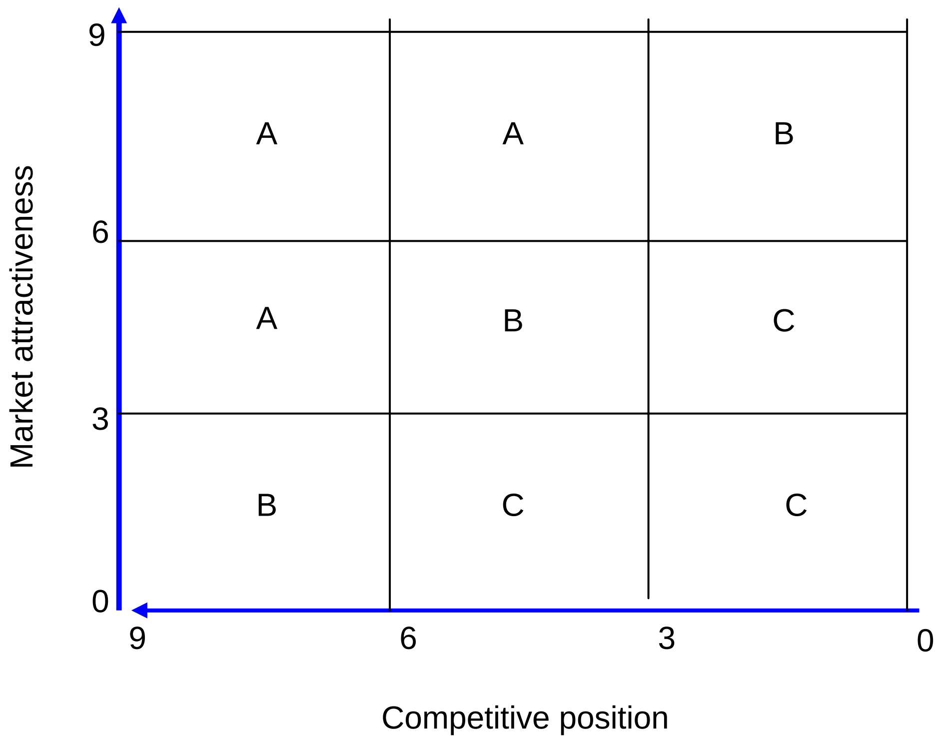
There are a number of limitations to use of the BCG matrices, especially with regard to non-fulfilment of the hypothesis. Against the first hypothesis is non-existence of economies of scale or an experience curve, or the existence of competitors who can obtain cheap raw materials from privileged suppliers. Against the second hypothesis is low or zero capital intensity or the existence of very large entry barriers.

5.2.2 General Electric/McKinsey Matrices

The GE matrices constitute a quantitative and qualitative improvement on the BCG matrices. However, to draw them up correctly requires many value judgments and thorough knowledge of the sector, the competition and the markets.

McKinsey starts with the hypothesis that profitability is much more relevant than cash flow when comparing the advantages of investing in one product or company rather than another. Many other factors, such as relative share and growth, also have to be taken into account. The axes are the attractiveness of the market in which the business is active, and the company's competitive position allowing it to take advantage of opportunities.

