CHAPTER 7 - Strategic options generation

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7.3 Ansoff's growth vector matrix

Active reading. Note that the focus is on strategies for growth. The matrix is based on the two key aspects of strategy that an organization decides - products and markets.

Video link [Growth strategies adapted from Ansoff's matrix](https://www.youtube.com/watch?v=mXi9Ctzf6p4)

[https://www.youtube.com/watch?v=mXi9Ctzf6p4]

Ansoff (1965) identified four key strategies for growing an organization: market penetration, product development, market development, and diversification. These can be represented in a matrix, as shown in Figure 7.2. The matrix provides a useful framework for thinking about potential strategic options available to an organization. Figure 7.2 also includes two other options in the existing products and existing market quadrant of consolidation and withdrawal. These were not part of the original Ansoff matrix, but they do provide strategic options to the current strategy of the organization and can aid growth. Strategies can also consist of more than one element; for example, an organization may pursue a dual strategy of product development and market development. It is also possible to launch a new product or enter a new market using a strategy of market penetration; therefore, the strategies can be used in conjunction with one another.

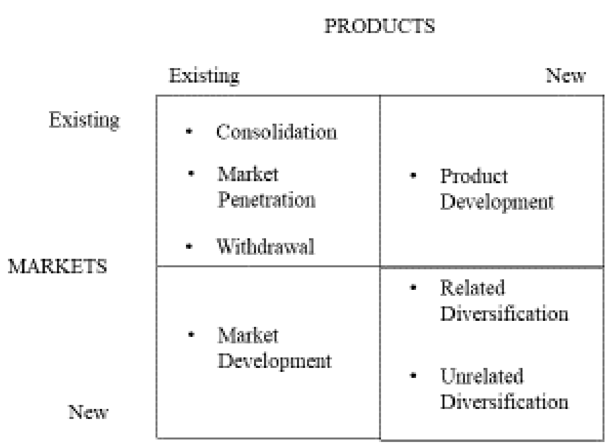

Figure 7.2 Growth strategies to fill the profits gap

7.4 Strategies for growth

Active reading. Note how the strategies described in this section build on knowledge gained from existing strategies.

7.4.1 Withdrawal

Portfolio analysis was discussed in section 4.5, in which the possibility of withdrawing an existing product from the market was highlighted as an option. Withdrawing a product can be a way of releasing resources that can be diverted to more profitable products and therefore present itself as an option to support growth. Similarly, withdrawing from unprofitable markets can achieve the same objective of releasing valuable resources.

There are, however, considerations to withdrawing as the organization will have invested time and resources in developing products and markets, and the decision will not be taken lightly. There may be costs of withdrawing; for example, an automotive vehicle organization deciding to withdraw from the 4 x 4 market may involve closing a factory making the staff redundant. In some cases, there has been political pressure on the organization not to withdraw, or there could be adverse publicity that impacts the public perception of the brand. It may even be prudent to keep the product line in the market as its presence may encourage sales of other products in the portfolio. For example, an organization selling air conditioning units found that by selling basic units on which it made very small margins enabled the sales of other energy-saving heat exchange and ventilation systems on which it made a much better margin. The basic units became a loss leader product.

7.4.2 Market penetration

Market penetration refers to the situation where an organization seeks to increase its market share in existing markets with the existing products, for example, through competitive pricing, advertising, sales promotion, and so on. The strategy seeks to secure dominance in growth markets. Models such as portfolio analysis (section 4.5) could be used to identify potential markets where this strategy might be appropriate to develop a question mark product into a star product. Market penetration strategies can also be used to force out competition from the market, leaving the organization with a dominant market share.

Typical strategies employ price and product awareness where a discounted price is offered coupled with aggressive marketing campaigns. The impact on margins needs to be considered here as there is a danger that if an aggressive pricing strategy is employed to achieve market dominance, it could reduce the overall profitability of the market as consumers become used to the lower price. Marketing devices employed to encourage brand loyalty, such as the introduction of loyalty cards and promotional activity, is also relevant, but again the cost of providing these needs to be understood.

7.4.3 Consolidation

Consolidation refers to the situation where a company seeks to consolidate its position within a market by maintaining its market share. Customer loyalty programs are common techniques. Focusing more effort on the profitable market segments determined via customer profitability analysis or on markets where a market-leading position can be maintained are common strategies that can be employed to consolidate the organization's position in the market.

