

CIMA

Subject E3

Strategic Management

Study Text



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Introduction

How to use the Materials

These official CIMA learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your objective tests.

The product range contains a number of features to help you in the study process. They include:

- a detailed explanation of all syllabus areas
- extensive 'practical' materials
- generous question practice, together with full solutions.

This Study Text has been designed with the needs of home study and distance learning candidates in mind. Such students require very full coverage of the syllabus topics, and also the facility to undertake extensive question practice. However, the Study Text is also ideal for fully taught courses.

The main body of the text is divided into a number of chapters, each of which is organised on the following pattern:

- **Detailed learning outcomes.** These describe the knowledge expected after your studies of the chapter are complete. You should assimilate these before beginning detailed work on the chapter, so that you can appreciate where your studies are leading.
- **Step-by-step topic coverage.** This is the heart of each chapter, containing detailed explanatory text supported where appropriate by worked examples and exercises. You should work carefully through this section, ensuring that you understand the material being explained and can tackle the examples and exercises successfully. Remember that in many cases knowledge is cumulative: if you fail to digest earlier material thoroughly, you may struggle to understand later chapters.
- **Activities.** Some chapters are illustrated by more practical elements, such as comments and questions designed to stimulate discussion.
- **Question practice.** The text contains three styles of question:
 - Exam-style objective test questions (OTQs).
 - 'Integration' questions – these test your ability to understand topics within a wider context. This is particularly important with calculations where OTQs may focus on just one element but an integration question tackles the full calculation, just as you would be expected to do in the workplace.

- ‘Case’ style questions – these test your ability to analyse and discuss issues in greater depth, particularly focusing on scenarios that are less clear cut than in the objective tests, and thus provide excellent practice for developing the skills needed for success in the Management Level Case Study Examination.
- **Solutions.** Avoid the temptation merely to ‘audit’ the solutions provided. It is an illusion to think that this provides the same benefits as you would gain from a serious attempt of your own. However, if you are struggling to get started on a question you should read the introductory guidance provided at the beginning of the solution, where provided, and then make your own attempt before referring back to the full solution.

If you work conscientiously through this Official CIMA Study Text according to the guidelines above you will be giving yourself an excellent chance of success in your objective tests. Good luck with your studies!

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Icon explanations



Definition – These sections explain important areas of knowledge which must be understood and reproduced in an assessment environment.



Key point – Identifies topics which are key to success and are often examined.



Supplementary reading – These sections will help to provide a deeper understanding of core areas. The supplementary reading is **NOT** optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an assessment question. **Reference to this text is vital when self-studying.**



Test your understanding – Following key points and definitions are exercises which give the opportunity to assess the understanding of these core areas.



Illustration – To help develop an understanding of particular topics. The illustrative examples are useful in preparing for the Test your understanding exercises.

Study technique

Passing exams is partly a matter of intellectual ability, but however accomplished you are in that respect you can improve your chances significantly by the use of appropriate study and revision techniques. In this section we briefly outline some tips for effective study during the earlier stages of your approach to the objective tests. We also mention some techniques that you will find useful at the revision stage.

Planning

To begin with, formal planning is essential to get the best return from the time you spend studying. Estimate how much time in total you are going to need for each subject you are studying. Remember that you need to allow time for revision as well as for initial study of the material.

With your study material before you, decide which chapters you are going to study in each week, and which weeks you will devote to revision and final question practice.

Prepare a written schedule summarising the above and stick to it!

It is essential to know your syllabus. As your studies progress you will become more familiar with how long it takes to cover topics in sufficient depth. Your timetable may need to be adapted to allocate enough time for the whole syllabus.

Students are advised to refer to the examination blueprints (see page P.13 for further information) and the CIMA website, www.cimaglobal.com, to ensure they are up-to-date.

The amount of space allocated to a topic in the Study Text is not a very good guide as to how long it will take you. The syllabus weighting is the better guide as to how long you should spend on a syllabus topic.

Tips for effective studying

- (1) Aim to find a quiet and undisturbed location for your study, and plan as far as possible to use the same period of time each day. Getting into a routine helps to avoid wasting time. Make sure that you have all the materials you need before you begin so as to minimise interruptions.
- (2) Store all your materials in one place, so that you do not waste time searching for items every time you want to begin studying. If you have to pack everything away after each study period, keep your study materials in a box, or even a suitcase, which will not be disturbed until the next time.
- (3) Limit distractions. To make the most effective use of your study periods you should be able to apply total concentration, so turn off all entertainment equipment, set your phones to message mode, and put up your 'do not disturb' sign.
- (4) Your timetable will tell you which topic to study. However, before diving in and becoming engrossed in the finer points, make sure you have an overall picture of all the areas that need to be covered by the end of that session. After an hour, allow yourself a short break and move away from your Study Text. With experience, you will learn to assess the pace you need to work at. Each study session should focus on component learning outcomes – the basis for all questions.
- (5) Work carefully through a chapter, making notes as you go. When you have covered a suitable amount of material, vary the pattern by attempting a practice question. When you have finished your attempt, make notes of any mistakes you made, or any areas that you failed to cover or covered more briefly. Be aware that all component learning outcomes will be tested in each examination.
- (6) Make notes as you study, and discover the techniques that work best for you. Your notes may be in the form of lists, bullet points, diagrams, summaries, 'mind maps', or the written word, but remember that you will need to refer back to them at a later date, so they must be intelligible. If you are on a taught course, make sure you highlight any issues you would like to follow up with your lecturer.
- (7) Organise your notes. Make sure that all your notes, calculations etc. can be effectively filed and easily retrieved later.

Progression

There are two elements of progression that we can measure: how quickly students move through individual topics within a subject; and how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

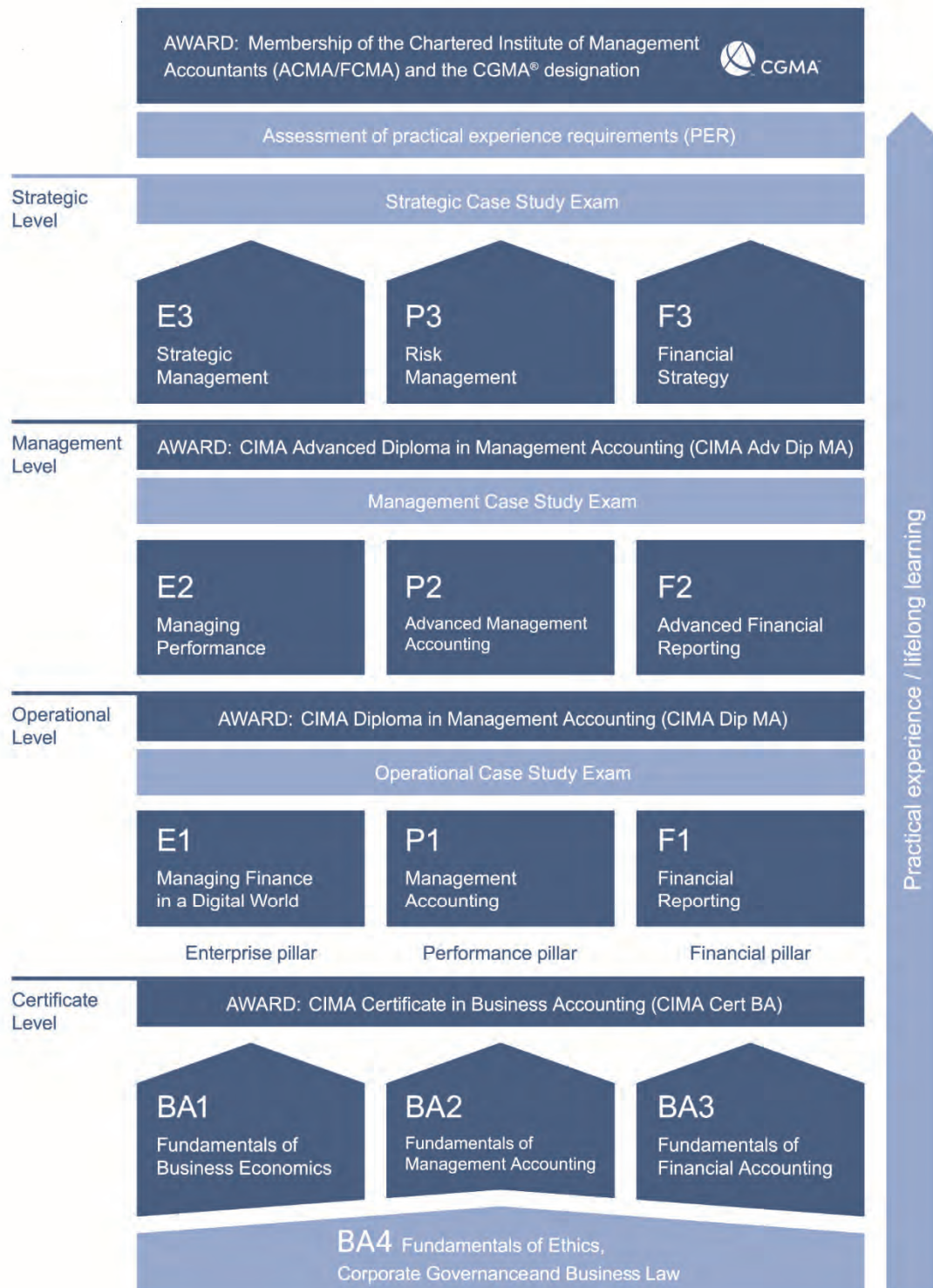
A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example 'I will finish this topic by 30 June', or for overall achievement, such as 'I want to be qualified by the end of next year'.

Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another. For example, E3 *Strategic management* builds on your knowledge of digital ecosystems and management of performance and projects from E2 *Managing performance*.

We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress. Make sure you carefully review the 2019 CIMA syllabus transition rules and seek appropriate advice if you are unsure about your progression through the qualification.



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Objective test

Objective test questions require you to choose or provide a response to a question whose correct answer is predetermined.

The most common types of objective test question you will see are:

- Multiple choice, where you have to choose the correct answer(s) from a list of possible answers. This could either be numbers or text.
- Multiple choice with more choices and answers, for example, choosing two correct answers from a list of eight possible answers. This could either be numbers or text.
- Single numeric entry, where you give your numeric answer, for example, profit is \$10,000.
- Multiple entry, where you give several numeric answers.
- True/false questions, where you state whether a statement is true or false.
- Matching pairs of text, for example, matching a technical term with the correct definition.
- Other types could be matching text with graphs and labelling graphs/diagrams.

In every chapter of this Study Text we have introduced these types of questions, but obviously we have had to label answers A, B, C etc. rather than using click boxes. For convenience, we have retained quite a few questions where an initial scenario leads to a number of sub-questions. There will be no questions of this type in the objective tests.

Guidance re CIMA on-screen calculator

As part of the CIMA objective test software, candidates are now provided with a calculator. This calculator is on-screen and is available for the duration of the assessment. The calculator is available in each of the objective tests and is accessed by clicking the calculator button in the top left hand corner of the screen at any time during the assessment. Candidates are permitted to utilise personal calculators as long as they are an approved CIMA model. Authorised CIMA models are listed here: <https://www.cimaglobal.com/Studying/study-and-resources/>.

All candidates must complete a 15-minute exam tutorial before the assessment begins and will have the opportunity to familiarise themselves with the calculator and practise using it. The exam tutorial is also available online via the CIMA website.

Candidates may practise using the calculator by accessing the online exam tutorial.

Fundamentals of objective tests

The objective tests are 90-minute assessments comprising 60 compulsory questions, with one or more parts. There will be no choice and all questions should be attempted. All elements of a question must be answered correctly for the question to be marked correctly. All questions are equally weighted.

CIMA syllabus 2019 – Structure of subjects and learning outcomes

Details regarding the content of the new CIMA syllabus can be located within the CIMA 2019 professional syllabus document.

Each subject within the syllabus is divided into a number of broad syllabus topics. The topics contain one or more lead learning outcomes, related component learning outcomes and indicative knowledge content.

A learning outcome has two main purposes:

- (a) To define the skill or ability that a well prepared candidate should be able to exhibit in the examination.
- (b) To demonstrate the approach likely to be taken in examination questions.

The learning outcomes are part of a hierarchy of learning objectives. The verbs used at the beginning of each learning outcome relate to a specific learning objective, e.g.

Calculate the break-even point, profit target, margin of safety and profit/volume ratio for a single product or service.

The verb '**calculate**' indicates a level three learning objective. The following tables list the verbs that appear in the syllabus learning outcomes and examination questions.

The examination blueprints and representative task statements

CIMA have also published examination blueprints giving learners clear expectations regarding what is expected of them.

The blueprint is structured as follows:

- Exam content sections (reflecting the syllabus document)
- Lead and component outcomes (reflecting the syllabus document)
- Representative task statements.

A representative task statement is a plain English description of what a CIMA finance professional should know and be able to do.

The content and skill level determine the language and verbs used in the representative task.

CIMA will test up to the level of the task statement in the objective tests (an objective test question on a particular topic could be set at a lower level than the task statement in the blueprint).

The format of the objective test blueprints follows that of the published syllabus for the 2019 CIMA Professional Qualification.

Weightings for content sections are also included in the individual subject blueprints.

CIMA VERB HIERARCHY

CIMA place great importance on the definition of verbs in structuring objective tests. It is therefore crucial that you understand the verbs in order to appreciate the depth and breadth of a topic and the level of skill required. The objective tests will focus on levels one, two and three of the CIMA hierarchy of verbs. However, they will also test levels four and five, especially at the management and strategic levels.

Skill level	Verbs used	Definition
Level 5 Evaluation How you are expected to use your learning to evaluate, make decisions or recommendations	Advise Assess Evaluate Recommend Review	Counsel, inform or notify Evaluate or estimate the nature, ability or quality of Appraise or assess the value of Propose a course of action Assess and evaluate in order, to change if necessary
Level 4 Analysis How you are expected to analyse the detail of what you have learned	Align Analyse Communicate Compare and contrast Develop Discuss Examine Interpret Monitor Prioritise Produce	Arrange in an orderly way Examine in detail the structure of Share or exchange information Show the similarities and/or differences between Grow and expand a concept Examine in detail by argument Inspect thoroughly Translate into intelligible or familiar terms Observe and check the progress of Place in order of priority or sequence for action Create or bring into existence
Level 3 Application How you are expected to apply your knowledge	Apply Calculate Conduct Demonstrate Prepare Reconcile	Put to practical use Ascertain or reckon mathematically Organise and carry out Prove with certainty or exhibit by practical means Make or get ready for use Make or prove consistent/compatible

Skill level	Verbs used	Definition
Level 2 Comprehension What you are expected to understand	Describe Distinguish Explain Identify Illustrate	Communicate the key features of Highlight the differences between Make clear or intelligible/state the meaning or purpose of Recognise, establish or select after consideration Use an example to describe or explain something
Level 1 Knowledge What you are expected to know	List State Define Outline	Make a list of Express, fully or clearly, the details/facts of Give the exact meaning of Give a summary of

Information concerning formulae and tables will be provided via the CIMA website, www.cimaglobal.com.

SYLLABUS GRIDS

E3: Strategic Management

Formulate strategy and create conditions for successful implementation

Content weighting

Content area		Weighting
A	The strategy process	15%
B	Analysing the organisational ecosystem	20%
C	Generating strategic options	15%
D	Making strategic choices	15%
E	Strategic control	20%
F	Digital strategy	15%
		100%

E3A: The strategy process

Strategy is at the heart of what organisations do. This section provides the foundation of strategic management for the organisation. It introduces the strategy process that is elaborated on in the rest of the subject.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Explain the purpose of strategy.	a. Define strategy. b. Explain the purpose of strategy.	<ul style="list-style-type: none">• Different definitions of strategy• Essential features and characteristics of strategy	This section introduces the rest of E3. It provides the various definitions of strategy and outlines its essential features and characteristics. It discusses the different types and levels of strategy and the leaders who have responsibility for them. Finally, it looks at the strategy process from both the rational and emergent perspectives.
2. Discuss the types and levels strategy.	Discuss a. Types of strategy b. Levels of strategy	<ul style="list-style-type: none">• Intended and emergent strategy• Corporate, business and functional strategies	
3. Outline the strategy process.	a. Outline the rational and emergent processes of arriving at strategy.	<ul style="list-style-type: none">• Analysis of organisational ecosystem• Generating options• Strategic choice• Strategic control	