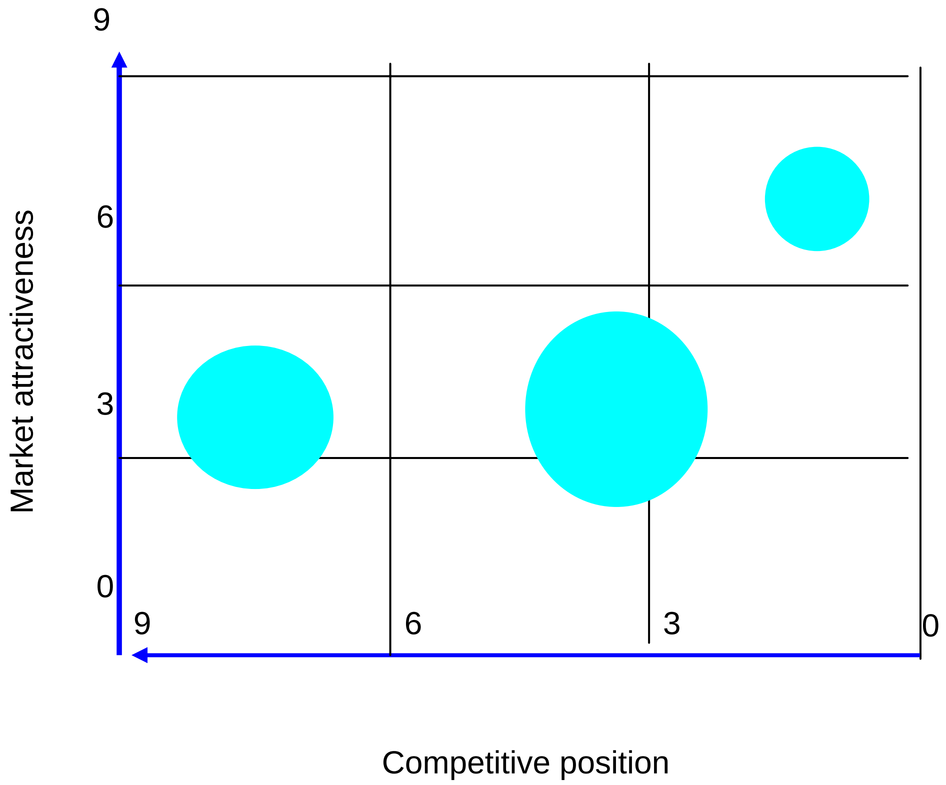
Graph 13. GEC/McKinsey Matrix(1)



The matrix is now divided into nine squares (called 3*3 matrices), for three types of area: A, B and C. The products or companies that are very attractive go in the A areas. In these, the company has the green light for investing. In B areas are companies with medium attractiveness, whose market share should in principle be maintained (selective investment). In C areas are companies or products that are not very attractive. The strategy to be applied to them is to reap profits or withdraw.

Remember that the more you move to the left in the matrix, the greater the potential for obtaining more profit than the competition and, the more you move upwards, the greater the potential for gaining higher profits.

GRAPH 14. GEC/MCKINSEY MATRIX



As before, products (companies, divisions, technologies, etc.) are represented by circles whose size is proportional to sales volume. But where do we place the centre of the circle? This is not as clear as it was in the previous case. In order to determine the 'market attractiveness' or the 'competitive position', we have to apply the following procedure:

- Identify the factors that are relevant for each of them

- Weight the factors (relatively, so that the total is 1)
- Give the factors scores

There are many different factors. Full lists are given in books specialising on this subject but in practice these are of little use. The most relevant are:

- Market factors: size, growth, seasonality, segment size, suppliers' negotiating power, etc
- Competition factors: type of competitor, degree of concentration, changes in market shares, type of integration.
- Economic and financial factors: economies of scale, experience effect, use of capability, entry and exit barriers
- Technological factors: maturity and volatility, differentiation.

In addition, socio-political and cultural factors in the environment may also be relevant.

Basically, and also in my experience, the McKinsey model recognises relative share as a prime factor for indicating competitive position—and others—but it tends to overweight size against growth as the prime factor of attractiveness in a business.

As you can see, this model allows us to include many more parameters and to recognise marginal influences. However, it is necessary to be an expert in the sector in order to use it correctly.

5.3 QUANTITATIVE METHODS

The use of quantitative methods is based on the fact that any strategy, or strategic decision, will be reflected in the company's annual accounts, and the effect can be calculated according to the starting point or a reference point. It is a question of comparing strategic alternatives, with their costs and utilities. This process is called cost-effectiveness analysis and it may take one of two forms:

- Trying to achieve minimum costs for a given utility

- Trying to achieve maximum effectiveness within budgetary limits.

The usual techniques for measuring and comparing investments are applied to strategic decisions. Practical aspects of these techniques are described below (the theoretical aspects will be covered in connection with finance).

5.3.1 Return on Investment (ROI).

This is the result of dividing average annual profit (before interest and tax) by capital employed. It is a simple measurement and perhaps the most popular of all, but it gives no weight to distribution over time of incoming cash, nor does it take into account the recovery of capital invested during the life of the project. It may be used in short-cycle decisions and projects.

5.3.2 Pay-back period

This is the name given to the time (months or years) needed for receipts to equal capital outlay. This technique ignores profitability so chooses between two alternatives depending on the speed at which the investment is paid back. Nor does it take into account distribution of receipts over time.

