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# **MANAGEMENT CONSULTING**

**METHODICAL GUIDELINES  
to practical classes and independent work  
for training Masters  
specialty 073 "Management"**

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## Preface

Management consulting is the practice of helping organizations to improve their performance, operating primarily through the analysis of existing organizational problems and the development of plans for improvement. Organizations may draw upon the services of management consultants for a number of reasons, including gaining external (and presumably objective) advice and access to the consultants' specialized expertise.

As a result of their exposure to, and relationships with numerous organizations, consulting firms are typically aware of industry "best practices", although the specific nature of situations under consideration may limit the transferability of such practices from one organization to another.

Consultancies may also provide organizational change management assistance, development of coaching skills, process analysis, technology implementation, strategy development, or operational improvement services. Management consultants often bring their own proprietary methodologies or frameworks to guide the identification of problems and to serve as the basis for recommendations for more effective or efficient ways of performing work tasks.

The functions of consulting services are commonly broken down into eight task categories.[6] Consultants can function as bridges for information and knowledge, and that external consultants can provide these bridging services more economically than client firms themselves.

Consultants have specialized skills on tasks that would involve high internal coordination costs for clients, such as organization-wide changes or the implementation of information technology. In addition, because of economies of scale, their focus and experience in gathering information worldwide and across industries renders their information search less costly than for clients.

The purpose of teaching the discipline Management consulting is the acquisition of skills management consulting and organizational development, mastering the methods of diagnosis of the problems and ways to encourage people to change processes.

The practical sessions cover theoretical principles according to thematic lesson plan, detailed examples and practical problems. Each practice session contains the necessary theoretical information, the order of execution of work and the sample solution that facilitates the perception of the new material, contributes to a better assimilation of the theoretical material that is of interest to students more in-depth study of the course. Developed options allow you to efficiently organize knowledge tests, to effectively understand and objectively evaluate theoretical and practical training of students in the discipline.

# 1 Topic 1

## Porter's Five Forces Model

**Learning aim:** provide an understanding of Porter's Five Forces Model for management of organizations

The five forces model was developed by Michael E. Porter to help companies assess the nature of an industry's competitiveness and develop corporate strategies accordingly. The framework allows a business to identify and analyze the important forces that determine the profitability of an industry (Figure 1.1).

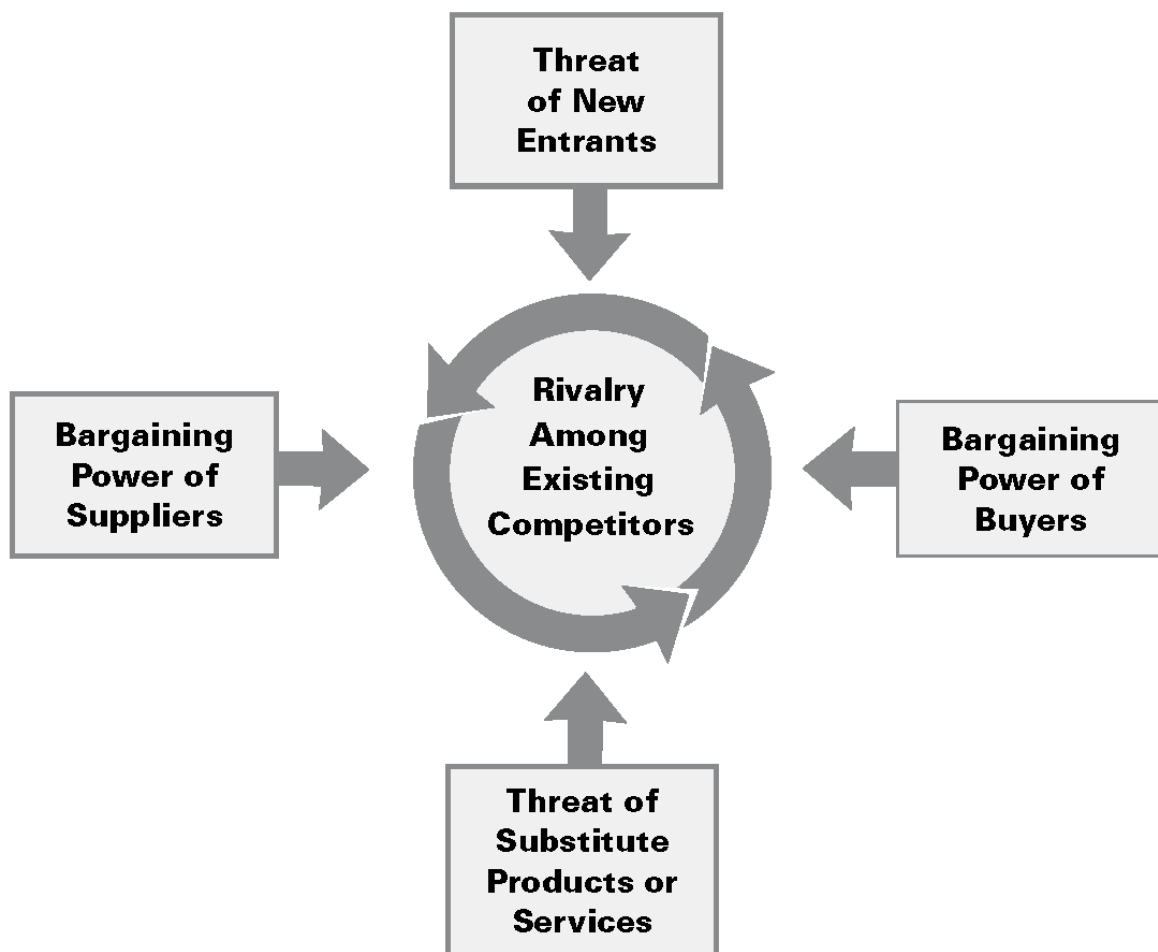


Figure 1.1 Five Forces Model

Through his model, Porter classifies five main competitive forces that affect any market and all industries. It is these forces that determine how much competition will exist in a market and consequently the profitability and attractiveness of this market for a company. Through sound corporate strategies, a company will aim to shape these forces to its advantage to strengthen the organizations position in the industry.

For the purpose of this model, industry attractiveness is the overall profitability potential of the industry. An attractive industry will be one where the combined

power of the competitive forces will increase profitability potential. An unattractive industry will be one where the collective impact of the forces will drive down profitability potential.

These forces, termed as the micro environment by Porter, influence how a company serves its target market and whether it is able to turn a profit. Any change in one of the forces might mean that a company has to re-evaluate its environment and realign its business practices and strategies.

An attractive market place does not mean that all companies will enjoy similar success levels. Rather, the unique selling propositions, strategies and processes will put one company over the other.

**Composition of Forces.** Within each industry, the effect of different forces will be different. This is why it becomes imperative to develop this model separately for every industry even if the same company is competing across different markets and industries. As an example, the airline industry has fierce competition among the two producers, Airbus and Boeing. The bargaining power of the buyers, all airlines, is fairly high. On the other hand, there is almost no threat of new entry into the market given high degrees of proprietary knowledge and high investments. There is also no threat of substitutes and the power of suppliers is also generally benign. On the other hand in the film business, there is a high threat of substitutes from various other forms of entertainment. In addition, the power of suppliers (e.g. filmmakers, etc.) is also high as they supply the vital most input for the industry.

Whatever the industry, there may be one or two forces that end up driving all strategy formation. It is not always easy to determine which force is the key one. An obvious force may not be the one increasing or decreasing profitability.

**History.** In 1979, Harvard Business School professor Michael E. Porter developed the five forces model. It was his first article for the Harvard Business review titled “How Competitive Forces Shape Strategy”. It was later detailed in his book on Competitive strategy. This model aimed to provide a new way to use effective strategy to identify, analyze and manage external factors in an organization’s environment.

Porter’s work has been recognized as extremely important in the field. Despite criticisms regarding its applicability in a much altered world, it remains one of the most widely used methods of industry analysis.

The five forces identified by Porter are divided into:

- **Horizontal forces:** Threat of substitutes, threat of new entrants, competitive rivalry;
- **Vertical forces:** Bargaining power of buyers and bargaining power of customers.

## **1. Rivalry among existing competitors (Competitive Rivalry)**

One important force that Porter describes is the degree of rivalry between existing companies in the market. If there are more companies competing with each other, the resulting competitive pressure will mean that prices, profits and strategy will be driven by it.

One company may end up having little or no power in its own industry if there is a variety of quality products are offered in the market in direct competition with it. Customers have the option of simply moving on to a different company easily. Conversely, in the absence of this rivalry, the company may be able to freely set prices and profit margins without being dictated by what the customer finds attractive.

### ***When is competitive rivalry high?***

Competitive rivalry may be higher when:

- Similar sized companies operate in one market;
- These companies have similar strategies;
- Products on offer have similar features and offer the same benefits;
- Growth in the industry is slow;
- There are high barriers to exit or low barriers to entry.

## **2. Threat of new Entrants**

The competitive threat to a company's business may not only be from existing players in the market but also from potential new entrants into the market place. If an industry is profitable, or attractive in a long term strategic manner, then it will be attractive to new companies. Unless there are barriers to entry in place, new firms may easily enter the market and change the dynamics of the industry.

The particular dynamics of an industry that restrict entry into it are called barriers to entry. The most attractive scenario for a new company is when a potential market has low barriers to exit but high barriers to entry. The economics of any industry will determine the level of difficulty faced when trying to enter this market.

### ***When are barriers for new entrants high?***

Barriers to entry may stem from things like:

- patents and proprietary knowledge;
- access to specialized technology or infrastructure;
- economies of scale or government driven obstacles;
- high initial investment needed;
- high switching costs for consumers, loyal consumers;
- difficulty in accessing raw material and difficulty in accessing distribution channels.

## **3. Threat of Substitutes**

Within the framework defined by Porter, substitute products are those that exist in another industry but may be used to fulfill the same need. When more substitutes that exist for a product, the larger the company's competitive environment and the lower the potential for profit. An example of this is that for a boxed juice producer, fresh juice, water and soft drinks are all substitutes though they exist in separate categories.

A high threat of substitutes will impact a company's ability to set prices that it wants. If a substitute is priced lower or fulfills a need better than it may end up

attracting consumers towards it and reduce sales for existing companies.