E3B: Analysing the organisational ecosystem

Every organisation inhabits an ecosystem within which it adapts and evolves. This ecosystem comprises markets and society, has its players and its own system of governance. Organisations can also join with others to form a smaller ecosystem within the broader one to reflect their strategic preferences. This section provides candidates with an understanding of the dynamics of the ecosystem (both the wider and the smaller more deliberate ones formed by organisations) and how it affects the strategy of the organisation.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Analyse the elements of the ecosystem.	Analyse a. Markets and competition b. Society and regulation	<ul style="list-style-type: none"> • SWOT analysis • PESTEL analysis • Competitor analysis • Customer analysis • Wider ecosystems • Industry ecosystems 	What types of markets do organisations operate in? What are the 'rules of the game' in these markets? What are the sources and opportunities for disruption in the market? How does society regulate the markets and provide 'permission to play' for organisations?
2. Discuss drivers of change in the ecosystem.	Discuss the following drivers of change: a. Institutional and systemic b. Social c. Market d. Technology e. Sustainability	<ul style="list-style-type: none"> • Globalisation • Geopolitics • Demography • Customer empowerment • Digital technology • Automation 	What are the drivers of change in the ecosystem? How are the individual drivers linked? What type of outcomes do they bring individually and collectively? What risks and opportunities do they bring organisations?
3. Discuss the impact of the ecosystem on organisational strategy.	a. Discuss the impact of strategic networks and platforms on organisational strategy b. Conduct stakeholder analysis in networks	<ul style="list-style-type: none"> • Value creation in ecosystems • Participants and interactions in networks and platforms • Technology enablers in networks • Process of creating networks and platforms • Stakeholder analysis in networks • Corporate social responsibility 	In a digital world what is the importance of networks and platforms? What are the roles, interactions, and governance systems in the ecosystems? Who are the key players? How does this affect the business model of organisations?

E3C: Generating strategic options

Strategy is about choice of options. These options must be generated and developed based on the dynamics of the ecosystem in which the organisation operates and the foundational contexts of the organisation (e.g. its purpose, values etc). This section covers how options are generated and links them to the purpose, values and vision of the organisation. In addition, it looks at the role of various parts and levels of the organisation in the strategy process.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Discuss the context of generating options.	Discuss: <ol style="list-style-type: none"> a. The role of governance and ethics in the strategy process b. The purpose, vision and values of the organisation and their impact on strategy 	<ul style="list-style-type: none"> • Roles and responsibility of leaders of organisations for strategy • Definition of purpose, vision and values of organisations • Linkage between purpose, vision and values to each other and to strategy 	Who is responsible for various aspects of the strategy formulation process? How are those roles determined and governed? How does the organisation derive its purpose, vision and values? What processes exist to ensure that strategy is based on and/or are aligned to these?
2. Discuss how to generate and develop options.	Discuss how to: <ol style="list-style-type: none"> a. Frame key strategic questions b. Diagnose organisation's starting position c. Forecast potential organisational operating ecosystem d. Use various frameworks to generate options 	<ul style="list-style-type: none"> • Product/market matrix • Generic strategies • Trend analysis • System modelling • Scenario planning • Tangible and intangible value drivers and data to measure them • Game theory perspectives • Real option perspectives 	What are the core strategic questions to ask and what are the criteria and constraints for asking them? What is the organisation's starting point? Where and how does it make money? What potential futures might it inhabit and what are the forces potentially driving these futures? What are the potential pathways to this future? What new business models are in play?

E3D: Making strategic choices

Once options have been generated in various areas of the organisation's operations the organisation has to choose between the alternatives. The choice is based on predefined criteria and an evaluation of the options against these criteria. The various options chosen must then be integrated into a coherent whole to form the organisation's strategy. This section covers how the options are evaluated, chosen and integrated coherently to form the strategy of the organisation.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Evaluate options.	a. Develop criteria for evaluation. b. Evaluate options against criteria. c. Recommend appropriate options.	<ul style="list-style-type: none"> Suitability, acceptability and feasibility framework 	What are the different criteria to guide the choice of options, one how are they prioritised and why?
2. Produce strategy by the integration of choices into coherent strategy.	Conduct: a. Value analysis b. Portfolio analysis	<ul style="list-style-type: none"> Value chain analysis Managing product portfolio 	What are the criteria to ensure effective integration and why? What are the trade-offs to be made when putting the individual choices together? How does one ensure integrated thinking?

E3E: Strategic control

Once strategy has been formulated, it has to be implemented. This involves developing and communicating action plans, allocating resources and monitoring the implementation of the plans. In addition, implementing strategy involves significant change. The nature of these changes should be evaluated and appropriate ways of managing change have to be developed and implemented. This section examines how these implementation objectives are achieved and how change is managed.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Develop strategic performance management system.	a. Develop detailed action plans b. Communicate action plans c. Monitor implementation d. Align incentives to performance	<ul style="list-style-type: none"> Action plans Target setting Critical success factors (CSFs) Key performance indicators (KPIs) 	How does the organisation prepare the grounds for executing strategy? How does it create and communicate action plans for implementation? How is the whole organisation mobilised, motivated and incentivised to implement the plans? What role can integrated reporting play?
2. Advise on resource allocation to support strategy implementation.	a. Advise on resource availability b. Align resource allocation to strategic choices	<ul style="list-style-type: none"> Audit of key resources and capabilities required to implement strategy Matching resources to strategy 	What are the resources needed to implement strategy? Where are the resources needed? How does the organisation re-align resource allocation from existing units or projects to new ones that match the strategic choices made?
3. Recommend change management techniques and methodologies.	a. Assess impact of strategy on organisation b. Recommend change management strategies c. Discuss the role of the leader in managing change	<ul style="list-style-type: none"> Types of change Impact of change on organisational culture Resistance to change Approaches and styles of change management Role of change leader in communication 	What is the impact of the new strategy on the whole organisation, parts of the organisation and partners of the organisation? What transformation is required and how does the organisation drive these changes?

E3F: Digital strategy

Strategy takes place within specific organisational contexts and ecosystems. The primary characteristics of the current context is digital transformation. Organisations need to think through their approach to strategy within this perspective. This section covers how to introduce thinking about digital transformation in the strategy of organisations.

Lead outcome	Component outcome	Topics to be covered	Explanatory notes
1. Describe the governance of digital transformation.	a. Describe the roles and responsibilities of the board and executive leadership in digital strategy.	<ul style="list-style-type: none"> • Role of board and senior leadership in digital strategy 	Who is responsible for leading the process of digital transformation? What is their role in the process and why?
2. Analyse digital transformation.	Analyse a. Digital technologies b. Digital enterprise	<ul style="list-style-type: none"> • Cloud computing • Big data analytics • Process automation • Artificial intelligence • Data visualisation • Blockchain • Internet of things • Mobile • 3-D printing 	What are the technologies that underpin digital transformation? How are they evolving and what impact do they have on the organisation and its immediate and wider operating environment? What type of organisation do such technologies create? What are the elements of the business and operating models of such digital enterprises.
3. Discuss the various elements of digital strategies.	Discuss: a. Economics of digitisation b. Digital ecosystems c. Digital consumption d. Data and metrics e. Leadership and culture	<ul style="list-style-type: none"> • Business case for digital transformation • Participants, interactions and dynamics of ecosystem and impact on strategy • Trends in consumption (e.g., hyper personalisation, move from products and services to experience) • New metrics (scale, active usage and engagement metrics) • Leadership in digital transformation 	What is the economic and business case for digitisation? How does the organisation create partnerships in the ecosystem to ensure strategic success? What are key trends underlying the consumption of the organisation's products and services by customers and consumers? What data and metrics should organisations use to evaluate success of digital enterprises? How should leaders and their organisations think, act and react differently because of digital transformation?

The strategy process

Chapter learning objectives

Lead	Component
A1: The purpose of strategy.	(a) Define strategy. (b) The purpose of strategy.
A2: Discuss the types and levels of strategy.	(a) Types of strategy. (b) The levels of strategy.
A3: Outline the strategy process.	(a) Outline the rational and emergent processes of arriving at strategy.



1 Introduction – the organisational ecosystem

The E3 syllabus, as its title suggests, looks at how organisations are managed from a strategic perspective. Much of this paper is therefore about understanding what is meant by the term strategy and the different processes that a management team might go through to formulate and implement an appropriate strategy.