Although it does not have the support of theoreticians or financial specialists, in some circumstances it gives a solution that is strategically useful and similar to what would be obtained using more sophisticated methods. In my opinion, it is a useful tool for taking decisions under unstable or turbulent conditions or in high-risk strategic movements.

5.3.3 Internal rate of return (IRR)

This is the name for the rate of interest which, when it is applied to the capital available at the start of each period, allows receipts to serve exactly to cover interest and replace paid-out capital. It solves the following equation:

$$\frac{C_0 + \sum C_i}{(1+r)^n} = 0$$

where: C_0 is cash movements at the start of the investment period

C_i is cash movements for each period

R is internal returns

N is the years considered as the measurement horizon

This rate used to be difficult to estimate but can now be found immediately by computer. It is a necessary tool in long-term projects, preferably in relatively stable environments. It gives good results when the flow profile includes both positive and negative years.

By definition, it cannot be applied to profiles which are always positive or always negative. Against it is the fact that it cannot distinguish satisfactorily between two alternatives having different horizons, and it does not take into account the possibility of lending or borrowing money at the going market interest rate. (Lost opportunities?)

5.3.4 Net Present Value (NPV)

The NPV is the updated value of all cash flows after discounting an interest rate equal to the average cost of the company's resources. So,

$$NPV = \frac{C_0 + \sum C_i}{(1+j)^\wedge n}$$

where j is the average cost of resources and C_0 and C_i are as defined in the previous case.

The option will become increasingly attractive the greater the Net Present Value it creates. If NPV is zero, the returns that can be reached with the project are equal to the cost of the financial resources, and this will be equal to the internal rate of return. Like the IRR, the NPV considers the time factor and capital replacement into account so it cannot distinguish satisfactorily between options requiring different capital outlays.

In summary, as you can see, there is no infallible method. They all have limitations and are practically never used in isolation, always in combination with others. Moreover, they need to be complemented with other types of economic and financial information, such as maximum cash exposure (maximum negative cash-flow), the time situation within the horizon, or the company's initial financial position.

5.4 MULTI-CRITERION DECISION METHODS

These are the processes whereby companies bring together a set of data and criteria when taking strategic decisions. It is the usual way of doing things.

GRAPH 15. MULTI-CRITERION DECISION

	OPTIMISTIC SCENARIO		PESSIMISTIC SCENARIO	
	Strat. A	Strat.B	Strat. A	Strat.B
Econ-financial factors				
Technology factors				
Production factors				
Organisation factors				
Strategic factors				

So, companies compare the various alternatives from different points of view—economic (IRR, NPV, etc.), financial (exposure, risk, etc.) and strategic (using matrices, for example) but also technological and organisational, amongst others. A company would never choose a strategic option just because it leads to slightly higher margins than another if the former requires a huge organisational shake-up (unless it is used as an excuse for such a shake-up).

The alternatives should be analysed in as many scenarios as possible and graded for each of the factors considered. The grading is almost always simple (-3 to 3, or ABCDE) because decimals are never a dominant factor. In practice, miracles don't happen, so the most productive options are likely to be the riskiest or will, at least, be more sensitive to changes in the environment. In the end, however many analyses are carried out, the decision will be taken by the Chief Executive Officer, or the Board of Directors.

I have deliberately not included sentimental, or personal factors which often dominate, especially in small businesses. Even in large conglomerates, the managers may prefer one option over another for reasons they cannot explain. This is much more common than they are prepared to acknowledge (and I'm not referring to corruption, just feelings). The most important strategic decision from the personal point of view, namely marriage, is taken without comparing McKinsey matrices nor calculating the Internal Rate of Return, or at least I think it is!

6. Drawing up Strategies

6.1 Basic principles

There are two stages involved in drawing up a strategy. Firstly, we have to determine the concepts on which it should be based and, secondly, we have to describe it so that it will be easy to understand.

A strategy should focus on those areas in which we are better than our competitors, focusing always on existing and future opportunities. We must remember that our competitors will always be waiting to see what we do next and trying to catch us off our guard.

The strategy must then be defined in a simple way and laid down in detail in a plan. We shall now go into all this in more detail.

6.2 Competitiveness and core competencies

The classic theory of competition, to which we have referred on previous occasions, states that understanding the five competitive forces is key to drawing up a strategy because it must be based on the company's competitive edge (through costs or differentiation, in line with general competitive strategies).

