E3 STUDY NOTES

Process of Strategy Formulation

Chapter 1

Strategy=

A course of action, including specifications of resources required to achieve a specific objective.

Strategy generally involves a comprehensive understanding of:

1. Resources (assets, employees, cash etc.)
2. Environment (Political, economic, customers, competitors)
3. Stakeholders (anyone who has in interest in your organization)

Characteristics of strategic decisions=

1. Likely to be affected by the scope of an organization's activities
2. Matching of an organization to its environment
3. Must match activities of an organization to its resource capabilities
4. Need to be considered in terms of the extent to which resources can be obtained.

Levels of strategy=

1. Corporate level (strategic level) = Examines the strategies of the organization as a whole.

   Come at the top of organization.

   Focuses on acquisitions, disposals and diversification, entering new industries and leaving existing industries

2. Business level (management level) = Business strategy looks at how the organization can compete successfully in the individual markets it chooses to operate within.

   Comes at the middle level of the organization.

   Mainly deals with advantage over competitors, meeting the needs of customers and avoiding competitive dis-advantage.
   Also deals with all decision of Strategic business units.

3. Function level (operational level) = this involves all the day to management strategies of the organization.
   Mainly dealing with HR, budgeting and variances.

   Come at the lowest level of the organization.

Strategic Planning process:

The rational model:

This is a logical step-by-step approach.

It has the following steps:

1. Mission and objectives
2. SWOT
3. Strategic options
4. Evaluation and choice
5. Implementation
6. Review and control

These 6 points given above are now compiled into 3 main headings and this is given by JSW: (also known as the JSW approach to rational model) =

Strategic analysis:

SWOT, identifying stakeholder objectives and Gap analysis.

Strategic Choice:

Making the decision, competitive strategy, growth directions.

Strategic implementation:

Target setting, monitoring and review.

Advantages of this model:

1. Forces managers to look ahead
2. Improves control
3. Identify key risks
4. Encourages creativity

Dis-advantages of this model:

1. Setting corporate objectives
2. Short term pressures
3. Difficulties in forecasting accurately
4. Bounded rationality
5. Rigidity
6. Cost

Emergent approach: (based on available opportunity)

Focus on normal strategy but if opportunity available in the market then capitalize on that opportunity. If you see an “emerging” strategy in the market take it.

Logical incrementalism:

This approach suggests that strategy tends to be a small-scale extension of past policy rather than radical change.

It is the step-by-step changes and adjustments are made.

Advantages:

1. More acceptable to stakeholders as consultation, compromise and accommodation are built into the process.

2. Less of a cultural shift.

Dis-advantages:

1. No overall long-term plan

2. May cause strategic drift and may not be able to meet the needs of customers.

Freewheeling opportunism=

Organisations should avoid planning and instead simply take advantage of opportunities as they arise.

Advantages=

1. Formal planning takes too long and this can save time.

2. Better for organisations in fast changing industries like pharmaceuticals and technology.

3. Better for experienced managers who dislike planning.

Dis-advantages=

1. Failure to identify risks

2. Business is not forced to look ahead.

3. Strategic drift.

4. Difficulty in raising finance.

5. Management skill (less experienced managers may find it difficult)

Formal planning= Rational and emergent approach

No formal planning= Incrementalism and freewheeling.

More formal planning suits=

Companies in stable industries where there is sufficient time to undertake strategic analysis. Have relatively inexperienced managers so formal guidelines will help them develop a strategy and can help them grow.

More informal planning suits=

More dynamic and fast changing industries where there is little time for planning, have experienced and innovative managers and which do not need to raise significant external finance.

Incrementalism will not be suitable for new organisations as they have no past strategies to build upon.

Problems with Not for Profit's and other profit seeking organisations=

It is difficult to measure objectives, there may be a more equal balance of power between stakeholders, the people receiving the service are not necessarily those paying for it.

KPI's and certain targets are set by the central government to exert control and ensure the government funding is used appropriately.

3 E's in Not For Profit strategy development=

1. Economy= looks solely at level of inputs. E.g. how much did we spend on wages, how much value of drugs did we buy. Looks at whether the budget has been met.

2. Efficiency= looks at the link between input and output. Internal processes approach. Looks at how well inputs have been used to achieve the outputs. E.g. average cost per patient, bed

occupancy rate achieved, average spend on bed per period. About doing things right. Deals mainly with averages.

3. Effectiveness= looks at outputs. The goal approaches. Looks at ultimate objectives of the organisation. E.g. have waiting lists reduce, mortality rates gone down, number of patients treated. Doing the right things.