It should be accepted from the outset that there is no ‘one size fits all’ strategy that is appropriate for all organisations; what will work for, say, a global oil company is likely to be very different for a manufacturer of consumer electronics.

Fundamental to recognising what will work for a particular organisation is understanding the **ecosystem** in which it exists.

What is meant by the term ‘ecosystem’?

An organisation’s ecosystem is made up of a network of organisations – including customers, suppliers, distributors, competitors, government agencies etc. – involved in the delivery of a product or service. This can be via either cooperation (e.g. customers and suppliers) or competition.

The idea is that all components of an ecosystem impact on each other, creating a relationship that is constantly evolving and within which each organisation must be flexible and adaptable to survive. The term ecosystem was first used in the 1930s in a botanic context; a community of organisms (for example, plants and insects) interact with each other and their environments (such as air, water, sunshine, the earth). In order to survive and thrive, these organisms compete and collaborate with each other on available resources, evolve together, and adapt jointly to external disruptions.

The same concept was then used in the 1990s to look at the business world. In his article “Predators and Prey: A New Ecology of Competition”, the strategist James Moore identified similarities between the commercial and botanical worlds. He argued that organisations operating in the increasingly connected world of commerce should not be viewed as single companies in an industry; instead they should be seen as members of a business ecosystem with participants spanning across multiple industries.

Advances in technology and the increasing degree of globalisation have made people question the best ways in which to do business. The concept of a business ecosystem is thought to help organisations consider how to succeed in an environment which is changing constantly and at great speed.



Illustration 1 – The Apple ecosystem

Apple exists in a highly complex business ecosystem, made up of many participants. Examples would include:

Software developers – both those employed by the company and those who are not e.g. developers of apps which are then marketed via the App Store.

Suppliers – of components, organisations that assemble the product, of accessories (e.g. Belkin is an approved manufacturer of Apple accessories).

Retailers – not just employees in Apple Stores, but also approved 3rd party retailers.

Competitors – organisations such as Microsoft and Samsung, which are constantly innovating and therefore forcing Apple to do the same.

Customers – both individuals and also corporate customers.

Learning institutions – such as universities, that develop potential employees with the necessary skills.

Governments – e.g. much of Apple’s product is sourced from China. Any trade wars between the US and China will inevitably impact Apple.

Legislators – those who formulate the law, which impacts not just on Apple but also other organisations e.g. privacy laws and Facebook.

This list is not exhaustive; there are many other elements of Apple’s ecosystem!

In this chapter we look at the process of strategy formulation. This is fundamental to your understanding of the E3 syllabus as a whole. However, before we look at how strategies are created, we will first look at what we mean by the word ‘strategy’.

2 The purpose of strategy

Strategy can be defined in a number of different ways, including:



'A course of action, including the specification of resources required, to achieve a specific objective.'

CIMA official terminology

'Strategy is the direction and scope of an organisation over the long term: which achieves advantage for the organisation through its configuration of resources within a changing environment, to meet the needs of markets and to fulfil stakeholder expectations.'

Johnson, Scholes and Whittington (Exploring corporate strategy)

Essentially strategy involves setting the future plans of the organisation, but it requires a comprehensive understanding of the organisation's:

- resources (such as cash, assets and employees)
- ecosystem i.e. its environmental factors (such as markets, political and economic issues, customers and competitors)
- stakeholders (anyone with an interest in the business, such as shareholders, staff, customers, government, etc) and what they expect of the organisation.

This will allow organisations to decide how they are going to achieve a sustainable competitive advantage in the market(s) they operate within.



The characteristics of strategic decisions

In their book 'Exploring Corporate Strategy', Johnson, Scholes and Whittington outline the characteristics of strategic decisions. They discuss the following areas:

- Strategic decisions are likely to be affected by the scope of an organisation's activities, because the scope concerns the way the management conceives the organisation's boundaries. It is to do with what they want the organisation to be like and be about.
- Strategy involves the matching of the activities of an organisation to its ecosystem.
- Strategy must also match the activities of an organisation to its resource capability. It is not just about being aware of the environmental threats and opportunities but about matching the organisational resources to these threats and opportunities.
- Strategies need to be considered in terms of the extent to which resources can be obtained, allocated and controlled to develop a strategy for the future.
- Operational decisions will be affected by strategic decisions because they will set off waves of lesser decisions.

- As well as the environmental forces and the resource availability, the strategy of an organisation will be affected by the expectations and values of those who have power within and around the organisation.
- Strategic decisions are apt to affect the long-term direction of the organisation.

In his book 'Competitive Strategy', Michael Porter put it this way:

'The essence of formulating competitive strategy is relating a company to its environment.'



Advantages and disadvantages of deliberate long-term planning

Advantages of adopting a long-term planning approach (such as the rational model discussed above) include:

- **Forces managers to look ahead** – formal planning methodologies require managers to identify changes in the organisation's circumstances and look at ways to deal with them. This will help to ensure that the organisation stays relevant in its market and survives in the long term.
- **Improved control** – the organisation is forced to identify a mission and objectives. This will be communicated to management, meaning that they know what targets they are working towards/being assessed against. This will also improve goal congruence.
- **Identifies key risks** – by undertaking detailed analysis, management can identify key external and internal risks and create contingency plans to deal with these.
- **Encourages creativity** – management will have to generate ideas for the organisation, meaning that it can benefit from their experience and ability to innovate.

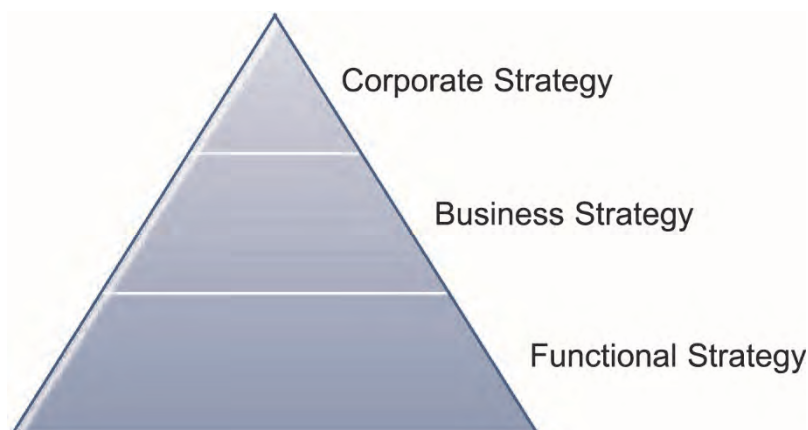
Disadvantages of formal, long-term planning include:

- **Setting corporate objectives** – it may be difficult for the organisation to create an overall mission and objectives. This is often due to the contradictory needs of key stakeholders. For example, maximising profit for shareholders may require restructuring to the organisation that causes employee redundancy. Dealing with stakeholder conflict will be dealt with in chapter 2.
- **Short-term pressures** – The pressures on management are often for short-term results. It can therefore be difficult to motivate managers by setting long-term strategies when short-term problems can consume their entire working day.

- **Difficulties in forecasting accurately** – it may be hard to identify long-term trends in the market - especially in fast-moving industries such as computing. This may make it difficult to create a strategy that is effective for the organisation over several years.
- **Bounded rationality** – the internal and external analysis undertaken as part of long-term strategic planning is often incomplete. This means that any strategies developed by the organisation based on this incomplete analysis may be ineffective.
- **Rigidity** – Once a long-term plan is created, managers often believe it should be followed at all costs – even if it is clearly no longer in the best interests of the organisation. This can also lead to the long-term strategy stifling initiative as managers refuse to act ‘outside the plan’.
- **Cost** – the strategic planning process can be costly, involving the use of specialists, sometimes a specialist department, and taking up management time.
- **Management distrust** – the strategic planning process involves the use of management accounting techniques, including forecasting, modelling, cost analysis and operational research. This may be unfamiliar to some managers, leading to resistance. It is worth noting that many academics mistrust these models – not just managers!

3 Levels of strategy

Strategy can be broken down into three different levels.



Corporate (or strategic) level

This is the highest level of strategy within the organisation and examines the strategies **for the organisation as a whole**. In particular it focuses on which businesses and markets the organisation should operate within.

Corporate strategy is therefore often concerned with issues such as:

- acquisitions, disposals and diversification
- entering new industries
- leaving existing industries.

Business (or management) level

Having selected a market, the organisation must develop a plan to be successful in that market. Business strategy therefore looks at **how the organisation can compete successfully in the individual markets** that it chooses to operate within.