Subsequently, throughout the eighties, other factors started to be taken into account (time, information) as sources of competitive advantages and, in some cases, as the key to a company's competitiveness. And when we talk about competitiveness, we refer to a company's capacity for competing in its present sector or a potential sector (its relative position as regards its competitors), achieving better results than average companies in its sector. Competition may exist on three levels—within the sector, internationally and in the search for excellence, that is, within the company itself. By definition, in a global business, the first two come together because competition is international and possibly even worldwide. In almost all cases, the market leader focuses on the search for excellence and its position will essentially be a defensive one aiming to administer the company's advantage over the company next in line, the one that challenges its lead.

I am sure you can appreciate that information or, rather, organised access to information, is one of the keys to business today. Information may have effects on:

- Strategic management of the company (internal and/or external monitoring, development and assessment of strategies)
- The chain of value (it advances faster than process technology, reaches the whole chain, creates inter-linking, etc.)
- The product
- The company culture

Time undoubtedly brings advantages:

- For purchases (materials requirement plan, just-in-time)
- For operations (experience curve, general coordination of activities, transport and logistics, etc.)
- For sales (turbo-marketing)
- In general (speed of response to changes in the environment)

Good management of the time variable becomes increasingly important with a more turbulent environment.

In the early nineties, Prahalad and Hamel developed the concept of core competence—a set of know-how, technologies, patents, services, etc. which allow a company to offer something unique to its customers. European writers (Pümpin, García Echevarría) tend to call core competencies "strategic excellence positions". But whatever we call them, they represent an important concept. Core competence or core business or strategic excellence position refer to a set of skills held by a company which allow it to be better than others in a specific area (segment, product, technology, etc.). These skills are, or may be, inter-disciplinary, and are applied to the products and services that the company sells.

It used to be possible to build a competitive advantage and maintain it for a certain period of time. When the "explosion of the eighties" made it no longer possible to achieve a sustainable competitive advantage in the medium and long term, the only solution was to focus efforts on a specific area and trust that it would be the right one in the future.

A preliminary, though obvious, step is to identify "utility potential" with a life cycle that is compatible with that of the company. It is no good achieving a very good strategic position in, say, the sex life of ants, if nobody is interested in our skill. (You might like to apply this in your personal lives). This is the 'billion-dollar question'. Is there a market for our idea?

I cannot resist the temptation to give an example from the company I know best, the one in which I have been working for almost twenty years—Construcciones Aeronáuticas, S.A. (now called EADS). CASA has two core competencies: light and medium military transport, and carbon fibre structures. I shall briefly describe these sectors so that you can understand the many nuances involved in a core competence.

The military transport aircraft segment is a small one within aeronautics (meaning we are relatively safe from the big fish). The core competence can be described as vertical because it requires domination of the full chain of value and life cycle, from concept to in-service support and from purchases to sales. However, in order to be competitive within the segment, it is not necessary to know more about aerodynamics than anyone else (I refer to the English and Americans), or more about integrated propulsion systems than the French. What is needed is to have basic control of a set of technologies (of design and production) in order to guarantee a reliable, robust, capable product, as well as tradition and a customer base. These should enable us to work well provided customers continue to demand this type of aircraft!

Carbon fibre structures are a horizontal core competence. They require knowledge of a much smaller number of specialisations than in the previous case but it is essential to be the best in the world at them (design, calculation, industrialisation and production). The structural components manufactured can be applied to a wide range of aircraft that are designed and qualified by others. These should enable us to work well provided planes continue to have a horizontal tail, which is our specialisation!

These core competencies have been established over decades and the company's future will be built on them, and on others deriving from them.

6.3 DRAWING UP A STRATEGY

I think it is now clear that the key to creating a strategy is to understand better than our competitors, and before them, what the future needs of markets will be and what skills are necessary for meeting such needs. We shall therefore have to develop the core competencies that will allow us to efficiently develop utility potential and obtain above-average results in the sector, assuming that the utility potential remains the same.

The core competencies will therefore determine the company's guidelines, the basic flow of resources and the concentration of forces. In addition, they should meet the following requirements:

- Be expandable (processes, plant, etc)
- Have fast effects
- Use real synergies harmoniously
- Build up employee motivation
- Develop strategic advantages (time factor)
- Weight risks.