***When is there a threat from substitutes?***

The threat of substitutes is affected by factors such as brand loyalty, switching costs, relative prices, as well as trends and fads.

#### **4. Bargaining Power of Buyers**

When buyers have the power to affect prices in an industry, it becomes an important factor to consider for a company.

***When is buyer power high?***

Buyers tend to have power over an industry if they are important to the company, this may be if the industry is such that buyers either buy in bulk, or can easily switch to another supplier. A limited number of strong buyers may be able to exert significant control over a seller. In addition, if a product is similar to its competitor with little or no differentiation, then there are chances that the company may need to let the supplier dictate terms in order to avoid losing the customer.

#### **5. Bargaining Power of Suppliers**

Suppliers provide the raw material needed to provide a good or service. This means that there is usually a need to maintain strong steady relationships with suppliers. Depending on the industry dynamics, suppliers may be in the position to dictate terms, set prices and determine availability timelines. Powerful suppliers may be able to increase costs without affecting their own sales volume or reduce quantities that they sell.

***When do suppliers have power?***

Supplier may enjoy more power if there are less of them. Costs of switching to an alternate are high, or there are no alternates. A supplier may also be the only provider of a certain raw material. This may be the case in instances where a supplier holds a patent or have proprietary knowledge. Because of a lack of alternates, they may be able to withhold quantities or increase prices without losing sales.

### **HOW TO USE THE MODEL**

The Porter's five forces model is often used as a starting point to evaluate a company's position in its industry and to assess its level of competitiveness. Though this framework is generic and applicable to any industry, it is only effective if it is used in a specific context that applies directly to the company undertaking the evaluation.

Porter also emphasized the importance of using this model at more basic industry level. If an organization operates in different industries, then it must develop a separate five forces model for each of its industries.

#### **Steps To Follow When Performing Analysis**

A company may follow three basic steps when performing an industry analysis:



### 1. *Gather information on each force*

During the first step, the company should gather information about their industry using the five forces as a guide for classifying this information.

### 2. *Analyze results and display in a diagram*

After substantial information has been gathered, a team may sit down and analyze how each of the identified factors affect the industry. Every industry will have different factors affecting it differently. This makes it vital to not compare across industries or use another industry's data.

### 3. *Formulate Strategy based on conclusions*

The analysis of factors affecting the industry can now be translated into specific strategies to further the interests of the company.

## **Navigating the Model Development: Before, During and After**

It is beneficial for a company working on a Porter's five forces analysis to maintain an analytical frame of mind before the process begins, during the process and after everything has been completed. Some aspects to keep in mind are:

### ***Before:***

- Understand the goals of the analysis and expectations from it;
- Understand the scope of the analysis and who are the potential beneficiaries;
- Allow open and honest brainstorming session regarding these questions.

### ***During:***

- Keep a focus on the future;
- Do not focus on what could've been done better in the past, but focus on future improvements;
- Analyze positives and negatives;
- Be open to new ideas and possibilities.

### ***After:***

- Identify lessons learnt and how they can be used in the future;
- Document positives and negatives. Identify best practices;
- Understand whether the analysis had the required impact;
- Follow up on implementation plans;
- Record information from the analysis to be used in future decisions.

## **Models DO'S and DONT'S**

As with any framework, there are specific ways to use this one successfully. In order to gain any benefits from a Porter's five forces analysis it should:

- ***Not*** be used on an individual company but rather in the entire industry;
- These findings can then be used to devise strategies for the company itself;
- ***Be used*** when there are at least three or more competing firms in the market;
- ***Consider*** the impact of the government on the industry;
- ***Consider*** which stage in the lifecycle the industry is;
- ***Consider*** the changing nature of industries and markets.

## CRITICISMS

Over the years, people have challenged underlying principles that Porter based his five forces model on. Some of these criticisms have been:

### **Doubtful Assumptions**

Academics such as Stewart Neill, have taken exception to what they call the three dubious assumptions made within the model. These are:

- The assumption that buyers, competitors and suppliers are separate entities that never interact, never collude and never influence each other directly;
- The assumption that structural advantage or the creation of entry barriers is the source of value;
- The assumption that there is always low uncertainty which allows participants in a market to always be able to plan ahead and counter competitor actions.

### **The 6<sup>th</sup> Force**

Through game theory, Adam Brandenburger and Barry Nalebuff of Yale, added a new concept to the Porter's five forces model. In the mid 1990s, they proposed the idea of complementary force which may have been termed a 6th force by Andrew Grove, former CEO Intel. These complementary forces may be the government or the public.

Porter himself countered this addition to the model by the assertion that the government or public are factors that affect the five forces.

## Control questions

### *Question 1*

What is the purpose of Porter's Five Forces Model?

### *Question 2*

What competitive forces refer to Michael E. Porter's model?

### *Question 3*

What can you say about composition of Forces?

Describe them in detail.

### *Question 4*

What is Competitive Rivalry? When is competitive rivalry high?

### *Question 5*

What is Threat of new Entrants? When are barriers for new entrants high?

### *Question 6*

What is Threat of Substitutes? When is there a threat from substitutes?

### *Question 7*

What is Bargaining Power of Buyers? When is buyer power high?

***Question 8***

What is Bargaining Power of Suppliers? When do suppliers have power?

***Question 9***

What basic steps may follow a company when performing an industry analysis?

***Question 10***

Explain in detail navigating of the Model Development: Before, During and After.

***Question 11***

Describe the Model's DO'S and DONT'S.

***Question 12***

What can you tell about criticisms of Five Forces Model?

## 2 Topic 2 The McKinsey 7-S Framework

**Learning aim:** study and analyze basic concepts, principles and applications of McKinsey 7-S Framework in consulting.

The McKinsey 7-S framework was developed by McKinsey in the early 1980s as a way of analyzing high-performance organizations.

The 7-S model can be used in a wide variety of situations where an alignment perspective is useful, for example, to help you:

- Improve the performance of a company;
- Examine the likely effects of future changes within a company;
- Align departments and processes during a merger or acquisition;
- Determine how best to implement a proposed strategy.

The McKinsey 7-S model can be applied to elements of a team or a project as well. The alignment issues apply, regardless of how you decide to define the scope of the areas you study.

### **The Seven Elements**

The McKinsey 7-S model involves seven interdependent factors which are categorized as either "hard" or "soft" elements:

<b>Hard Elements</b>	<b>Soft Elements</b>
Strategy Structure Systems	Shared Values Skills Style Staff

"Hard" elements are easier to define or identify and management can directly influence them: These are strategy statements; organization charts and reporting lines; and formal processes and IT systems.

"Soft" elements, on the other hand, can be more difficult to describe, and are less tangible and more influenced by culture. However, these soft elements are as important as the hard elements if the organization is going to be successful.

The way the model is presented in Figure 1 below depicts the interdependency of the elements and indicates how a change in one affects all the others.

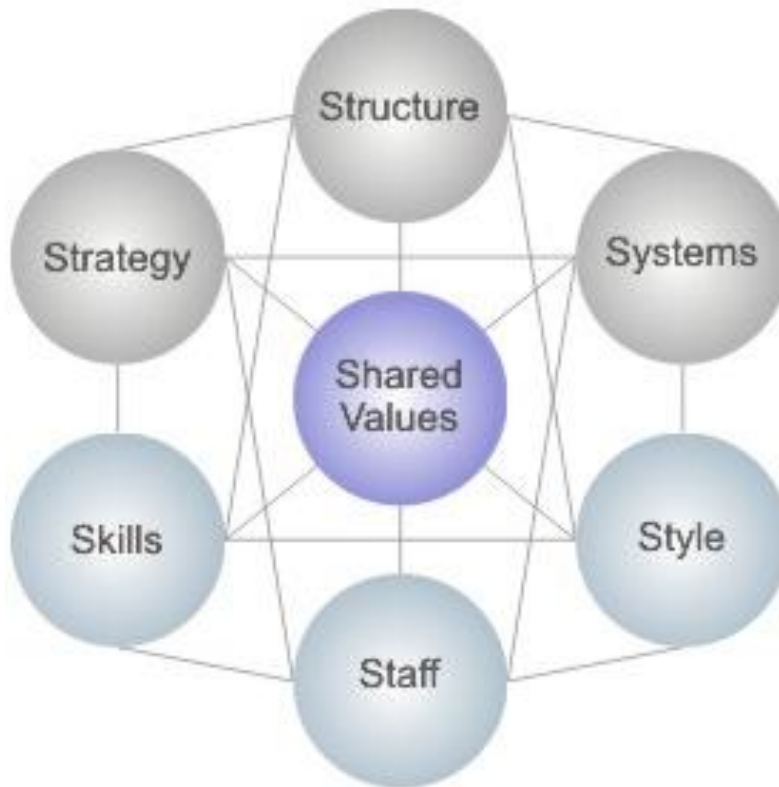


Figure 1. The McKinsey 7S Model

#### Elements of 7S Model

- **Strategy:** the plan devised to maintain and build competitive advantage over the competition.
- **Structure:** the way the organization is structured and who reports to whom.
- **Systems:** the daily activities and procedures that staff members engage in to get the job done.
- **Shared Values:** called "superordinate goals" when the model was first developed, these are the core values of the company that are evidenced in the corporate culture and the general work ethic.
- **Style:** the style of leadership adopted.
- **Staff:** the employees and their general capabilities.
- **Skills:** the actual skills and competencies of the employees working for the company.

Placing Shared Values in the middle of the model emphasizes that these values are central to the development of all the other critical elements. The company's structure, strategy, systems, style, staff and skills all stem from why the organization was originally created, and what it stands for. The original vision of the company was formed from the values of the creators. As the values change, so do all the other elements.

Also, the first version of this model, published in 1982, classified "systems" as "soft". Since 1982, very many processes in very many organizations have been

meticulously documented or automated, making them relatively easy to analyze and change. They are therefore shown above as “hard”.

### **How to Use the Model**

The model is based on the theory that, for an organization to perform well, these seven elements need to be aligned and mutually reinforcing. So, the model can be used to help identify what needs to be realigned to improve performance, or to maintain alignment (and performance) during other types of change.