Business strategy is concerned with issues such as:

- achieve advantage over competitors
- meet the needs of key customers
- avoid competitive disadvantage.

Corporate strategy affects the organisation as a whole, but business strategy will focus upon **strategic business units (SBUs)**. An SBU is a unit within an organisation for which there is an external market for products distinct from other units.

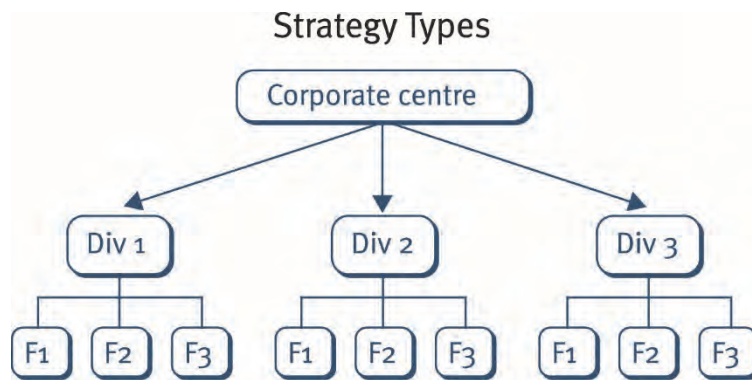
Functional (or operational) level

This level of strategy is concerned with how the component parts of the organisation in terms of resources, people and processes are pulled together to form a strategic architecture which will effectively deliver the overall strategic direction. It looks at the **day to day management strategies of the organisation**.

Operational strategy is concerned with:

- human resource strategy
- marketing strategy
- information systems and technology strategy
- operations strategy.

These could be unique to the SBU and benefit from being individually focused or the corporate unit may seek to centralise them and so benefit from synergy.



- ✓ One corporate strategy
- ✓ Three business strategies
- ✓ A choice for functional strategies

Remember that all three levels are linked. A corporate or business level strategy is only going to succeed if it is supported by appropriate operational strategies.

For instance, a hotel chain may have a high level strategy of ‘excellence in customer care’, but the success or failure of this will depend on the staff who clean the rooms and cook the meals, etc. Therefore the day to day activities **must** be focused on achieving the corporate level strategy.

It is worth mentioning that formulating the strategy is the easy part. Actually implementing it is the difficult part. Premiership football clubs in the UK will all have strategies in place to win their league. Only one will actually do so!



Illustration 2 – Levels of planning

Gap is an international clothing retailer. Classification of different levels of planning could be as follows.

Strategic

- Should another range of shops be established to target a different segment of the market? (Gap opened Banana Republic, a more up-market chain to do just that.)
- Should the company raise more share capital to enable the expansion?

Business

- Which geographical markets should the new range of shops open in?
- How often should inventories be changed to ensure the business keeps up with changing fashions?
- What prices should be charged in the new stores relative to rivals?

Operational

- How will suitable premises be found and fitted out for the new range of shops?
- Which staff should be hired for the new stores?
- Which IT systems need to be installed in the stores?

Gap's strategic decision to create the Banana Republic chain had to be supported by new business and operational level strategies. For example, poor business strategies for Banana Republic (such as pricing goods too high relative to rivals) would have led to the failure of the new stores. Likewise, poor operational strategies (such as poor training for employees in the new stores) would have damaged Banana Republic's brand and ruined Gap's overall strategic level strategy.

Whichever approach is chosen, remember that many different types of organisation will need a strategy. This will include companies (large and small), unincorporated businesses, multinational organisations, not-for-profit organisations such as charities, schools and hospitals, etc.

Anywhere that is likely to have a management accountant is likely to need a strategy. Remember that the exam itself will be based on any of these types of organisation. Be prepared for a wide range of scenarios!

4 Types of strategy

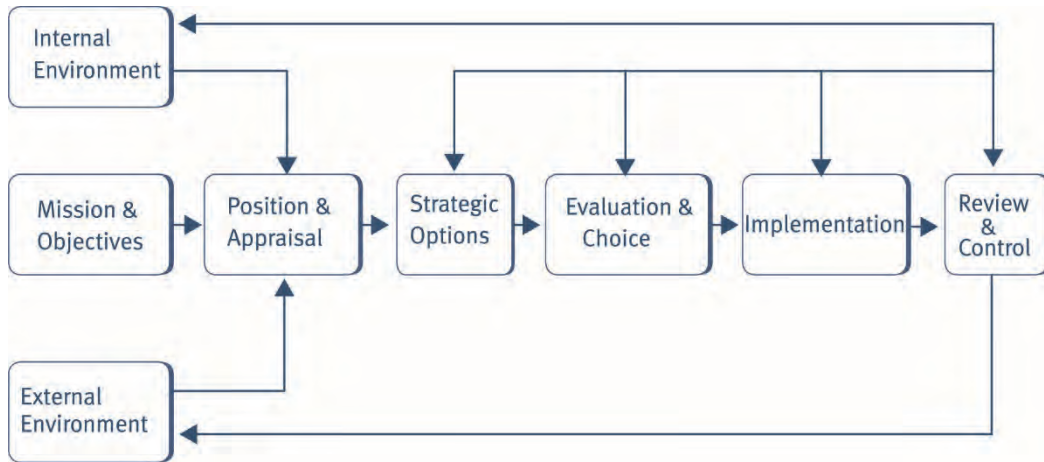
Having an appropriate strategy is seen as vital to the future success of most organisations. So how does an organisation create a strategy?

There are a number of different models that can be adopted. None can be considered to be the 'best' approach – it simply depends on which one each organisation feels is the most appropriate for their needs.

4.1 The rational model

The rational model is a logical, step-by-step approach. It requires the organisation to analyse its existing circumstances, generate possible strategies, select the best one(s) and then implement them.

The rational model follows a series of set stages as shown in the diagram below:



Johnson, Scholes and Whittington took the stages from the rational model and grouped them into three main stages:

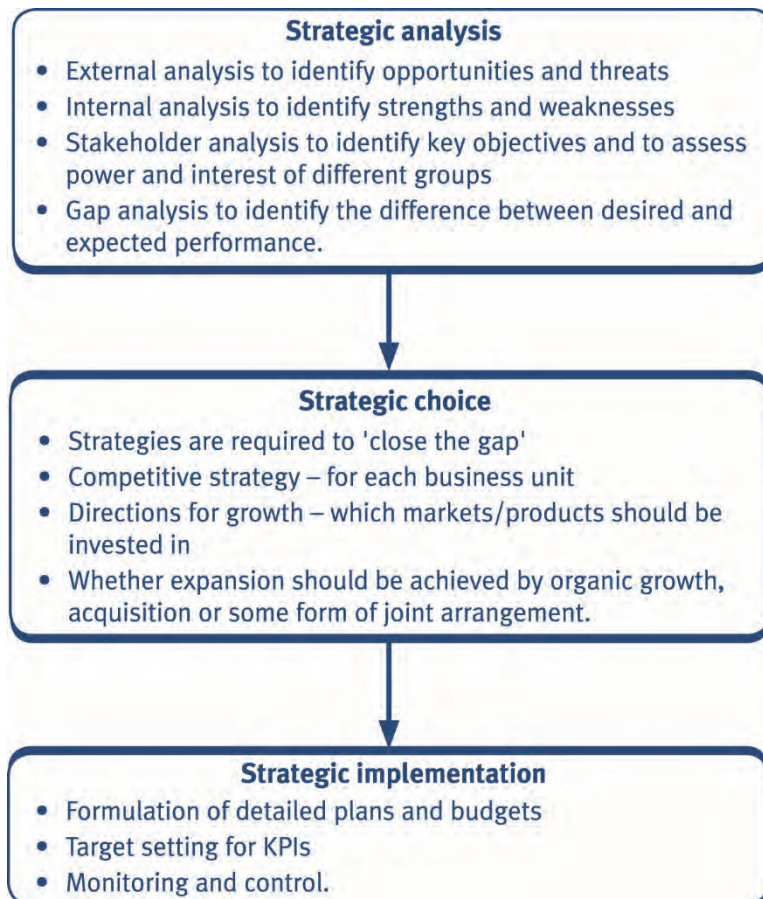




Illustration 3 – The rational model

H plc is a company with a chain of high-street stores selling CDs and DVDs across country V. It has posted significant losses in the last three financial years and wishes to create a strategy using the rational model.