7.4.4 Product development

Product development refers to developing new products for existing customers. It is slightly riskier than concentrating on existing products and existing markets, as not all new products will be successful. The argument is that the organization should understand its customers and therefore be able to launch products that are attractive to existing markets. Ideally, they should be new products to profitable customers. It is also relatively important to keep a product base up to date via the development of the new product offerings, particularly if cash cows are reaching the end of their life. If this is maintained as a long-term strategy, it requires constant investment. The technology industries such as mobile phones are one in which new products are launched at regular intervals, with marketing campaigns to persuade customers to upgrade.

7.4.5 Market development

Market development refers to the strategy of entering new markets with existing products and is also riskier than market penetration and consolidation as the products may not sell well in new markets. It can include new geographical areas and new channels to market, such as selling via the Internet or TV shopping channels. The classic example is expanding sales into overseas markets, which raises cultural issues and may require some adjustment to the product offering with an associated impact on costs, pricing, and profitability.

7.5 Evaluating viable international markets

Active reading. Note the use of a strategic framework to provide the basis of considering suitable targets for overseas expansion. Note the elements that need to be considered under each heading of the framework discussed in section 7.5.2.

Video link [Porter's competitive advantage of nations (Porter's diamond)](https://www.youtube.com/watch?v=4LxwaBikP6o&t=26s)

https://www.youtube.com/watch?v=4LxwaBikP6o&t=26s

There are three critical decisions to make when considering expanding into international markets. Firstly, whether to market aboard at all? Secondly, which markets to enter? And finally, which mode of entry is the most appropriate at the time?

7.5.1 Whether to market abroad.

Opportunities to expand into international markets may be identified from the environmental analysis. The advantages include expanding sales and potential profits, lengthening the life cycle by selling into new markets, and spread the risk, both geographically and economically. There may be seasonal aspects that can be exploited, for example, products that are enjoyed in summer months can be sold in different countries depending on when their seasons occur. Operating in different countries can reduce the risk of economic cycles, for example, economies may do well at different times, and the risk exposure to political influences could be mitigated by operating in several markets.

There are, however, drawbacks in that the further away from the domestic market, the more difficult it is to control. The issue of control can be addressed via the market entry mode. There is a cost associated with the expansion, and considerable investment may be required, again depending on the entry mode adopted. There may be elements of the product or service that need adapting to make it acceptable in overseas markets, for example, cultural or legal reasons. The legal aspects need careful research as regulations will differ between markets.

In some cases, there may be cost advantages, for example, the safety requirements of an automotive vehicle sold into India are less stringent, and hence less costly, than the one sold into European markets. This sets up an ethical issue as to whether local standards are adopted, or a higher organization-wide standard is applied based on the most stringent standards to which the product must be made in the markets it serves. Using a higher standard could put the organization at a cost disadvantage to competitors that adopt the local standard in each location.

7.5.2 Which markets to enter?

It would be advisable to undertake an environmental analysis concerning the potential overseas markets. One aspect would be the attractiveness of the overseas market and whether the organization would have any possible competitive advantage over the existing competition.

Porter (1990) proposed a framework for analyzing the competitive advantage of nations to explain why some nations have a global competitive advantage in certain industries. The elements of the model that Porter identified can be used to aid the evaluation of a potential country for expansion.

Factor conditions

When expanding overseas, the degree to which the basic factors (land, labor, and capital) and advanced factors (technology, education, and infrastructure) are required need to be assessed. The basic idea behind Porter's theory is that a nation that has an abundance of basic and advanced factors will be more competitive than a nation that has not. It has echoes of comparative advantage in that a country that has access to cheap labor will potentially have a comparative advantage in labor-intensive goods. In contrast, a country that has access to capital and technology will likely have an advantage in capital intensive goods.

The mode of entry and degree to which operations are established, for example, export or local manufacture, will again influence the local need for these basic and advanced factors. Still, an assessment must be made as to the extent to which the factors need to be present. For example, is a skilled workforce required? It may be that labor does not need to be highly skilled and is plentiful and inexpensive, and establishing manufacturing facilities in a certain country to access the less expensive labor is advantageous. It is, however, important to note that a presence of factors does not guarantee success; it is how they are deployed that matters.

Demand conditions

The demand conditions in the overseas market need to be reviewed. For example, how sophisticated and demanding are consumers? What are the demographics? An educated workforce from the factor conditions analysis also implies an educated consumer. Ideally, if there are segments of the market that have the same characteristics of the domestic or home market, it means that the organization may understand how the market will respond to its products. Is the market growing or mature? Cultural issues need to be considered, and any adaptations to the product or service ascertained and costed. The degree to which alternative products exist within the market and the price ranges of competitor products needs to be researched.