Whatever the type of change – restructuring, new processes, organizational merger, new systems, change of leadership, and so on – the model can be used to understand how the organizational elements are interrelated, and so ensure that the wider impact of changes made in one area is taken into consideration.

You can use the 7-S model to help analyze the current situation (Point A), a proposed future situation (Point B) and to identify gaps and inconsistencies between them. It's then a question of adjusting and tuning the elements of the 7-S model to ensure that your organization works effectively and well once you reach the desired endpoint.

Changing your organization probably will not be simple at all! Whole books and methodologies are dedicated to analyzing organizational strategy, improving performance and managing change. The 7-S model is a good framework to help you ask the right questions – but it won't give you all the answers. For that you'll need to bring together the right knowledge, skills and experience.

When it comes to asking the right questions, we've developed a Mind Tools checklist and a matrix to keep track of how the seven elements align with each other. Supplement these with your own questions, based on your organization's specific circumstances and accumulated wisdom.

### **7-S Checklist Questions**

Here are some of the questions that you'll need to explore to help you understand your situation in terms of the 7-S framework. Use them to analyze your current (Point A) situation first, and then repeat the exercise for your proposed situation (Point B).

#### **Strategy:**

- What is our strategy?
- How do we intend to achieve our objectives?
- How do we deal with competitive pressure?
- How are changes in customer demands dealt with?
- How is strategy adjusted for environmental issues?

#### **Structure:**

- How is the company/team divided?
- What is the hierarchy?
- How do the various departments coordinate activities?
- How do the team members organize and align themselves?
- Is decision making and controlling centralized or decentralized? Is this as it should be, given what we're doing?
- Where are the lines of communication? Explicit and implicit?

**Systems:**

- What are the main systems that run the organization? Consider financial and HR systems as well as communications and document storage.
- Where are the controls and how are they monitored and evaluated?
- What internal rules and processes does the team use to keep on track?

**Shared Values:**

- What are the core values?
- What is the corporate/team culture?
- How strong are the values?
- What are the fundamental values that the company/team was built on?

**Style:**

- How participative is the management/leadership style?
- How effective is that leadership?
- Do employees/team members tend to be competitive or cooperative?
- Are there real teams functioning within the organization or are they just nominal groups?

**Staff:**

- What positions or specializations are represented within the team?
- What positions need to be filled?
- Are there gaps in required competencies?

**Skills:**

- What are the strongest skills represented within the company/team?
- Are there any skills gaps?
- What is the company/team known for doing well?
- Do the current employees/team members have the ability to do the job?
- How are skills monitored and assessed?

**7-S Matrix Questions**

Using the information you have gathered, now examine where there are gaps and inconsistencies between elements. Remember you can use this to look at either your current or your desired organization.

**McKinsey 7-S Worksheet**

**Current Situation (Point A)**

	Shared Values	Strategy	Structure	Systems	Style	Staff	Skills
Shared Values							
Strategy							
Structure							
Systems							
Style							
Staff							
Skills							

**Future Situation (Point B)**

	Shared Values	Strategy	Structure	Systems	Style	Staff	Skills
Shared Values							
Strategy							
Structure							
Systems							
Style							
Staff							
Skills							

McKinsey 7-S Worksheet contains a matrix that you can use to check off alignment between each of the elements as you go through the following steps:

- Start with your Shared Values: Are they consistent with your structure, strategy, and systems? If not, what needs to change?
- Then look at the hard elements. How well does each one support the others? Identify where changes need to be made.
- Next look at the other soft elements. Do they support the desired hard elements? Do they support one another? If not, what needs to change?
- As you adjust and align the elements, you'll need to use an iterative (and often time consuming) process of making adjustments, and then re-analyzing how that impacts other elements and their alignment. The end result of better performance will be worth it.

**Key Points**

The McKinsey 7-S model is one that can be applied to almost any organizational or team effectiveness issue. If something within your organization or team isn't working, chances are there is inconsistency between some of the elements identified by this classic model. Once these inconsistencies are revealed, you can work to align the internal elements to make sure they are all contributing to the shared goals and values.

The process of analyzing where you are right now in terms of these elements is worthwhile in and of itself. But by taking this analysis to the next level and determining the ultimate state for each of the factors, you can really move your organization or team forward.

**Control questions**

**Question 1**

In what situations can be used the 7-S model?



**Question 2**

What factors does McKinsey 7-S model involve?

**Question 3**

How we can use the 7-S Model? Describe it in detail.

**Question 4**

What are the 7-S Checklist Questions? What kind of the questions will you need to explore to help you understand your situation in terms of the 7-S framework?

**Question 5**

What questions from 7-S Checklist refer to the Strategy, Structure and Systems?

**Question 6**

What questions from 7-S Checklist refer to Shared Values, Style, Staff and Skills?

**Question 7**

How to use the McKinsey 7-S Worksheet?

**Question 8**

What are the Key Points of The McKinsey 7-S model?

### 3 Topic 3 Value chain analysis

**Learning aim:** study the value chain analysis as a tool for defining a firm's core competencies and the activities in which it can pursue a competitive advantage.

Value chain analysis is a way of describing the activities within and around an organization that is then used to identify potential sources of a company's economic advantages, and thereby make an assessment of its competitive strengths.

Value chain analysis, originated by Porter (1985), derives from value analysis, an accounting tool developed in the 1950s. Value analysis was designed to show the value-added components in a company's manufacturing process. Porter took the concept a stage further by linking all an organization's separate operations and then assigning a value to each activity.

Porter identified primary and support activities as shown in the following diagram:

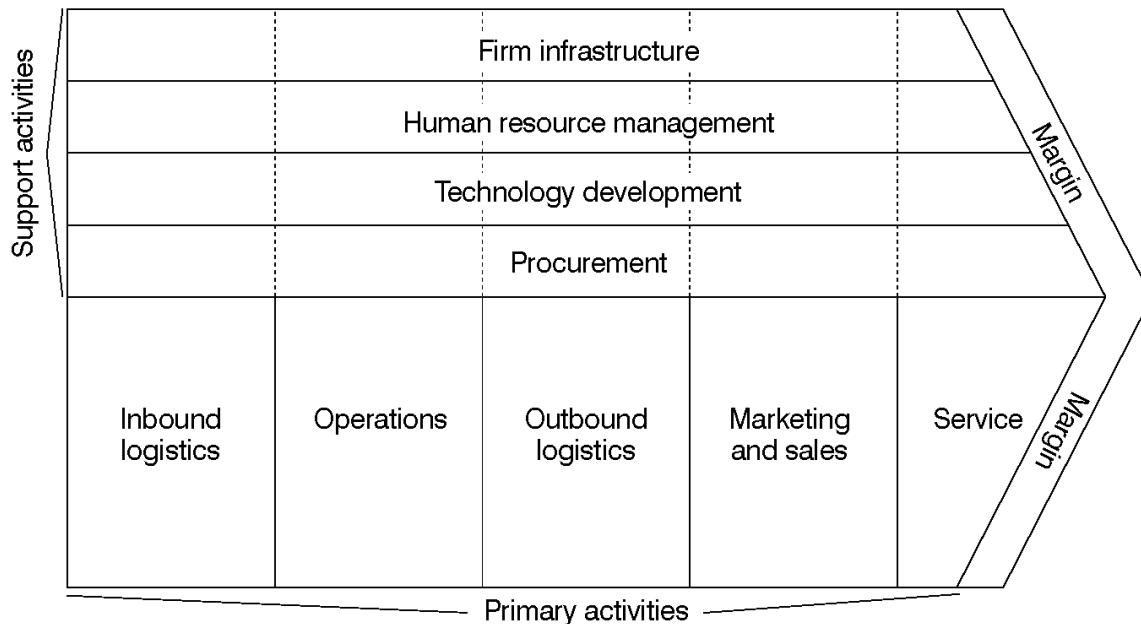


Figure 3.1 The generic value chain

The goal of these activities is to offer the customer a level of value that exceeds the cost of the activities, thereby resulting in a profit margin.

The primary value chain activities are:

- Inbound Logistics: the receiving and warehousing of raw materials, and their distribution to manufacturing as they are required;
- Operations: the processes of transforming inputs into finished products and services;
- Outbound Logistics: the warehousing and distribution of finished goods;

- Marketing & Sales: the identification of customer needs and the generation of sales;
- Service: the support of customers after the products and services are sold to them.

These primary activities are supported by:

- The infrastructure of the firm: organizational structure, control systems, company culture, etc.;
- Human resource management: employee recruiting, hiring, training, development, and compensation;
- Technology development: technologies to support value-creating activities;
- Procurement: purchasing inputs such as materials, supplies, and equipment.

The firm's margin or profit then depends on its effectiveness in performing these activities efficiently, so that the amount that the customer is willing to pay for the products exceeds the cost of the activities in the value chain. It is in these activities that a firm has the opportunity to generate superior value. A competitive advantage may be achieved by reconfiguring the value chain to provide lower cost or better differentiation.

The value chain model is a useful analysis tool for defining a firm's core competencies and the activities in which it can pursue a competitive advantage as follows:

- **Cost advantage:** by better understanding costs and squeezing them out of the value-adding activities;
- **Differentiation:** by focusing on those activities associated with core competencies and capabilities in order to perform them better than do competitors.

## Cost Advantage and the Value Chain

A firm may create a cost advantage either by reducing the cost of individual value chain activities or by reconfiguring the value chain.

Once the value chain is defined, a cost analysis can be performed by assigning costs to the value chain activities. The costs obtained from the accounting report may need to be modified in order to allocate them properly to the value creating activities.

Porter identified 10 cost drivers related to value chain activities:

- Economies of scale;
- Learning;
- Capacity utilization;
- Linkages among activities;
- Interrelationships among business units;
- Degree of vertical integration;
- Timing of market entry;
- Firm's policy of cost or differentiation;
- Geographic location;
- Institutional factors (regulation, union activity, taxes, etc.)

A firm develops a cost advantage by controlling these drivers better than do the competitors.

A cost advantage also can be pursued by reconfiguring the value chain. Reconfiguration means structural changes such as a new production process, new distribution channels, or a different sales approach. For example, FedEx structurally redefined express freight service by acquiring its own planes and implementing a hub and spoke system.