Mission and objectives

In this stage, H will decide on what it needs to accomplish. For this business, it may consider its mission to be a 'turnaround' of the organisation's fortunes.

While this gives an overall direction to the organisation, it will also need to convert this into specific objectives, or targets. These may include (for example) a return to profitability, a reduction of costs by fifteen percent and a rise in sales by three percent over the next five years.

H can use these objectives to assess when it has achieved its mission of turning the business around.

Position and appraisal

This stage will require H to undertake a detailed analysis of its situation. It needs to understand its operations and external environment before it can suggest how to achieve its mission.

H will examine its internal environment – for example the quality and number of its stores, the ability and motivation of its staff and its cash balances. It will also examine its external environment – noting the shift in the market towards online downloading of music and films, rather than the purchase of DVDs and CDs.

H will also examine its stakeholders at this point to try and understand what they expect from the company. For example, what do H's shareholders want? Are they willing to invest more money into the company? What do H's customers expect from H and how powerful are they in determining H's overall strategic direction?

Strategic options

Once H has gained an understanding of its position (and why it is making significant losses), it can suggest possible strategic options that would help it achieve its mission.

For example, it could consider offering online downloads to customers as well as selling through its traditional stores. Alternatively it could continue selling via its stores, but dispose of any that are unprofitable. There are likely to be a number of different options that H could consider.

Evaluation and choice

Based on H's position analysis, H will pick the strategic option that best fits its circumstances. For example, it may lack the cash and skills to create a new online download site, meaning that it simply chooses to dispose of any unprofitable stores.

Implementation

H undertakes the chosen strategy. This involves choosing and closing any stores identified as underperforming as well as dealing with any unexpected problems (such as the reaction of staff unions).

Review and control

Once H's new strategy has been implemented it can go back to its initial mission and objectives. Has the store closure led to a return to profits, a reduction in costs by fifteen percent and a rise in sales by three percent? If not, H will need to decide on a new strategy to accomplish these goals.



Illustration 4 – The JSW approach

A full-price airline is considering setting up a 'no-frills', low-fare subsidiary. The strategic planning process, according to JSW, would include the following elements:

Strategic analysis: Competitor action, oil price forecasts, passenger volume forecasts, availability of cheap landing rights, public concern for environmental damage, effect on the main brand.

Strategic choices: Which routes to launch? Set up a subsidiary from scratch or buy an existing low-cost airline? Which planes to use? Which on-board services to offer?

Strategic implementation: Setup of new subsidiary. Staff recruitment and training. Acquisition of aircraft and obtaining of landing slots.



Test your understanding 1

Which THREE of the following are stages in the rational model of strategic development?

- A Implementation
- B Strategic analysis
- C Mission and objectives
- D Review and control
- E Strategic planning
- F Operational strategy

4.2 The emergent approach – Mintzberg



Strategies are not always formally planned. In reality, strategies may evolve in response to unexpected events that impact on the organisation.

Mintzberg referred to these as emergent strategies.

Mintzberg argued that in a changing environment, the rational model is often too slow and quickly becomes outdated. As an alternative, Mintzberg suggested that in reality, an emergent approach to strategy development occurs, whereby strategy tends to evolve rather than result from a logical, formal process. An emergent approach is evolving, continuous and incremental.

A strategy may be tried and developed as it is implemented. If it fails a different approach will be taken. It is likely to be more short term than the traditional process. To attempt to rely on emergent strategies in the longer term requires a culture of innovation where new ideas are readily forthcoming.

In effect the timing, order and distinctions between analysis, choice and implementation become blurred in emergent approaches. For this reason the analysis/choice/implementation identified earlier approach is sometimes shown as a triangle rather than a straight line in the emergent approach.

Note that the emergent approach does not necessarily mean that the organisation does not have a formal plan for the future. However to be successful it will need to be able to amend this strategy for unexpected events.



Illustration 5 – The emergent model

The emergent model

Pfizer, a multinational pharmaceutical company, developed a drug known as Sildenafil in an attempt to deal with high blood pressure in patients.

The drug was ultimately unsuccessful, but patients in the test groups reported an interesting side-effect. Pfizer sold the drug as Viagra and started a new multi-billion dollar market.

4.3 Logical incrementalism

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

Incrementalism (initially developed by **Lindblom**) does not believe that the rational model of decision-making is sensible and suggests that, in the real world, it is rarely used. This is because:

- Strategy is not usually decided by autonomous strategic planning teams that have time to impartially sift all the information and possible options before deciding on the optimal solution.

- Instead, managers have to sift through the options themselves. Due to time and knowledge constraints (also known as **bounded rationality**), this means that they usually only choose between relatively few options.
- This typically leads to strategy being small scale extensions of past policy – in other words, managers try to make small changes to what they know has worked well in the past.

This approach to strategy has a number of advantages over the rational model. In particular it is often more acceptable to stakeholders as consultation, compromise and accommodation are built into the process. In addition, it is less of a cultural shift for the organisation to adopt an incremental approach to strategy as the organisation will not be trying to implement major shifts in its activities.

However, incrementalism may mean that the organisation has no overall long-term plan, causing it to suffer from strategic drift, eventually leading to it being unable to meet the needs of its customers. In addition, it could mean that the organisation fails to make major changes if needed.



Test your understanding 2

Which ONE of the following statements are consistent with incrementalism?

- A Strategy tends to be small-scale extensions of past policies
- B No formal planning should be undertaken – the business should simply react to events as they occur
- C Strategy development should follow a series of logical stages
- D Detailed internal and external analysis should be undertaken before deciding on the future strategy of the organisation

4.4 Freewheeling opportunism



Freewheeling opportunism suggests that organisations should avoid formal planning and instead simply take advantage of opportunities as they arise.

The main justification for this is that formal planning takes too long and is too constraining – especially for organisations in fast-changing industries, such as pharmaceuticals and technology development. It may also suit any experienced managers who happen to dislike planning.



Problems with a lack of formal planning

Freewheeling opportunists dislike formal planning. However, there are a number of practical risks involved with this approach.

- **Failure to identify risks** – the business is not being forced to look ahead. This means that it may fail to identify key risks, which means that it will not have contingency plans in place to deal with these, should they arise.
- **Strategic drift** – the organisation does not have an overall plan for the future, meaning that it may be difficult for it to effectively compete in its market in the long term.
- **Difficulty in raising finance** – investors typically like to know what plans the organisation has for the future. If the company does not have a formal plan, it may be difficult to convince shareholders and banks (amongst others) that the company is a worthwhile investment.
- **Management skill** – freewheeling opportunists require managers that are highly skilled at understanding and reacting to the changing market. Less able or experienced managers will find this a difficult approach to use.



Test your understanding 3

T plc is an electronics manufacturer, which has recently created a detailed strategic review of its operations, as well as its external environment. T identified that it had significant skills with regards to the manufacture of electronic displays and launched a range of flat screen televisions. Unfortunately, its new product range, while praised by reviewers, failed to sell well to the public. T therefore abandoned its original strategy and took advantage of an offer by HHH, another electronics manufacturer, to make screens for HHH's popular mobile smartphones.

Which ONE approach to strategy is closest to that adopted by T when accepting HHH's offer?

- A Emergent
- B Rational
- C Incrementalist
- D Opportunism

4.5 Which approach to strategy should we adopt?

We have identified four different approaches to developing a strategy. While we have already mentioned that there is no 'correct' approach, it is important that you can justify which one would be the most appropriate for a particular organisation to adopt.

We can consider the four approaches as a spectrum:



More formal planning approaches, such as the rational model (and to a degree the emergent model) tend to suit organisations which:

- exist in relatively stable industries, meaning there is sufficient time to undertake detailed strategic analysis
- have relatively inexperienced managers, as the formal planning approach helps to ensure they are familiar with the organisation as well as providing a series of guidelines they can follow to help them develop a strategy.

More informal approaches, such as freewheeling opportunism (and to a degree incrementalism) tend to suit organisations which:

- are in dynamic, fast changing industries where there is little time to undertake formal strategic analysis
- have experienced, innovative managers who are able to quickly identify and react to changes in the organisation and its environment
- do not need to raise significant external finance (external investors typically prefer a formal planning approach).

Note that incrementalism is unlikely to be suitable for new organisations as they have no past strategies upon which they can base their future policy.