Firm structure, strategy, and rivalry

The structure of the industry, degree of competition, and capital markets all need to be considered. How competitive is the industry? Are there influential domestic organizations? Are other international organizations already operating in the market? What is the political climate like for foreign investors? Is foreign direct investment encouraged or restricted? Are there any legal barriers?

Related and supporting industries

To what extent are supporting industries, for example, distribution, raw material/component suppliers, maintenance, and complementary products and services required and available?

Although it was not the original rationale for Porter's analysis, the framework can be used to assess the desirability of expanding into overseas markets and comparing the suitability of different countries.

7.5.3 Mode of entry

Active reading. Think of how the accountant can contribute to an evaluation of each mode of entry.

The mode of entry is significant as the degree of investment required increases as the mode of entry becomes more embedded within the oversea location. Ohmae (1990) suggested that a move towards globalization can be achieved by stages, and this framework provides options for market entry. The first step in overseas expansion is usually exporting. This can be achieved by the organization selling directly to customers, or via an overseas agent. Understanding demand conditions is a critical factor in deciding whether exporting is a potential opportunity. The next step might be to open a sales office in the country. If the market proves to be extremely promising, production often follows the sales. In cases where establishing a production capability in the country is being considered, the availability of basic and advanced factors needs to be evaluated.

The costs of progression and the viability of the options are an area where the accountant is well placed to support the strategic decision. Following overseas production Ohmae suggests that a fully functional organization can be established in a foreign country. He terms this insiderization, and the company is, in effect, a multinational company, in that it operates in more than one country. The difference between a multinational and global company is that a multinational company would still recognize a domestic market; for example, it is a U.S. company that also has operations in several overseas markets. A truly global company, however, does not recognize a domestic market as it takes a world view. The maxim "think global, act local" still holds true as the global company tries to integrate learning, skills, and competencies to achieve global efficiency while retaining responsiveness to local markets.

The method of entry can also include acquisition and merger as well as the organic growth option. These are discussed in section 7.10.

Learning activity. Think of other frameworks discussed in Chapter 3 that could be used to understand the business environment and market forces operating in the industry. Apply these and elements of Porter's theory of competitive nations to create a list of criteria that would be considered by an automotive manufacturer thinking of expanding into a new international market.

7.6 Diversification

Active reading. Note the benefits and drawbacks of diversification and why diversification might be reducing in popularity as a strategy.

Diversification is essentially selling new products into new markets and represents the option with the highest risk to the company. Diversification may be a suitable strategy if existing markets are becoming extremely competitive or are changing rapidly; thus, it may help to spread the risk for the organization. Diversification can be subdivided into related and unrelated. Related diversification has some relationship to existing activities, whereas unrelated diversification is something completely new, and can represent a higher risk.

Related diversification involves either vertical or horizontal diversification as illustrated in Figure 7.3.

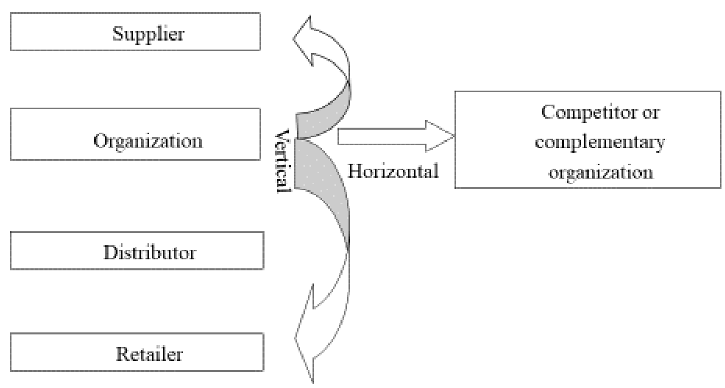

Figure 7.3 Vertical and horizontal diversification

Diversifying backward or forwards through the supply chain can have strategic advantages in that it guarantees surety of quality suppliers or closer links with customers. It can reduce the incidence of buyer or supplier power, release the margin within the supply chain to the organization, and can lead to higher profits. It could also raise barriers to entry, making it more difficult for competitors to compete. However, it can lock in more fixed costs, thus increasing the operating gearing (the proportion of total costs that are fixed) of the organization, making it more vulnerable to fluctuations in end demand. The strategy is also reliant on economies of scale being realized, and it takes the organization away from its core competencies and into areas where senior managers may not have the knowledge or expertise to manage two or more diverse businesses effectively.