Approaches to strategic planning=

1. **Traditional approach (Stakeholders)=**

   Starts by looking at stakeholders and their objectives. relevant for NFP'S as discussion of mission and objectives is key there. Problem is that objectives are set in isolation from market conditions and thus may be unrealistic.

2. **Market-led or positioning approach=**

   Analysis of markets and competitors' objectives. Ensures firm has a good fit in the environment. If markets are expected to change then firm needs to change too. Idea is to predict the change in advance to be able to control it rather than having to react to it. Main problem here is the ability to predict the future. Some markets are so volatile that it is impossible to estimate ahead in the short term. Outside-in view.

3. **Resource based or Competence-led approach=**

   Emphasis here is to look at what the firm is good at. i.e. its core competencies. Critical success factors are important here and difficult for competitors to copy.

Role and responsibility of Directors=

Directors have a fiduciary duty which means that they have been placed in a position of trust and must act in interest of the company and not their own. They also have a duty to exercise care and skill.

Duties of directors in the UK= Duty to act within power, duty to promote success of the company, duty to exercise independent judgement, duty to exercise reasonable care, skill, diligence, duty to avoid conflicts of interests, duty not to accept benefits from 3rd parties, duty to declare interests in proposed transactions and arrangements.

Directors duties are owed to the company rather than towards any individual shareholder and thus breaches of any duty can be enforced only by the company and not the shareholders.

Corporate Governance = System by which companies are directed and controlled in the interests of shareholders and stakeholders.

1. **Main purpose of governance=**

Primary=is to monitor those parties within the company who control resources owned by the investors.

Secondary=ensure there is suitable balance of power, ensure executive directors are remunerated properly, BODS are responsible for management of risk, ensure external auditors remain independent, look at ethics, CSR, protection from whistle-blowers.

2. **Main objective of governance=**

Primary=

is to improved performance and accountability in creating long term shareholder value.

Secondary=

increasing amount of reporting and disclosure to shareholders, increase level of confidence and transparency, ensure company is run in a legal and ethical manner, build a good control system.

Relevant items of corporate governance=

1. Increase disclosure to stakeholders
2. To ensure Companies are run on ethical grounds
3. Provide increased confidence in the company for existing and potential investors.
4. To increase transparency

UK corporate governance code

1. Leadership= headed by an effective Board, segregation of duties between CEO and Chairman, NEDS must be included, Culture of openness and debate.

2. Effectiveness= board must have appropriate balance of skill and experience, formal rigorous and transparent procedure for appointment of directors.

3. Accountability= balanced and understandable assessment of company's position, directors must publish all necessary information for shareholders.

4. Remuneration= formal and transparent policy for executive remuneration, there should be a remuneration committee.

5. Relations with shareholders= encourage participation and recognise contribution of providers of capital.

Result of increasing focus on governance issues=

1. Increasing power of governance bodies.

2. Increasing shareholder power

3. Greater pressure on boards to formulate strategies.

4. Greater scrutiny resulting in short termism.

5. Greater emphasis on risk assessment so directors may feel pressured to undertake lower risk and thus lower returns on projects.

6. Greater scrutiny of mergers and acquisitions.

How does corporate governance impact organisational strategy=?

1. Works to ensure that no individual can dominate the BODS. NEDS must be able to impartially assess whether the strategy is in the best interests of the organisation.

2. Diversity in BODS thus there will be different viewpoints.

3. Adequate internal audit and control systems will give the organisation a better chance to implement strategies successfully.

4. Having good corporate governance is an attraction to investors. Will make it easier for organisations to raise funds.

Strategic Management Accounting=

Emphasis is placed on information which related to factors external to the entity as well as non-financial information and internally generated information.

External Focus=

Strategic management accountants must provide managers with strategic information they can use for decision making. This requires information regarding behaviour of competitors, customers and suppliers.

Forward Looking

Information provided by strategic management accountants=

1. Competitors analysis
2. Customer profitability
3. Pricing decision
4. Portfolio analysis
5. Corporate decision support.
6. Evaluation of brand value
7. Strategic information on acquisitions, mergers and disposals
8. Investment in strategic management systems.

Traditional Management accountant’s vs Strategic Management accountants.

Cost structure vs Competitor cost structure

Product costs vs Competitor product costs

Market share vs Relative market share

Profitability vs Relative Profitability

Price margins vs Competitor Price margins.

Value of Strategic management information=

1. More effective strategic planning.
2. Increased awareness of business environment
3. Increased control over business performance.
4. Better decision making.