Let us assume that we have identified the core competencies and that the associated utility potential will remain the same at least long enough to allow us to develop the business.

The objective will be to draw up a document that should be as clear and concise as possible containing the most important statements on the company's orientation for the future:

- Positioning (basic strategy)
- Clear statement of core competencies (efficiency, differentiation, time)

It may sometimes also include:

- The activities and processes to be expanded
- Priorities for actions and markets
- Implications in functional areas
- Main measurements and actions regarding the time factor.

A more detailed document will give rise to the Strategic Plan, which we shall see in the next lesson.

If you are desperate and there is no alternative, ask the office messenger to draw it up.

7. Strategic implementation

7.1 Strategic impulses

The management of a company decides what they want for the company in the future by:

- Designing the organisational structure
- Managing human resources
- Guiding operations

The aim is to produce goods and services for the community, while producing sufficient added value and satisfactory returns. But, in spite of the management's determination and efforts, their objectives are not always met.

In most cases, it is the Managing Director who is the company's strategist. (Although a strategist can be any person controlling key actions or establishing basic criteria so, in practice, this role may be taken by a group of people). As leader of the management team and head of strategists, the Managing Director is the main creator of strategy and is essential for deploying and institutionalising it. He or she will have to be imaginative and resourceful, will have to concentrate on just a few key aspects, and will have to inject value into the organisation and influence the company culture. (Personality is to person what culture is to business).

Strategy is formulated, or reformulated, though strategic impulses. It cannot be limited to a new definition of functions or new products to be developed. A very important aspect is the use of resources that previously were not made full use of, always in line with the core competence. This is the basic refernece for all staff, even in daily action and they must identify with it. (An example is the advertisement by Singapore Airlines which states that, however hard others try, they will never beat their customer service because it has been put into practice for centuries, or decades in aviation). Only through such impulses can a real difference be made to quality in business.

So, in pioneering or growing companies, it is normal to allow core competencies to become stronger and to multiply by making the most of utility potential, developing other capabilities, etc.

In companies that are mature or in a period of recession, the impulse usually comes from focusing efforts. The management and all the staff concentrate on the core competence, and all the necessary resources are assigned to it. This allows the company to concentrate on recovering its position, and to obtain better results than its competitors.

7.2 Dimensions of strategic implementation

The problem of strategic impementation should be considered from three points of view—firstly, an overall approach including the classic tools of strategic planning such as plans, programmes, budgets, etc.; secondly, an approach that brings together indirect measures, mostly related to culture; and thirdly, an essential factor to which I have referred on several occasions, timing.

7.2.1 Direct measures

- Action plans have to be drawn up, as follows:
  - Determination of any discrepancies and/or differences between the current situation and the situation we hope to obtain
  - Weighting of any discrepancies according to urgency and importance. We can rarely hope to change everything in one fell swoop.
  - Scheduling of actions according to urgency and importance.
  - Implementation of action plans.
- Budgets must be allocated to promote strategic results. The budgetary cycle should tie in with the planning cycle, so the annual operating plan may be considered a detailed version of the strategic plan (more details are given in the next section). All action plans must be included in the budget so that they can be implemented without problems.
- Management systems, including remuneration (which should be flexible and based on strategic performance, etc.). Management should be target-based, with proper coordination of logistics and plant in line with core competencies, etc.

Remember that staff will not be prepared to "cross the desert" unless you can convince them that the "promised land" lies on the other side. Measures must be properly explained so that staff understand the reason for strategic movements.

- Organisation. A new strategy may involve fundamental changes and reorganisation must serve to promote core competencies. (As you can imagine, it is often difficult to apply the theory in practice).
- IT systems. Once good, processed, structured information becomes available, the speed at which it flows will be of fundamental importance in strategic management. IT systems are to some extent responsible for fast, reliable use of internal and external information.

7.2.2 INDIRECT MEASURES

Indirect measures, to complement the direct measures, include:

- Informing the staff, at least in an overall, objective way, of the company's future orientation. Formal or informal channels can be used, with verbal or written information, or a combination of both. I personally believe that it is best to inform the staff of the strategy rather than keeping it secret because I consider that people are only prepared to collaborate when they know why they should. It is therefore necessary to give information in order to deploy the strategy. Moreover, as in advertising, the messages will have to be repeated several times in order for them to be understood and assimilated. We shall have to take advantage of any opportunities (events, the in-house bulletin, the annual report, elements pertaining to the corporate image) to pass on our message and obtain feedback on reactions to it.