Horizontal integration seeks to take advantage of economies of scale, or technical and technological competencies. Both forms of related diversification would involve exploiting synergies, the 2 + 2 = 5 effects of working together. These synergies could take the form of marketing synergies, such as making use of common distribution channels, sales staff, and warehousing. Operating synergies such as central purchasing, administration, technical support, or shared facilities. Investment synergies such as the ability to raise finance from an increased asset base, or the transfer of research and development between product ranges. Management synergies, mostly relevant to horizontal diversification, where skills and expertise can be transferred and rationalized.

Unrelated diversification, often by merger and acquisition, has been a popular strategy in the past but has fallen out of favor more recently, where the trend is to stick to the core competencies. There are advantages of unrelated diversification, such as spreading the risk, increasing profitability, gaining access to capital and resources, and enhancing the image of the organization and reputation of the senior managers (although this is a not good reason on its own to diversify). There have been examples of senior managers pursuing diversification strategies for the wrong reasons, and it comes with a high degree of risk as there is often a lack of shared identity and purpose between the organizations as the term “unrelated” implies. There is also an argument that investors could diversify their investment portfolio, and managers should not try and do this for them.

The emergence of the concept of the business ecosystem, lean manufacturing, value creation through the supply chain, collaborative working, and other strategic mechanisms for working closely with other organizations has led to the suggestion that there is often no additional benefit to be gained by trying to undertake all activities in the supply chain, that is being entirely vertically integrated, or by diversifying into other areas and away from the core competencies of the organization.

7.7 A mix of strategic options for growth

Active reading. Note how BT adopted a mix of growth strategies to its overall strategy. The options are not mutually exclusive.

In the mid-1980s, British Telecom (BT) enjoyed a near-monopoly position in the infrastructure telecoms market in the U.K. The industry regulator decided to change this situation as it was deemed to be anticompetitive. However, BT found that the domestic market was mature and growing very slowly, if at all. However, at the same time, there was increasing deregulation in other areas of the world, and markets such as Africa and Asia were showing signs of steady growth.

The senior management of BT was looking to diversify its interests into media and develop new products that could be offered via the provision of superfast broadband. As a strategy, they sought to consolidate their position in their domestic market for telecoms provision while using an approach of market penetration to target expansion in the growing overseas markets. A BT Sports TV channel was launched with the acquisition of rights to broadcast premier sporting events. The management adopted several of the strategies outlined in this section to develop an overall strategy enough to close the profits gap.

The role of management accounting in evaluating strategic options is discussed in Chapter 8. It focuses on the financial evaluation of the options as investment opportunities and the forecasting of likely outcomes. There are, however, two techniques that are particularly useful in the development of new products. These are target costing and life cycle costing, which are discussed in detail in the next two sections.

7.10 Methods of Growth

Active reading. Note the main methods described but think about the practical implications of each method and situations where the different methods might be the most appropriate way of achieving growth.

The strategic options available to an organization can be viewed as a three-stage process. Review the competitive strategy (section 6.3) for appropriateness given the changes in the environment, decide the strategic option to be undertaken based on Ansoff's ideas, and then determine the best method of achieving the strategy. Growth could be achieved via organic growth, that is, undertaking the strategy by relying on the organization's resources and capabilities, merger or acquisition, or joint development. This section briefly considers the benefits and drawbacks of each method before looking at the accountant's role.

7.10.1 Organic growth/internal development

Organic growth involves developing the internal resources and capabilities of the organization. The distinct advantage is that the organization is in total control over its destiny and has strategic independence. The organization does not have to compromise on its strategic plans, but conversely, it is bearing all the risks and costs of development. The process of developing new products and new markets under an organization's resources can sometimes take a long time, involve considerable investment in resources, and carry a high risk. However, it is possible to spread the investment over time, and the organization is gaining experience and enhancing its capabilities via organizational learning through direct involvement in the process of developing new products and markets.

7.10.2 Mergers and acquisitions

The option of a merger or acquisition provides a speedier option than organic development. Entry into new markets or acquiring new products to complement an existing product portfolio can be achieved via merger or acquisition. The strengthening of a poorly balanced product portfolio, as determined by portfolio analysis, could be improved. For example, a merger between two pharmaceutical companies where one has many profitable cash cow products, but few rising stars or question mark products in development, and the other has products in development, but very few cash cows would benefit both companies by producing a merged company with a more balanced product portfolio. New capabilities and knowledge can be acquired, such as expertise in technology or enhanced skill base. Local knowledge of markets can be gained, or the strategy can be used as a means of overcoming barriers to entry to overseas markets, perhaps by merging with a local organization already operating in the country.