## **Differentiation and the Value Chain**

A differentiation advantage can arise from any part of the value chain. For example, procurement of inputs that are unique and not widely available to competitors can create differentiation, as can distribution channels that offer high service levels.

Differentiation stems from uniqueness. A differentiation advantage may be achieved either by changing individual value chain activities to increase uniqueness in the final product or by reconfiguring the value chain.

Porter identified several drivers of uniqueness:

- Policies and decisions;
- Linkages among activities;
- Timing;
- Location;
- Interrelationships;
- Learning;
- Integration;
- Scale (e.g. better service as a result of large scale);
- Institutional factors.

Many of these also serve as cost drivers. Differentiation often results in greater costs, resulting in tradeoffs between cost and differentiation.

There are several ways in which a firm can reconfigure its value chain in order to create uniqueness. It can forward integrate in order to perform functions that once were performed by its customers. It can backward integrate in order to have more control over its inputs. It may implement new process technologies or utilize new distribution channels. Ultimately, the firm may need to be creative in order to develop a novel value chain configuration that increases product differentiation.

## **Technology and the Value Chain**

Because technology is employed to some degree in every value creating activity, changes in technology can impact competitive advantage by incrementally changing the activities themselves or by making possible new configurations of the value chain.

Various technologies are used in both primary value activities and support activities:

- **Inbound Logistics Technologies**
  - Transportation;
  - Material handling;
  - Material storage;
  - Communications;
  - Testing;
  - Information systems.
- **Operations Technologies**
  - Process;
  - Materials;
  - Machine tools;
  - Material handling;
  - Packaging;
  - Maintenance;
  - Testing;
  - Building design & operation;
  - Information systems.
- **Outbound Logistics Technologies**
  - Transportation;
  - Material handling;
  - Packaging;
  - Communications;
  - Information systems.
- **Marketing & Sales Technologies**
  - Media;
  - Audio/video;
  - Communications;
  - Information systems.
- **Service Technologies**
  - Testing;
  - Communications;
  - Information systems.

Note that many of these technologies are used across the value chain. For example, information systems are seen in every activity. Similar technologies are used in support activities. In addition, technologies related to training, computer-aided design, and software development frequently are employed in support activities.

To the extent that these technologies affect cost drivers or uniqueness, they can lead to a competitive advantage.

### **Linkages between Value Chain Activities**

Value chain activities are not isolated from one another. Rather, one value

chain activity often affects the cost or performance of other ones. Linkages may exist between primary activities and also between primary and support activities.

Consider the case in which the design of a product is changed in order to reduce manufacturing costs. Suppose that inadvertently the new product design results in increased service costs; the cost reduction could be less than anticipated and even worse, there could be a net cost increase.

Sometimes however, the firm may be able to reduce cost in one activity and consequently enjoy a cost reduction in another, such as when a design change simultaneously reduces manufacturing costs and improves reliability so that the service costs also are reduced. Through such improvements the firm has the potential to develop a competitive advantage.

### **Analyzing Business Unit Interrelationships**

Interrelationships among business units form the basis for a horizontal strategy. Such business unit interrelationships can be identified by a value chain analysis.

Tangible interrelationships offer direct opportunities to create a synergy among business units. For example, if multiple business units require a particular raw material, the procurement of that material can be shared among the business units. This sharing of the procurement activity can result in cost reduction. Such interrelationships may exist simultaneously in multiple value chain activities.

Unfortunately, attempts to achieve synergy from the interrelationships among different business units often fall short of expectations due to unanticipated drawbacks. The cost of coordination, the cost of reduced flexibility, and organizational practicalities should be analyzed when devising a strategy to reap the benefits of the synergies.

### **Outsourcing Value Chain Activities**

A firm may specialize in one or more value chain activities and outsource the rest. The extent to which a firm performs upstream and downstream activities is described by its degree of vertical integration.

A thorough value chain analysis can illuminate the business system to facilitate outsourcing decisions. To decide which activities to outsource, managers must understand the firm's strengths and weaknesses in each activity, both in terms of cost and ability to differentiate. Managers may consider the following when selecting activities to outsource:

- Whether the activity can be performed cheaper or better by suppliers.
- Whether the activity is one of the firm's core competencies from which stems a cost advantage or product differentiation?
- The risk of performing the activity in-house. If the activity relies on fast-changing technology or the product is sold in a rapidly-changing market, it may be advantageous to outsource the activity in order to maintain flexibility and avoid the risk of investing in specialized assets.

- Whether the outsourcing of an activity can result in business process improvements such as reduced lead time, higher flexibility, reduced inventory, etc.

## The Value Chain System

A firm's value chain is part of a larger system that includes the value chains of upstream suppliers and downstream channels and customers. Porter calls this series of value chains the *value system*, shown conceptually below:

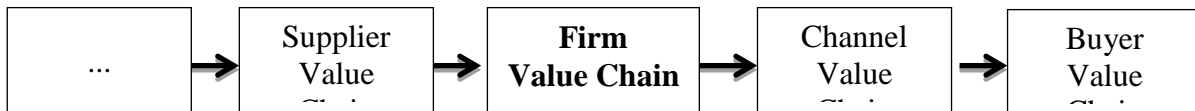


Figure 3.2 The Value System

Linkages exist not only in a firm's value chain, but also between value chains. While a firm exhibiting a high degree of vertical integration is poised to better coordinate upstream and downstream activities, a firm having a lesser degree of vertical integration nonetheless can forge agreements with suppliers and channel partners to achieve better coordination. For example, an auto manufacturer may have its suppliers set up facilities in close proximity in order to minimize transport costs and reduce parts inventories. Clearly, a firm's success in developing and sustaining a competitive advantage depends not only on its own value chain, but on its ability to manage the value system of which it is a part.

### Control questions

#### **Question 1**

What is the aim of Value chain analysis?

#### **Question 2**

Describe the generic value chain.

#### **Question 3**

What are the primary value chain activities?

#### **Question 4**

What can you say about Cost Advantage and the Value Chain?

#### **Question 5**

What drivers of uniqueness are identified by Porter?

#### **Question 6**

What technologies are used in both primary value activities and support activities?

***Question 7***

What Linkages are between Value Chain Activities?

***Question 8***

Describe the Analyzing Business Unit Interrelationships.

***Question 9***

What is the role of Outsourcing in Value Chain Activities?

***Question 10***

Describe the Value Chain System.



## **4 Topic 4**

### **The Boston Matrix**

**Learning aim:** study the Boston Matrix as a method for classifying products based on their current value and future value.

Today's organizations find themselves operating in an environment that is changing faster than ever before. The process of analyzing the implications of these changes and modifying the way that the organization reacts to them is known as business strategy.

A key role of management within the strategy planning process is to provide market intelligence. This information and data will play a significant role in analyzing the internal capabilities of the organization, an essential part of strategy development and implementation.

The organization's response can only be effective if it has a clear understanding of its own internal capabilities. One of the most popular tools used by organizations to analyze these is the Boston Matrix. Bruce Henderson developed this business analysis technique in 1970 for use within the Boston Consulting Group. It was designed for use by its consultants to help corporations with analyzing their business units or product lines.

This technique has become known by several different names including: B-Box, BCG Analysis, BCG-matrix, Boston Box, Boston Matrix, Boston Consulting Group Analysis and the Portfolio Diagram.

The Boston Matrix is used to help the organization decide how to allocate resources to each product or service it sells depending on how that product or service is positioned in the market. It is often used by people responsible for brand marketing, product management, strategic management, and portfolio analysis.

The Boston Matrix helps to facilitate discussions on the value of the contribution made by, and investment required for, specific products and services. Its findings enable decisions to be made as to which ones should be maintained, which should be withdrawn, and which should be developed further.

The matrix consists of two axes: one showing market growth and the other showing market share. The resulting four quadrants form the categories by which an organization can classify its business units or products. The analysts then plot a scatter graph within the matrix that ranks either business units or products and services on the basis of their relative market shares and growth rates (figure 4.1).

This provides an initial and high-level way to screen of organization's opportunities. It provides a mechanism that enables you to think about how best to allocate resources and investment funding in order to maximize future profit and growth for portfolio of products and services.

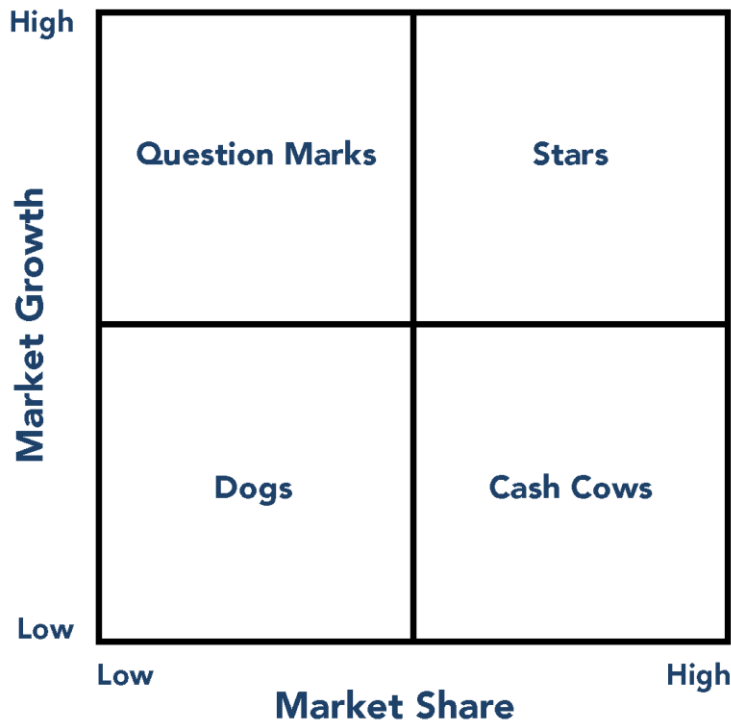


Figure 4.1 The Boston Matrix

This matrix considers the two strategic parameters of market share and market growth when it allocates a priority to a product in terms of organizational focus and activity. In order to appreciate how this prioritization is assessed you need to understand how market share and market growth are interrelated (figure 4.2).