- Training is essential if the staff is to draw up specific guidelines for action, based on the general strategy. The departments should be able to take the strategy on board and apply the full process—as described above—on a departmental scale. The company's core competencies will indicate the area in which staff and the management should receive training.

- Company culture. If the strategy is to be effective, it will have to be devised and implemented within the company culture. Although it might seem that a new, different strategy will require adaptation of the company culture, it is practically impossible to change beliefs, practices, values and patterns of behaviour fast. The best way is to set an example! Any measure aiming to implement the strategy will have an influence on values. If we adopt certain behaviour through the action plans, this may serve to set an example for others. (But note that the opposite might also happen!) As with information, it is important to take advantage of any opportunities to pave the way naturally.

7.2.3 The time factor

What are called "strategic windows" are only open for a limited period of time. The company has to be prepared to act when the opportunity arises because the success of a strategy will depend on our taking up the strategic position before the competitor does. (It is often said that there is only room in a specific market for two, or three, or four companies so speed is of the essence). Not only must the time be right but movement must be fast.

I trust this is now clear. It is important to think slowly, to be prepared and to move fast, in the right direction.

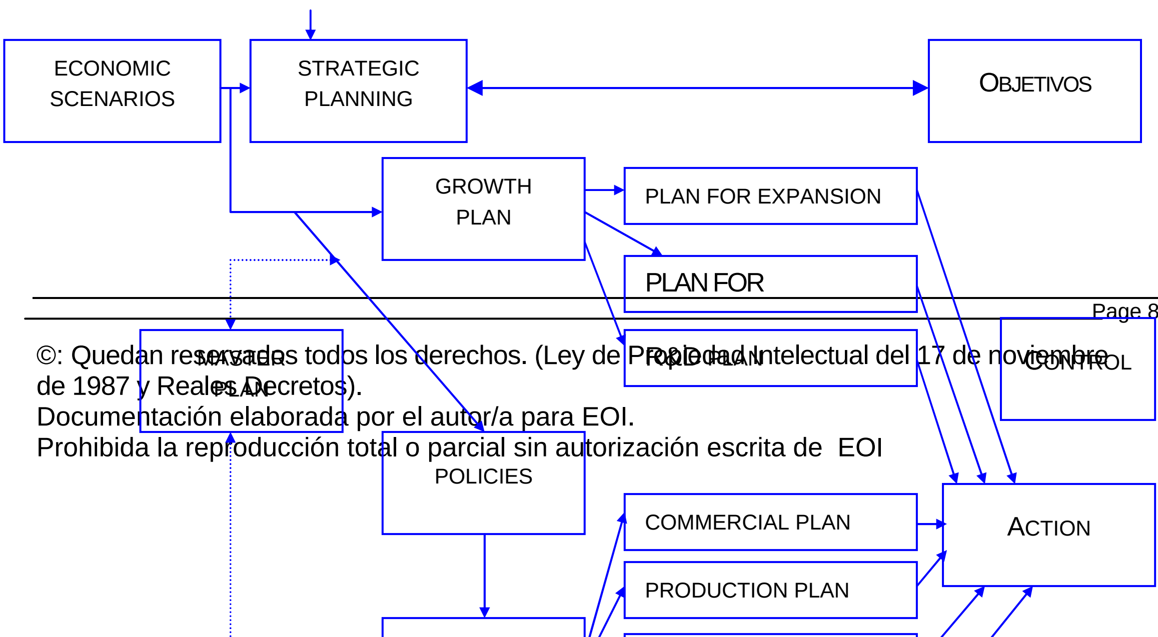
7.3 THE STRATEGIC PLAN

The strategic plan is the document covering strategic actions over a specific period of time. Although the level of detail, the scope and the volume of the document vary considerably from one sector to another and from one business situation to another, there is still a standard procedure for drawing it up.