Financial benefits can arise from mergers, such as improved financial efficiency via a stronger balance sheet or achieving tax efficiencies due to tax treaties between different tax regimes where the companies are based in different countries. Rationalizing product capacity or releasing value by selling off unprofitable parts could also be a motivation for merger and acquisition activity.

There are, however, some drawbacks, such as the potential for a clash of cultures. This clash of cultures is more in evidence as the two organizations try to find a way to integrate the operations and potential rationalization costs, such as the elimination of duplicated resources, or excess capacity is closed involving redundancy of personnel.

Considerations

Factors that need to be considered when undertaking an acquisition or merger include:

- Strategic fit—does it build on the strengths, address the weaknesses, grasp the opportunities, or help to minimize the threats?
- Financing—how will the acquisition be financed? What level of financial risk is involved?
- Stakeholders' attitude, particularly shareholders—what do the stakeholders involved think of the proposed acquisition or merger? Are they for or against? How will they be affected?
- Value of the target—how to value the potential target? What is the ideal price? What is the maximum that the organization is prepared to pay? That is, what are the boundaries for negotiation?
- Effect on other organizations—what is the impact on suppliers, customers, and intermediaries?

- Rationalization costs, both financial and human—what are the costs of integration, and how will these be managed? How will the impact on employees of both organizations be managed?
- Potential synergies—what are the benefits of acquisition or merger in terms of synergies? Operating, marketing, and administrative synergies all need to be considered to ensure that they are achieved.
- The manner of integration and management approach—how much autonomy will be allowed to the acquired or merged organization(s)?

Integration Issues

The manner of integration of an acquisition can range from leaving the organization completely autonomous to subsuming the organization into the operations of the acquiring organization. This process needs careful consideration as it has implications for the motivation of staff and the effectiveness and costs of the integration. The parent organization also needs to consider the degree of control that it grants to a newly acquired subsidiary or business unit. (Goold and Campbell, 1987) identified three options.

- Financial control in which the parent organization allows a high degree of autonomy but sets strong financial controls.
- Strategic planning in which the parent organization undertakes the planning for the subsidiary and management simply implements the plan.
- Strategic control is a halfway house in which the parent sets strategic guidelines within which the subsidiary has some autonomy. It is sometimes referred to as parental control.

7.10.3 Joint Development Forms

Consortia

Consortia in which several individual organizations join to undertake a large-scale project, for example, a massive construction project.

Joint Venture

A joint venture, or equity alliance, in which a separate legal entity is formed to pursue a common purpose. The participant organizations still exist in their own right, and the joint venture is also a separate legal entity that employs its own staff. Profits and losses are shared in accordance with a joint venture agreement, as is the provision of resources and operational aspects of the venture. The key benefits here are that costs and risks can be shared as well as expertise, but there is the potential for disagreement between partners, or worse, the failure of one partner organization.

Compromises might also need to be made to accommodate partner views resulting in a dilution of the strategic aims and objectives.

Strategic Alliance

A non-equity strategic alliance is usually governed by a contractual arrangement, which benefits both parties. Typical examples might be a franchise arrangement in which the franchisor grants certain rights to the franchisees, and provides the product or know-how and training, thus retaining some control over quality as well as managing the brand image and marketing. The franchisee contributes personal commitment to success, capital, and often local knowledge.

Licensing

There are also licensing agreements whereby the organization grants rights to manufacture a product under license, or confers rights to use a product, process, or brand name for which the licensee pays a royalty payment or fee.

Local Agent

In the case of overseas developments, the use of local agents is often beneficial as they provide the local knowledge of the market, and regulatory regimes of operating in the country. They can be incentivized to encourage referrals with penalties also imposed to prevent misuse of the arrangement.

De-Merger and restructuring

An option that should not be overlooked is that of de-merger or restructuring where an organization decides to split into several smaller parts to become more focused on specific markets, or to achieve more flexibility and speed of response to environmental changes from a smaller-scale operation. Unprofitable parts or elements of the business can also be sold off where there is no longer a strategic fit with the overall direction of the organization.

7.10.4 Direction and method of growth

The direction and method of growth can be considered as providing a matrix of choice options. Table 7.5 illustrates how, together, they form part of the strategic choice.

Table 7.5 Strategic choice

Method of growth		Internal (organic)	Joint development	Merger or acquisition	Reconstruction
Direction of growth	Market penetration				
	Product development				
	Market development				
	Diversification				

Learning activity. Using news articles available on the Internet, research two recent acquisitions or mergers that have been reported. Try and find two in different industry sectors. What were the main reasons given for the acquisitions or mergers that were reported? Are there any similarities between the two that you have found?