Figure 4.2 The Boston Matrix strategic parameters

**Market share** is the percentage of either revenue or volume of sales that organization has of the total market. In other words, the higher your market share, the bigger the proportion of the market you control and influence. The matrix also

assumes that earnings rise as your market share does. This is not always the case and is one of the limitations of this analysis.

The Boston Matrix also makes a big assumption in its interpretation of market share and how it relates to profitability. It assumes that a high market share means that this organization is highly profitable for this product or service. It attributes this to the organization being well established and knowledgeable about the market, and having attained the advantages of the economies of scale.

**Market growth** is the percentage growth compared to the previous year. It is used as a measure of how attractive a market is to existing providers and potential new entrants.

High market growth creates an environment in which it is relatively easy for organizations to grow their profits, even if their market share remains the same.

In contrast, if your product is in a low growth market you will face intense competitive activity and your organization will need to employ significant effort just to retain its market share, even if it is an established provider. Often such market retention is only achieved by aggressive discounting, which makes such a low-growth market less profitable and unattractive.

The Boston Matrix consists of two axes (market growth and market share) that are split between high and low. The resulting four quadrants form the categories by which an organization can classify its business units or products.

The four categories are given the following names:

- Stars — tend to be relatively new, have a high market share, and be more or less self-financing;
- Question Marks — require substantial amounts of cash to try to attain or regain dominance in its growth market;
- Cash Cows — are a market leader in a stable market that has little potential growth. They generate significantly more cash than is needed to sustain the product;
- Dogs — are products that represent a cash drain and are near the end of their product life cycle.

Most organizations expect their products to begin life as a Question Mark, later becoming a Star and then a Cash Cow as the market matures. Finally, the product becomes a Dog as the market declines. There is no inevitability about this and some products are Stars from the moment of launch, whereas others become Dogs almost immediately.

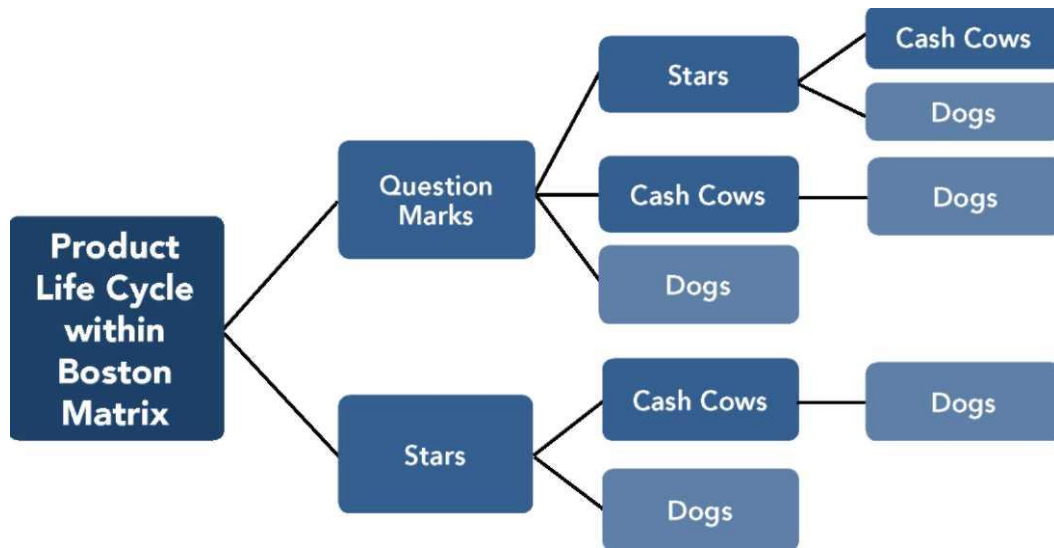


Figure 4.3 Product Life Cycle

For example, the increasing pace of technological change means that many products never have the time to achieve Cash Cow status before obsolescence turns them into a Dog.

### Stars

These are products with a substantial share of a fast-growing market.



An organization will usually consider it worthwhile to invest in retaining and growing a star's strong market share because the revenue it brings in equals or exceeds the investment required.

In an immature market, the rapidly increasing number of new customers results in fast growth and high potential profits, both of which attract new competitors into the market. Organizations operating in immature markets should remember that high revenues might come with high product development and marketing costs.

As a fast growing market reaches maturity, those products with the biggest market share become Cash Cows, whereas those that have not been able to build market share will move into the Dogs category.

### Question Marks

This category of the Boston Matrix has several common names. It is usually known as 'Question Mark' but can sometimes be referred to as a 'Wildcat' or 'Problem

Child.' This eBook refers to it as 'Question Mark' throughout.

A Question Mark has a low market share in a fast-growing market. Whilst this type of product is likely to generate some revenue it may not be enough to sustain rapid growth and it may become a net consumer of cash as it struggles to retain its market share.

Identifying those Question Marks that have the potential to gain sufficient market share to become a Star and eventually a Cash Cow is critically important to the future of any organization.



Question Marks require careful analysis to determine whether or not they are worth the investment required to grow their market share. This may be especially important if the emerging market could replace your established market in the near future.

It is essential to define how much investment the organization is prepared to allocate to a Question Mark product in order to gain market share. This type of decision requires more sophisticated analysis than the Boston Matrix can offer and an organization may need to invest heavily to transform a Question Mark product.

### **Cash Cows**

Successful products or services in mature markets are referred to as Cash Cows. Some well-known examples are:

- Ford Transit Vans and Pickup Trucks;
- Kellogg's Corn Flakes;
- Coca-Cola.

These products and services consistently generate substantial revenues that can be used to invest in markets that offer higher growth rates. Products that are described as Cash Cows will typically be market leaders and be able to provide a return on assets (ROA) that exceeds the market growth rate.



This market leadership enables a Cash Cow to earn profits that easily exceed any funding or investment required to produce or sustain them. This factor combined with few growth opportunities in this type of market allow organizations to divert or 'milk' the majority of the revenue generated to invest in faster-growing markets.

In fact, one problem with the classification of products as Cash Cows is that it can encourage people to think in terms of 'milking' the Cash Cow, something that may turn out to be short-sighted.

## **Dogs**

Dogs are found in slow-growing or shrinking mature markets and their market share is low. Any revenue they generate is just enough to sustain this low market share and from the organizational perspective they represent a drain on its resources because even though they may be 'breaking even' financially, they are using assets (people and capital) that could be better used to support a Question Mark or Star.



Ideally, the number of Dogs should be minimized so that they don't use up resources that could be better deployed elsewhere. Many products in this category are reaching the end of their product life cycle and management need to judge the benefits of continued production against withdrawing them from the market. Any redevelopment of the product is unlikely to be covered by increased revenues because any costs associated with a redesign or relaunch will prove difficult to recover in a stagnant market.

The profitability of Dogs should be constantly reviewed as the lack of profits impacts an organization's return on assets (ROA) ratio. This ratio is important to potential investors and is one of the tools that they use to make judgments about how well your organization is being run and whether or not to invest in it.

One criticism of the Boston Matrix is that the term 'Dog' is unnecessarily pejorative and derogatory. An organization may continue to produce a Dog, even though its profitability is marginal, because of its synergy with other product offerings.

Organizations would like all of their products or services to be either Cash Cows or Stars, but in reality there is always a mixed product portfolio with a variety of products at differing stages of their life cycle.\

## Control questions

### *Question 1*

For what purpose is The Boston Matrix used?

### *Question 2*

Describe The Boston Matrix in detail.

### *Question 3*

What The Boston Matrix provides?

### *Question 4*

What strategic parameters this matrix considers?

### *Question 5*

What is a market share as a strategic parameter?

### *Question 6*

What does market growth mean?

### *Question 7*

What categories The Boston Matrix includes?

### *Question 8*

Describe the Product Life Cycle.

### *Question 9*

Describe "Stars" as a category of Boston Matrix.

### *Question 10*

Describe "Question Marks" as a category of Boston Matrix.

### *Question 11*

Describe "Cash Cows" as a category of Boston Matrix.

### *Question 12*

Describe "Dogs" as a category of Boston Matrix.

## 5 Topic 5

### Financial-oriented approaches to business strategy

**Learning aim:** study Financial-oriented approaches to business strategy as a strategic tool that predicated on the evaluation with financial criteria in order to select the best one in terms of its economic effect.

The word ‘Strategy’ comes from the ancient Greek word meaning the art of leading an army. It is traditionally the ‘art of generalship’; with the word general meaning both the high military rank as well as the art of having a general, high-level, overview. The concept of strategy being applied to business first generally emerged after the Second World War in the USA. The methodology of the US forces was adapted to US industry in the late 1940s, led by people such as Robert McNamara, then President of the Ford Motor Company and later US Defense Secretary under Kennedy. The specific bridge to business strategy, according to Igor Ansoff (1965), was the 1953 publication *Theory of Games and Economic Behaviour* by von Neumann and Morgenstern, two Princeton academics. They formulated methods of resolving conflict in politics, war and business, by interpreting strategy in two ways: pure strategy and grand strategy.

Pure strategy was exemplified by a move, or series of moves, by a business in a specific area, such as product development. Grand strategy was exemplified by statistical rules against which a business could decide what pure strategies it should pursue according to the situation. In business today, strategy traditionally answers the question, ‘How can we compete in the market, and maintain an advantage?’ Such a question assumes that the market is a zero sum game, that the cake is only so big and that, inevitably, there will be winners and losers. In some instances this may well be so. However, markets are fast evolving, traditional wisdoms are becoming blurred and competitive dynamics are changing to the extent that Andy Groves, the CEO of Intel, talks of ‘coopetition’ (the merger of cooperation and competition). Thus, strategy also needs to answer the question, ‘How can we add value to customers in a sustained way?’

Whatever the answers to such questions are, business strategy needs to be linked to both systems (including IT strategy) and structure (HR strategy). Any successful business strategy will need to ensure it has fast and efficient processes and systems, in a structure and culture that supports the overall strategy. One should also not forget that a successful business needs a successful financing strategy (such as the correct sourcing and optimum mix of debt and equity capital). So, strategy can encapsulate any issue within business.