Test your understanding 4

K is a small organisation which makes plastic toys. The company was very recently formed by Mr V. Mr V is a skilled entrepreneur with many years of experience in the industry.

The toy industry is incredibly fast-changing, with new innovations being developed regularly. In addition, tastes and trends change regularly, meaning that sales of toys can drop quickly as they fall out of fashion.

Mr V is aware that K will often require radically new strategies in order to keep up with these changes.

Which ONE of the following approaches to strategic development would be most appropriate for K to adopt?

- A Incrementalism
- B Rational
- C Emergent
- D Freewheeling



Test your understanding 5 – HAA – (Case Style)

You are Ali, a management accountant working for HAA plc – a computer games company that operates in country F. You have just found the following note from your manager on your desk:

NOTE

Hi Ali,

As I'm sure you're aware, HAA is planning to expand abroad, into the European market. To support this, we have undertaken a detailed review of our existing operations and the European market. This has been used to produce a three-year budget and operational plan for our proposed European operations.

The European electronics market has always been seen as a difficult market for new entrants. This is due to the fast-moving, innovative nature of the companies currently operating there. HAA has a high spend on research and development and our directors feel that the company is well placed to compete with European games manufacturers.

I'm meeting with the directors in fifteen minutes so I need you to make some brief notes for me evaluating our current approach to strategic planning. Can you suggest any more appropriate approaches we should consider?

Thanks

Required:

Draft a response to your manager, as requested.

(15 minutes)



Strategic planning for not-for-profit organisations (NFPs)

Strategic planning

Many of the organisations in exam questions will be profit-seeking businesses. However, some may involve charities, councils, schools, hospitals and other organisations where profit is not the main objective. With such a 'NFP' a discussion of objectives is likely to be problematic for the following reasons:

- It is more likely to have multiple objectives. A large teaching hospital may want to give the best quality care and treat as many patients as possible and train new doctors and research new techniques. Conflict is inevitable.

This is not just an issue for NFPs, profit-seeking organisations also have multiple stakeholders with conflicting demands.

- It will be more difficult to measure objectives. How can one measure whether a school is educating pupils well? Performance in exams? Percentage going on to university? Percentage getting jobs? Percentage staying out of prison once they leave?
- There may be a more equal balance of power between stakeholders. In a company, the shareholders hold ultimate power. If they do not use it, the directors generally get their way. In a school, the balance of power may be more even (or even undefined) between parents, governors, the headmaster and the local education authority.
- The people receiving the service are not necessarily those paying for it. The Government and local NHS trusts determine a hospital's funding, not the patients. Consequently there may be pressure to perform well in national league tables at the expense of other objectives.

In spite of these problems, NFPs are still likely to need strategies. In the UK, for example, many public sector organisations have to produce strategic plans for between one and five years ahead as this is a Government requirement.

One of the reasons for this is that the public sector is required to hit certain targets and key performance indicators (KPIs), which are set by central government. In a company these targets and KPIs are used to ensure that the business is competitive. For a public sector organisation, they are used by the government to exert control over the activities of the organisation and to ensure that the government's funding is being used appropriately.

The 3Es

Public sector organisations and charities often have difficulty in using traditional private-sector-based approaches to objective setting since they do not make a profit by which their success or failure can be measured. One way to address this problem is to use the following approach.

The 'three Es approach' of the Audit Commission:

- **Economy** looks solely at the level of inputs, e.g. did the hospital spend more or less on drugs this year? Or on nurses' wages?
- **Efficiency** looks at the link between outputs and inputs (the internal processes approach). The 'internal processes approach' looks at how well inputs have been used to achieve outputs – it is a measure of efficiency. For example, what was the average cost per patient treated? What was the average spend per bed over the period? What was the bed occupancy rate that this achieved?
- **Effectiveness** looks at the outputs (the goal approach). The 'goal approach' looks at the ultimate objectives of the organisation, i.e. it looks at output measures. For example, for an NHS hospital, have the waiting lists been reduced? Have mortality rates gone down? How many patients have been treated?

The best picture of the success of an organisation is obtained by using all of the above approaches and by examining both financial and non-financial issues. Think about effectiveness meaning 'doing the right things' and efficiency 'about doing things right'.



Illustration 6 – The 3Es

Consider O – a large teaching hospital based in a major city which is funded by the Central Government. O may want to analyse its value for money using the 3Es in the following ways:

Economy:

O is given an annual budget by the Central Government. Economy is likely to look at whether this budget has been met. Has O spent more overall than expected? Has more or less been spent on drugs or wages than predicted? These would help O measure if it has been economical with the use of its funds.

Efficiency:

How well have O's inputs been used to generate its desired outputs? This looks at O's internal processes and could include measures such as the average cost per patient, average spend per hospital bed, or the spend per student in the period.

Effectiveness:

This looks solely at the outputs of O's operations. For example, has O had a higher or lower mortality rate than expected? What percentage of students have qualified or passed exams? How long is the patient waiting list at O?



Test your understanding 6

H College is a government funded provider of education to several thousand students in country G. It aims to ensure that at least 75% of all exams sat by its students are passed.

In the last year, it achieved a pass rate of 75% on its exams (the same as the previous year). The head of the college claimed that this was in spite of the government limiting H College's budget rise to 3%, which meant that H College was unable to provide the level of service it had in previous years. Inflation in the economy of country G is 2%.

The government's official auditor has discovered that the cost per student has risen by 5% in H College over the last year, due to internal problems in operations.

H College is expected to offer value for money (VFM). Which ONE aspect of VFM has H College managed to achieve over the last year?

- A Efficiency
- B Economy
- C Effectiveness
- D Ethical behaviour

5 Perspectives to strategic planning

While each aspect of strategic planning is important, firms may prioritise the perspectives in different ways:

5.1 A traditional approach – stakeholders

The traditional approach starts by looking at stakeholders and their objectives (e.g. increase EPS by 5% per annum). The emphasis is then on formulating plans to achieve these objectives.

Objectives are very important but this approach is often flawed in so far as objectives are often set in isolation from market considerations and are thus unrealistic.

However, this approach can be particularly useful for not-for-profit organisations where a discussion of mission and objectives is often key.

5.2 A 'market-led' or 'positioning' approach

The more modern 'positioning' approach starts with an analysis of markets and competitors' actions before objectives are set and strategies developed.

The essence of strategic planning is then to ensure that the firm has a good 'fit' with its environment. If markets are expected to change, then the firm needs to change too. The idea is to be able to predict changes sufficiently far in advance to control change rather than always having to react to it.

The main problem with the positioning approach lies in predicting the future. Some markets are so volatile that it is impossible to estimate further ahead than the immediate short term.

5.3 A 'resource-based' or 'competence-led' approach

Many firms who have found anticipating the environment to be difficult have switched to a competence or resource-based approach, where the emphasis of strategy is to look at what the firm is good at – its core competences.

Ideally these correlate to the areas that the firm has to be good at in order to succeed in its chosen markets (critical success factors or CSFs – see chapter 5 for more detail on this area) and are also difficult for competitors to copy.



Test your understanding 7

J Ltd is a company which offers home television repairs to customers. It has an excellent reputation for customer service and good quality workmanship. J feels that this has given it a competitive advantage in the market.

J is considering launching a car maintenance and repair service. It feels that its excellent reputation is likely to make such a move successful.

Which ONE of the following approaches to strategic planning is J adopting?

- A A positioning approach
- B A traditional stakeholder approach
- C A resource-led approach
- D A corporate approach



Test your understanding 8 – GYU – (Case Style)

You have just received an email from your manager.

To: A

From: A. B Jones

Date: 17/05/XX

Subject: GYU

Hi A,

You may not have heard of GYU – they are a new client of ours. GYU is a large company which manufactures mobile phone handsets. This is an extremely competitive market and GYU has recently been struggling to keep up with other companies in its sector. This is due to the fast-paced nature of the market. New handsets with increasingly complex features are constantly being launched by competitors and the directors of GYU are concerned that the range of handsets manufactured by the company are beginning to look dated.

This has caused a sharp fall in GYU's cash balances and in response, for the first time in its history, GYU has had to cut its dividend. The fall, which was around 10%, was met with an angry response by shareholders and GYU's share price has fallen significantly since the announcement.

While GYU's position appears weak, it is still seen as a market leader in the production of mobile handset software. While the reviews of its handsets are no longer entirely favourable, most customers agree that the software on the mobile phones is significantly superior to that produced by any of GYU's competitors.