- First determine what the company should be (its mission), with regard to the current situation
- Set corporate objectives for the time horizon under consideration
- Define the business areas in which the company wishes to compete
- Determine the competitive strategy for each business
- Define the main strategic actions
- Establish functional goals in each business
- Draw up detailed plans
- Consolidate budgets for all the plans

You will have realised that this general outline is the same as for the company's strategic management. The analytical phase is sometimes included in the plan, as well as some of the main control targets. What is substantially different is the way the plan is used in practice, which will depend on the company's planning philosophy. An "old" company which is not in the habit of planning will set up a strategic plan only when it faces problems or wishes to re-orient the company. One that has a strategic management philosophy will consider the plan to be a living, renewable document that includes the annual operating plan.

GRAPH 16. THE STRATEGIC PLAN



Graph 16 shows the elements of a strategic plan and how they interact. Actions in each of the functional areas (sales, production/operations, finance, etc.) must not only be coordinated but also perfectly adapted to growth plans (expansion, diversification, etc.). The plan should focus on the growth gap or functional coordination of activities depending on the particular situation of the company.

7.4 ADAPTATION OF STRATEGY TO STRUCTURE

The traditional approach was to consider the organisation to be the basis of a business. It was normally associated with resistance to change, with a marked focus on the organisation chart and function-oriented management. It was even seen as a tool for obtaining power.

Within the outline for strategic business management, organisation is a key factor in that it has a direct effect on efficiency and costs and reflects (or influences) the behaviour of the management and staff. Any organisational design must take into account:

- The company's core competencies and the stage at which they are at
- Requirements of the environment (market complexity / competition)
- Available human capacity ("intellectual capital", predisposition, etc.)
- Inter-dependence amongst the different areas of the company.

It should also be flexible, motivating, problem-oriented and should promote strategic positions. Today the theoreticians advocate a reduction of organisational levels to the minimum.

Graph 17 shows how the organisational structure of a company develops in line with its business development. A new company may have no explicit organisation at all (although there will necessarily be tacit organisation of work and of decision-making). As the company develops, becoming a large, diversified conglomerate, it goes through different stages of functional, mixed, divisional and matrix structure. The right-hand column shows changes in the decision-making process, moving from intuitive, individual decision to collective decision-making based on experience.

GRAPH 17. DEVELOPMENT

STAGES	COMPANY	STRATEGY	TYPE OF STRUCTURE	CHARACTERISTICS
1	Small	– Very few products – One technology – One market	None	Creativity
2	Medium	The same as a small company but with greater volume	Functional	Standard tasks
3	Large	The same as a medium company but with greater volume	Functional with decentralisation . Functional relations	Double line of command
4	Large and diversified	– Several products – Several technologies – Several markets – Several channels	– Mixed – By product – By division – By matrix	Collective decision-making

No single structure is necessarily better than another. It will always depend on conditions in the company, and the organisational structure will always condition the strategy to be adopted. This ambivalent effect, which is clear to any person with a Latin way of thinking and some business experience, is now being widely accepted by American writers and is becoming the accepted norm.

For example, there is no point in a company promoting a strategy involving increased foreign presence if its staff do not like travelling. This would require taking on new staff and comparing the additional revenue with the extra cost. The new staff would probably not be welcomed by the older staff who would feel they were being excluded from the future of the company. It seems obvious but is not always recognised.

7.5 THE PROCESS OF STRATEGIC CONTROL

Re-read the last paragraphs of point 1.3 to remember the concept and working principles of strategic control. This is a basic tool for applying strategic management in a company. In advanced companies it also forms the basis for economic calculation—at both product and company level—and for decision-making, as well as acting as a significant tool for coordination and coherence and for creating doctrine. Strategic control brings together the three key elements of customer, competition and company.

It is based on the quality and efficiency of the business information system which collects, filters, orders and processes internal information (sales, costs, margins, collections, payments, order portfolios, etc.) and external information (market, prices, competitors' advantages, changing legislation, etc.). The speed at which the information system works will to a large extent determine the company's reaction to impacts from the environment. Setting up and operating a system requires time, money and effort but it brings huge returns. A company with no business information system cannot correctly apply its strategic management.

The benefits of a control process include:

- Evaluation of the efficiency of the strategic plan
  - Determination of target variables
  - Establishment of the results measurement system
  - Procedure for corrective actions

- Identification of results at business unit level
  - In line with target variables
  - Allowing comparison amongst units

- Determination of management quality
  - Enforcement of plans
  - Definition of preventive measures
  - Measures for adapting strategies