The financial-oriented approaches are mainly predicated on the assumption that any strategic review will generate a range of options. These options can be evaluated against financial criteria in order to select the best one in terms of its effect on shareholder value. There are quite a few theories and measures that can be used, and two of the more forwardlooking ones have been selected here: Rappaport’s shareholder value approach and Reimann’s value-based strategic management.



This topic will concentrate on the traditional views of strategy, which are externally focused on the market environment within which the company operates. It will consider a selection of the more common financial tools and techniques that can be employed to help rational decision making regarding the strategic direction of a company. Any company faces options and choices in its overall strategy, and these formulation tools are designed to ensure that choices are based on rational analysis, rather than ill-informed opinion.

### Shareholder value approach (SVA)

The basic premise of SVA is fairly simple. The shareholders have invested money in assets and the true value of that investment is the future cash generated by those assets, discounted back to the present by the ‘weighted average cost of capital’ (WACC), to take into account the time value of money.

If £100 is invested at 18 per cent to give a return of £18 in a year’s time, then £118 in a year’s time is worth £100 today, if we assume a cost of capital of 18 per cent. Thus, for any given corporate strategy, a net present value of the strategy can be worked out and, when compared to alternative strategies, rational decisions can be made.

This model can be particularly useful when acquisitions are involved in a strategy. It is also useful to put a monetary present value on various future strategic options. *Creating Shareholder Value* by A Rappaport (1986) gives a detailed founding in the principles and *Valuation* by McKinsey consultants T Copeland, T Koller and J Murrin (1994) also shows how the theory can be used. A succinct summary of the approach can be found in the appendix of my book *Practical Business Re-engineering* (1994).

It is outside the scope of this topic to cover all the ins and outs of SVA. However, the outline that follows should give enough of an explanation for you to be able to at least understand what the component parts of SVA are. Shareholder value is made up of four parts – three added together and one deducted – as follows:

$$\boxed{\text{Shareholder Value}} = \boxed{\text{Future cash flows discounted at WACC}} + \boxed{\text{Residual value discounted at WACC}} + \boxed{\text{Marketable securities + Cash}} - \boxed{\text{Current value of long-term debt}}$$

Figure 5.1 SVA analytical approach

Let’s look at each one of these components in turn.

- To work out future cash flows, you’ll need to decide three key things: the most reasonable yearly forecast of cash being generated by the strategy (note that profit is not cash!), the forecast period and the rate at which future cash flows should be discounted back to the present. The discount rate is derived by working out the cost of the capital of the company (which will depend on its mix and what the sources of debts and equity are).

- The residual value calculation picks up the value of the post-forecast period that is generated. After all, the business will either continue after the forecast period or an exit will be sought. There are various ways in which to calculate this, depending on what the assumptions are of what you want to do with the business at the end of the forecast period. You can multiply the last period's earnings by an expected profit/earnings ratio or the equity by an expected market to book ratio. This would assume an exit by the investors. Alternatively, you can assume a break-up and calculate the liquidation value (which is the most conservative approach) or that the business will continue as an ongoing concern, and turn the post-tax operational cash flow (profit after tax plus interest plus depreciation/non-cash expense) into perpetuity. Whichever way is used, the resultant amount is discounted back to the present using the weighted average cost of capital (WACC). The most commonly used approach is to use the perpetuity method by taking the last cash flow, deducting depreciation (which was added back), and ignoring working capital and fixed asset cash flow. This assumes that the fixed assets needs after the forecast period will be met by depreciation, and that working capital will come to be balanced with short-term assets matched by short-term liabilities. The resultant amount is turned into perpetuity by dividing it by the WACC, and then, by discounting the result to the present, you have the present value (PV) of the residual value. Some people are initially uncomfortable with using perpetuity as nothing lasts for ever. However, nearly 90 per cent of the value of perpetuity is generated in the 15 years after the forecast period.
- The final part of the calculation is to add the marketable securities and cash of the business and deduct the liabilities to get the shareholder value approach figure.

A worked example of the whole process is shown in Figure 5.2.

As you can see, there are a lot of debatable assumptions behind this approach. It is very number oriented, and will not appeal to intuitive, 'right-brained' individuals. However, it is a very powerful tool. Its value as an approach does not lie in the absolute value figure generated but, rather, in how that figure compares to either other strategic options (calculated using the same SVA approach) or other approaches in calculating shareholder value. As such, it is a useful diagnostic tool to assist decision making when there are several ways forward.

### **Value-based strategic management (VSM)**

VSM is similar to the SVA approach outlined above and can best be described by means of Reimann's VSM matrix. One of the variables is the net present value (NPV) generated by a particular strategy, product or part of a corporate portfolio, and the second variable is the return on investment (ROI) compared to the weighted average cost of capital (WACC). Thus, the first variable looks into the future (with the NPV result), and can be calculated using the SVA approach outlined above.

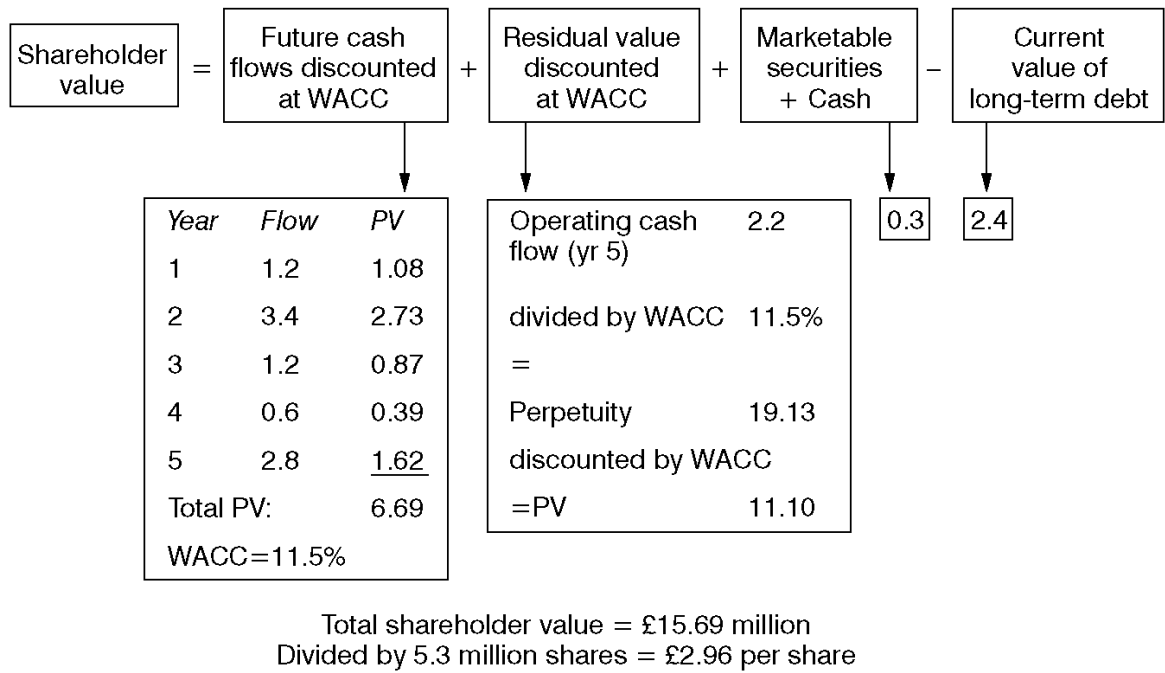


Figure 5.2 A worked example of the SVA approach

The second variable looks at the current situation by comparing the ROI with the WACC. ROI is earnings divided by assets. This matrix (see Figure 5.3) is best suited to instances when acquisitions or a variety of company options exist that need differing levels of investment.

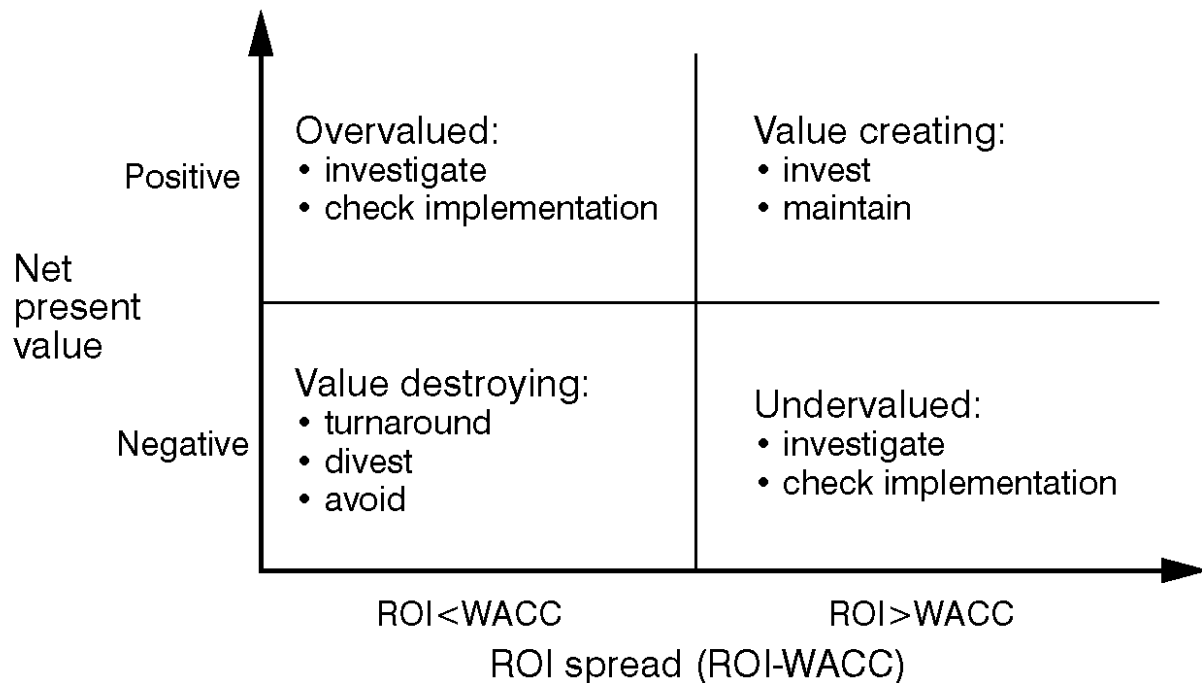


Figure 5.3 The VSM matrix

There are a number of variations on the theme of value assessment, but all are based on an analysis of the future cash flows which will be generated. This analysis involves the discounting of future cash flow values by an appropriate cost of capital.