I'm about to have a meeting with GYU's directors for the first time and I think they will ask me to advise them about the three different approaches to strategy that GYU could use and which is the most appropriate for their business. I'd like you to email me back in the next fifteen minutes and tell me your thoughts on these matters.

Required:

Reply to the manager as requested.

(15 minutes)

6 The role of the management accountant

It is important to appreciate the role of management accountants within the process of developing strategy. Normally this will involve providing information to aid in strategic planning and decision-making.

Strategic management accounting

Strategic management accounting is a 'form of management accounting in which emphasis is placed on information which relates to factors external to the entity, as well as non-financial information and internally generated information'.

CIMA Official Terminology

This indicates some key differences between **strategic** and **traditional** management accountants.

External focus

Traditional management accountants tend to focus on internal company issues. This is because their role is, amongst other things, to:

- aid in the creation of operational strategies for the business
- safeguard company assets – both tangible and intangible
- measure and report both financial and non-financial performance to managers
- ensure efficient use of assets and resources.

Strategic management accountants must provide information to help managers make key strategic decisions. This requires a stronger external focus – especially regarding the behaviour of competitors, customers and suppliers. Indeed, the strategic management accountant will need to consider all aspects of the ecosystem in which their organisation operates; the activities of business partners will also need to be carefully monitored.

This information will be vital to allow the business to understand the market it is operating in, which is a fundamental part of strategic planning.

Forward-looking

A large part of a traditional management accountant's role is to do with the measurement of historic performance of a business and its divisions.

Strategic management accountants need to be more forward-looking. This is because they will be analysing strategies that the business will employ in the future, rather than looking back at past performance.

Information provided by strategic management accountants

The information provided by strategic management accountants (SMAs) will include:

- **competitor analysis** – identification of competitors and detailed analysis of their activities
- **customer profitability** – which customers are the most important?
- **pricing decision** – forecasting of customer behaviour as well as competitor responses may help the business to decide on product pricing
- **portfolio analysis** – identification of key products and the strategies that should be adopted for each
- **corporate decision support** – this could include helping managers to decide whether or not to launch new products or enter/leave new markets
- **customer profitability analysis** – the SMA can help the business to identify which of its customers are most profitable and which may be costing the business money.
- **evaluation of brand value** – SMAs can help assess the value of an organisation’s brand name, which may be useful when considering acquisitions and disposals of businesses or strategic business units
- **strategic information for acquisitions, disposals and mergers** – the SMA can help to assess what value such actions could have for an organisation
- **investment in strategic management systems** – SMAs can help management assess the need for and value of investment in new information technology and systems. For example, establishing and managing use of technology such as cloud computing or blockchain as part of the organisational ecosystem.

A comparison of the information produced by strategic and traditional management accountants may be useful:

Traditional management accountants:	Strategic management accountants:
Cost structure	Competitor cost structure
Product costs	Competitor product costs
Market share	Relative market share
Profitability	Relative profitability
Price margins	Competitor price margins

Value of strategic management information

The information produced by strategic management accountants will help the business in a number of ways, including:

- more effective strategic planning
- increased awareness of the business and its environment
- increased control over business performance
- better decision-making.



Test your understanding 9

Which ONE of the following statements is consistent with the role of a typical strategic management accountant?

- A They focus primarily on the provision of information about internal company issues to management.
- B The information they provide to management is typically forward-looking.
- C Their primary focus is on the provision of financial information to management.
- D They typically focus on the production of the organisation's financial statements.

7 Summary

By the end of this chapter, you should be able to discuss:



Test your understanding answers



Test your understanding 1

The correct answers are A, C and D.



Test your understanding 2

The correct answer is A

B relates to freewheeling opportunism.

C and D relate to the rational model.



Test your understanding 3

The correct answer is A

T has created a formal strategy after extensive analysis of its position. While this is consistent with the rational model, T has subsequently abandoned this and reacted to unforeseen events – i.e. the failure of its product to sell well.

This willingness to adapt to events as they occur is consistent with the emergent approach.

Note that incrementalism would involve small scale extensions to past strategies. HHH's proposal is significantly different to its original strategy, so this does not appear to be the case.

HHH is still basing its actions, at least in part, on a formally designed original strategy. This would indicate that it is not following an opportunistic approach.



Test your understanding 4

The correct answer is D

The pace of change in the market would tend to indicate that formal planning is not viable. This would suggest that the rational and emergent models are less useful. Incrementalism suggests that future strategies are small scale extensions of what has worked in the past. Again, this is clearly not appropriate given the need for radically new strategies highlighted in the scenario.



Test your understanding 5 – HAA – (Case Style)

Meeting notes

Current approach to strategy

HAA is currently using the rational model to develop its strategies. This involves taking a logical, step-by-step approach. HAA has clearly done this by undertaking such detailed planning, including strategic analysis of the market and the production of detailed operating plans.

The key advantage of such an approach to HAA is the level of understanding it will give them in the new market. They are currently not used to operating in the European market, so the initial strategic analysis they have performed will be invaluable. It will give them a picture of the their own capabilities as well as the European market they will be entering.

However, the European market is fast-moving, both due to its nature (high-tech) and the level of innovation by competitors. HAA will have to be prepared to quickly change its approach to deal with unexpected developments in the market. If the company produces a detailed operational plan, this may stifle the innovation that is required.

In addition, given the lack of experience that HAA has in the European market, any detailed forecasts it produces may prove to be unreliable. This may cause it to make inaccurate decisions based on flawed market predictions.

Alternative approaches to strategy for HAA

HAA could adopt the **emergent model**. While this would still involve some initial formal planning, these plans would merely be a starting point for the European operations. They will be continuously reviewed and updated as the games market changes, improving HAA's chances of success in the fast-moving market.

Alternatively HAA could choose the **freewheeling opportunism** approach to strategy. This would involve not producing a formal strategy – instead merely taking advantage of opportunities as they arise. The more rapidly the market evolves, the more applicable this approach may be, although it is considered too high risk for many managers.



Test your understanding 6

The correct answer is C

Effectiveness looks at the outputs of the organisation. As H has achieved its goal of a 75% pass rate, it has been effective.

Economy looks at the level of inputs – in this case, inputs have risen by 3% in the year (above inflation), but the efficiency with which H has used these inputs has fallen significantly. These factors would indicate a lack of efficiency and economy.



Test your understanding 7

The correct answer is C

J has identified a key resource or capability – its strong reputation. It is now looking for new ways to capitalise on this.



Test your understanding 8 – GYU – (Case Style)

There are three main approaches to strategic planning that GYU could take.

Traditional

This would involve GYU examining its key stakeholders and developing objectives that will meet their needs. The two key stakeholders in the scenario are GYU's customers and shareholders. The shareholders are clearly upset with the reduction in their dividend and will expect GYU to reverse this in coming years. The customers will be looking for handsets with more features and that are less 'dated'.

Unfortunately, while these are important objectives, they may be difficult for GYU to accomplish in the short term. Given the poor level of its finances, it may struggle to either increase dividends or invest enough in research and development to update its product line.

Market-led

This will involve the examination of GYU's competitors and market. Doing so should help GYU to ensure that it is competitive in what is a very fast-paced market.

While this appears to have been a weakness of GYU's to date (given the fact that it seems to have fallen so far behind many of its competitors), it may be inherently difficult in the mobile phone handset market. As the market is changing so rapidly, it may be difficult for GYU to accurately predict future trends and create appropriate strategies.

Resource-based

This involves GYU focusing its business strategies on areas that it is good at. For GYU its key area of skill is in the production of mobile handset software. It is acknowledged to be the market leader in this area and it appears to be very important to customers. Any future strategies should therefore be based around leveraging this area of skill.

For example, if it feels unable to produce handsets that are competitive, GYU could consider focusing on producing software which could then be licensed on other manufacturer's handsets. If this is a big enough market, this could help GYU to turn its business around.

Conclusion

Based on the information provided, the resource-based approach is likely to be best for GYU.



Test your understanding 9

The correct answer is B

Strategic management accountants tend to focus on information that is both internal and external, financial and non-financial information, and forward-looking. This will help management to make the best strategic decisions possible by having all relevant information to hand. Note that strategic management accountants would not usually focus on the production of the financial statements of the organisation – this role would usually be filled by financial accountants.