Economic value appraises future expectations rather than current and past performance.

The limitations seen by the companies in the survey relate mainly to its practical application, for its usefulness relies heavily on making the correct assumptions and preparing the cash projections.

The advantages, it is argued, outweigh the limitations, making it the clearly favored approach, because:

- It measures cash, not accounting profit, which can be distorted by accounting conventions such as those for depreciation, stock valuation and provisions.
- Accounting measures concentrate on the past and the present profits, not on the future. Investors focus on future cash generation, looking for dividends and capital gains.
- It considers the time value of money, unlike the other methods. It is concerned with the timing of all cash flows.
- Empirical studies show that future cash flow is a better indicator for potential value creation.

### **Control questions**

#### ***Question 1***

What does Strategy mean?

#### ***Question 2***

What are the financial-oriented approaches?

#### ***Question 3***

Describe the Shareholder Value Approach (SVA).

#### ***Question 4***

What are the component parts of SVA?

#### ***Question 5***

What is the "Value-based Strategic Management (VSM)"?

#### ***Question 6***

Give a working example of the SVA approach.

#### ***Question 7***

Describe the VSM matrix and explain how it is used.

#### ***Question 8***

Why VSM is a clearly favored approach?

## **6 Topic 6**

### **Profit Impact of Marketing Strategy (PIMS)**

**Learning aim:** explore the Profit Impact of Market Strategies (PIMS) as comprehensive, long-term study of the performance of strategic business units (SBUs) and database of the market profiles and business results of major American and European companies.

In the mid-1960s, Sidney Schoeffler and his colleagues at the Strategic Planning Institute in Cambridge, Massachusetts, began to collect and analyze data from a large number of companies, covering literally hundreds of different product markets. The intention was to provide participating companies with advice, based on empirical evidence about the most suitable strategies to pursue in search of increased profitability. Essentially the analysis focused on comparing the effect of various business strategies on net cash flow and profitability and this came to be termed the **'profit impact of marketing strategy'** (PIMS).

PIMS database "yields solid evidence in support of both common sense and counter-intuitive principles for gaining and sustaining competitive advantage": Tom Peters and Nancy Austin. It was developed with the intention of providing empirical evidence of which business strategies lead to success, within particular industries. Data from the study is used to craft strategies in strategic management and marketing strategy. The study identified several strategic variables that typically influence profitability. Some of the most important strategic variables studied were market share, product quality, investment intensity, and service quality, (all of which were found to be highly correlated with profitability).

According to Lancaster, Massingham and, PIMS seeks to address three basic questions:

- What is the typical profit rate for each type of business?
- Given current strategies in a company, what are the future operating results likely to be?
- What strategies are likely to help improve future operating results?

Dibb, Simkin, Pride and Ferrell cite six principal areas of information that PIMS holds on each business:

- characteristics of the business environment
- competitive position of the business
- structure of the production process
- how the budget is allocated
- strategic movement
- operating results.

### **Brief history of PIMS**

The PIMS project was started by Sidney Schoeffler working at General Electric in the 1960s, managed by the Marketing Science Institute in the early 1970s, and has been administered by the American Strategic Planning Institute since 1975.

It was initiated by senior managers at GE who wanted to know why some of their business units were more profitable than the others. With the help of Sidney Schoeffler they set up a research project in which each of their strategic business units reported their performance on dozens of variables. This was then expanded to outside companies in the early 1970s.

The initial survey, between 1970 and 1983, involved 2,600 strategic business units (SBU), from 200 companies. Today 12,500 observations exist for 4162 SBU's; PIMS is managed by PIMS Associates in London. Each SBU give information on the market within which they operated, the products they had brought to market and the efficacy of the strategies they had implemented.

The PIMS project analyzed the data they had gathered to identify the options, problems, resources and opportunities faced by each SBU. Based on the spread of each business across different industries, it was hoped that the data could be drawn upon to provide other business, in the same industry, with empirical evidence of which strategies lead to increased profitability. The database continues to be updated and drawn upon by academics and companies today.

### **Information reports**

Using the evidence built up in the database, the subscribing company then receives both diagnostic and prescriptive information contained in four main reports:

- The 'Par' Report: specifying what return on investment is normal (or 'par') for that particular type of business;
- The Strategy Analysis Report: the likely outcome (on profit, sales, cash flow, etc.) of several possible 'broad' strategic moves based on evidence of similar moves by similar businesses;
- The Optimum Strategy Report: nominates the combination of strategic moves likely to give the client optimal results for the business;
- Report on 'Look alike' (ROLA): provides information on likely successful tactics based on analyzing the successful moves of strategically similar businesses.

The information is thus client- and business-specific, but in addition, the extensive analyses made by the Strategic Planning Institute have provided a number of general guidelines to strategy selection and implementation.

Thirty-seven basic strategic influences on profitability and cash flow have been identified by the Institute. Taken together, the Institute suggests that these account for 80 per cent of the determination of business success or failure. Of primary importance are the following:

- Investment intensity: Higher investment intensity is associated with lower rates of return and cash flow.
- Productivity: High value is added for each employee in the businesses, making the company generally more profitable.
- Market position: Higher share of served markets leads to higher profits and cash flow.

- Growth of served market: 'Favourable to cash' measures of profit; no effect on percentage measures of profit; negative effect on cash flow.
- Quality of products or services: Favourable impact on all measures of financial performance.
- Innovation/differentiation: Usually has positive effect on financial performance, but only if company has strong initial market position.
- Vertical integration: Positive effect in stable markets, negative in unstable ones.
- Cost push: Increases in salaries, raw material prices etc., have complex effects on performance according to specific nature of business or company.
- Current strategic effort: The existing direction of change of any of the preceding factors often affects financial performance in an inverse manner, e.g. having strong market share increases cash flow; achieving strong market share reduces it.

These and other profit impact marketing strategies (PIMS) findings provide useful insights for the process of strategy development and implementation. A company can use PIMS data in a variety of ways to help in strategic market planning. Clearly, for the subscriber company the information provided is detailed and wide-ranging; in particular, PIMS data can be used for:

- analysing business performance;
- formulating and selecting future strategies;
- analysing and focusing on problems and opportunities;
- assessing competitor performance.

### **Criticisms and limitations of PIMS**

Although PIMS is useful, there is some criticism. The findings are given as conclusions from empirical research, but many of them are self-evident. O'Shaughnessy believes that 'the findings cannot distinguish between causal factors and factors in a state of mere co-existence'. He goes on to say: 'without supporting explanations and appropriate tests, the findings can be misleading in tempting management to deal with symptoms rather than causes'.

Day to some extent agrees with O'Shaughnessy when he states three basic limitations of PIMS:

1 Interpreting and utilizing PIMS findings: PIMS has been used to predict profitability. This should not be so because the model does not tell us about causality.

2 Specification problems: i.e. whether the regression models have omitted important variables and have been properly structured.

3 Measurement error: this happens because of eliminating outliers, standardized inputs etc.

Research by Doyle, although not specifically aimed at criticizing the PIMS system, has shown that perhaps the database does not give sufficient importance to certain facets of marketing strategy.

Clearly, it could be argued that a database operating on information gathered in

the period 1970 - 1983 is outdated. However data continues to be collected from participating companies and PIMS argues that it provides a unique source of time-series data, the conclusions from which have proven to be very stable over time.

It has also been suggested that PIMS is too heavily biased towards traditional, metal-bashing industries, such as car manufacturing; perhaps not surprising, considering the era in which the majority of the surveys were carried out. In reality, as of 2006, the 3,800+ businesses contained within the database includes data from the consumer, industrial and service sectors.

It is also heavily weighted towards large companies, at the expense of small entrepreneurial firms. This resulted from the data collection method used. Generally only larger firms are prepared to pay the consulting fee, provide the survey data, and in return have access to the database in which they can compare their business with other large businesses. Mintzberg claims that because the database is dominated by large established firms, it is more suitable as a technique for assessing the state of "being there rather than getting there".

A serious theoretical criticism has also been mentioned. An empirical correlation does not necessarily imply cause. There is no way of knowing whether high market share caused the high profitability, or whether high profitability caused the high market share. Or even more likely, a spurious factor such as product quality could have caused both high profitability and high market share.

Tellis and Golder claim that PIMS defines markets too narrowly. Respondents described their market very narrowly to give the appearance of high market share. They believe that this self-reporting bias makes the conclusions suspect. They are also concerned that no defunct companies were included, leading to "survivor bias".

### **Control questions**

#### ***Question 1***

What was the intention of collecting and analyzing data from a large number of companies?

#### ***Question 2***

What definition of PIMS was offered by Tom Peters and Nancy Austin?

#### ***Question 3***

What are the basic questions according to Lancaster and Massingham?

#### ***Question 4***

What can you say about principal areas of information that PIMS holds on each business?

#### ***Question 5***

Describe in brief the history of PIMS.

#### ***Question 6***

What reports PIMS provides using the evidence built up in the database?



***Question 7***

What basic strategic influences on profitability and cash flow have been identified by the Strategic Planning Institute?

***Question 8***

What are the uses for PIMS data?

***Question 9***

What O'Shohnessi and Doyle criticize in PIMS?

***Question 10***

What Mintzberg claims about data collection methods that uses PIMS?

***Question 11***

What Tellis and Golder criticize in PIMS?

## 7 Topic 7 Force Field Analysis

**Learning aim:** study Force Field Analysis as a powerful strategic tool that used to understand what's needed for change in both corporate and personal environments.

Force field analysis is a management technique developed by Kurt Lewin, a pioneer in the field of social sciences, for diagnosing situations. It will be useful when looking at the variables involved in planning and implementing a change program and will undoubtedly be of use in team building projects, when attempting to overcome resistance to change.

Lewin assumes that in any situation there are both driving and restraining forces that influence any change that may occur.

### Driving Forces

Driving forces are those forces affecting a situation that are pushing in a particular direction; they tend to initiate a change and keep it going. In terms of improving productivity in a work group, pressure from a supervisor, incentive earnings, and competition may be examples of driving forces.

### Restraining Forces

Restraining forces are forces acting to restrain or decrease the driving forces. Apathy, hostility, and poor maintenance of equipment may be examples of restraining forces against increased production. Equilibrium is reached when the sum of the driving forces equals the sum of the restraining forces. In our example, equilibrium represents the present level of productivity, as shown below.

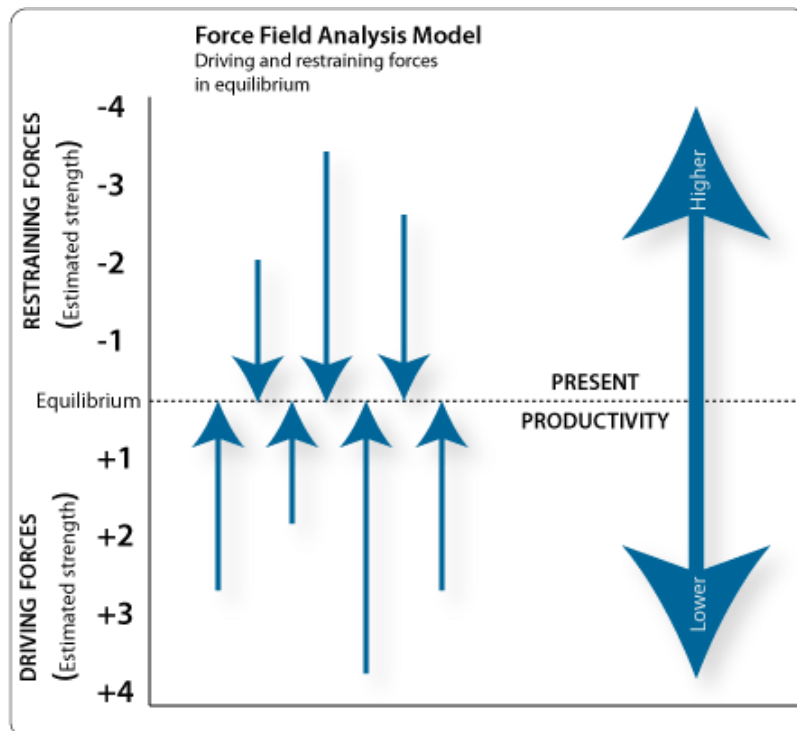


Figure 7.1 Force Field Analysis Model

## **Equilibrium**

This equilibrium, or present level of productivity, can be raised or lowered by changes in the relationship between the driving and the restraining forces.

For illustration, consider the dilemma of the new manager who takes over a work group in which productivity is high but whose predecessor drained the human resources.

The former manager had upset the equilibrium by increasing the driving forces (that is, being autocratic and keeping continual pressure on subordinates) and thus achieving increases in output in the short run.

By doing this, however, new restraining forces developed, such as increased hostility and antagonism, and at the time of the former manager's departure the restraining forces were beginning to increase and the results manifested themselves in turnover, absenteeism, and other restraining forces, which lowered productivity shortly after the new manager arrived. Now a new equilibrium at a significantly lower productivity is faced by the new manager.

Now just assume that our new manager decides not to increase the driving forces but to reduce the restraining forces. The manager may do this by taking time away from the usual production operation and engaging in problem solving and training and development.

In the short run, output will tend to be lowered still further. However, if commitment to objectives and technical know-how of the group are increased in the long run, they may become new driving forces, and that, along with the elimination of the hostility and the apathy that were restraining forces, will now tend to move the balance to a higher level of output.

Managers are often in a position in which they must consider not only output but also intervening variables and not only short-term but also long-term goals. It can be seen that force field analysis provides framework that is useful in diagnosing these interrelationships.

## **Implementation**

Although there are several different methods and variations for conducting force field analysis, there are commonalities among all of them. The steps outlined below capture many of these commonalities and represent the process needed for successful implementation of a typical force field analysis.

- Identify and understand the current state
- Identify and understand the desired goal state relative to the proposed change.
- Identify and list driving forces acting to support the change. It is important to list all forces regardless of their seemingly small influence. Driving forces are forces acting to move the current state towards the goal state.
- Identify and list restraining forces acting to hinder the change. Remember restraining forces are forces holding the current state back from the goal state.
- For each force, designate the level of influence using a numerical scale e.g. 1=extremely weak and 7=extremely strong.

- Chart the forces by listing the driving forces on the left and restraining forces on the right. Also chart the numbers allocated in step 5 next to their related force.
- Evaluate the chart and determine whether change is viable.
- Discuss how the change can be affected by decreasing the strength of the restraining forces or by increasing the strength of driving forces.
- Discuss action strategies to eliminate the restraining forces and to capitalize on the driving forces.

Through conducting this process, a force field diagram like the one shown in figure 7.2 should be created.

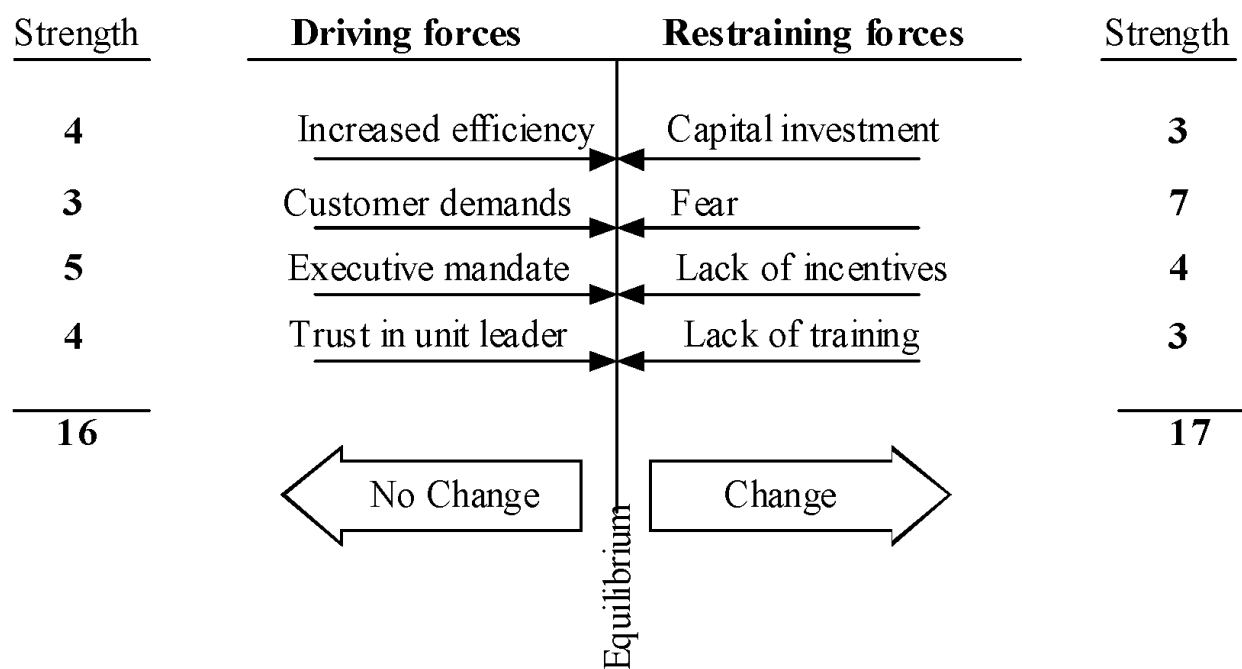


Figure 7.2 Force Field Diagram

As shown in the above force field diagram, the total point value for restraining forces exceeds the total value of the driving forces. This means that the proposed change would likely fail if nothing is done to change the balance. To increase the likelihood of success, management can attempt to reduce restraining forces, increase driving forces, or some combination of the two. In changing the impact of one force, the impacts of other forces often change as well. One example of this interdependency would occur if management decides to reduce the level of employee fear by providing extra training and resources. The impact of fear as a restraining force may drop from a 7 to a 4, but the capital investment restraining force may increase from a 3 to a 7 resulting in a higher restraining force than before the change. The relationships among the many forces must be understood and evaluated before strategies to eliminate the restraining forces and to capitalize on the driving forces are implemented.

## **Applications**

Force field analysis is being used for many different applications in a wide variety of industries. There are three main applications of the force field analysis tool:

1. Change management (which has been the focus of this article);
2. Productivity improvement ;
3. Decision making .

Change management is the primary application for force field analysis. One industry that has embraced the usefulness of this tool is the health care industry. Change is a regular occurrence in the healthcare environment. One area of change in which the health care industry has used force field analysis is in the computerization of nursing systems. Nurses have widely varying attitudes toward computers and change in the workplace. To help in the transition, managers are evaluating the forces that encourage and the forces that impede the change. Based on the force field analysis, strategies must be developed to assist nurses in moving forward with the transition.

Productivity improvement is the second main application of force field analysis. This universal application of how to increase employee productivity demonstrates a powerful need for the force field analysis tool. Instead of looking at factors promoting and inhibiting change, managers can look at forces promoting and inhibiting productivity. This analysis can shed light on methods, strategies, and systems that can promote long-term improvements in employee productivity.

Force field analysis is also a powerful decision-making tool. By evaluating the forces supporting and opposing a specific decision, managers can know the likelihood of acceptance and can also manage the influencing forces to maximize the potential for acceptance and success.

The force field model is a valuable tool for use in these three applications; however, it is not limited to these forms of application. By understanding the principles of force field analysis, managers can customize the technique for use in a large variety of situations.

By recognizing that every decision and every change has forces that promote the change and forces that impede the change, managers can make smarter decisions and can use force field analysis to effectively manage change in their organizations.

## **Control questions**

### ***Question 1***

What is the purpose in using of Force Field Analysis?

### ***Question 2***

What kinds of forces are considered in Force Field Analysis?

### ***Question 3***

What does Equilibrium mean in Force Field Analysis?

***Question 4***

Describe in detail the steps needed for successful implementation of a typical force field analysis.

***Question 5***

What kind diagram should be created for conducting the process of implementation of a typical force field analysis?

***Question 6***

Which applications use the Force field analysis in a wide variety of industries?

***Question 7***

Which applications use the Force field analysis in a wide variety of industries?

***Question 8***

Give examples of using of Force Field Analysis.

## Recommended literature

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