Master of Science in Innovation and Entrepreneurship 2008

ENT 4000

2nd meeting

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Overview

- 1st meeting:
  strategy – fundamentals and competition
- 2nd meeting:
  strategic choices – content and process
- 3rd meeting:
  extreme strategic choices – the rise and fall of businesses via M&A

Agenda for 2nd meeting

- **Strategic choices: the process**
- **Evaluation of strategic alternatives**
  - **Suitability**
  - **Feasibility**
  - **Accept**

- **Recommended reading:**
  - **Technology Ventures ch. 15,20**

Framework for strategic choice

Strategic analysis → **Strategic alternatives**

Evaluation of suitability

↓

Filtering

↓

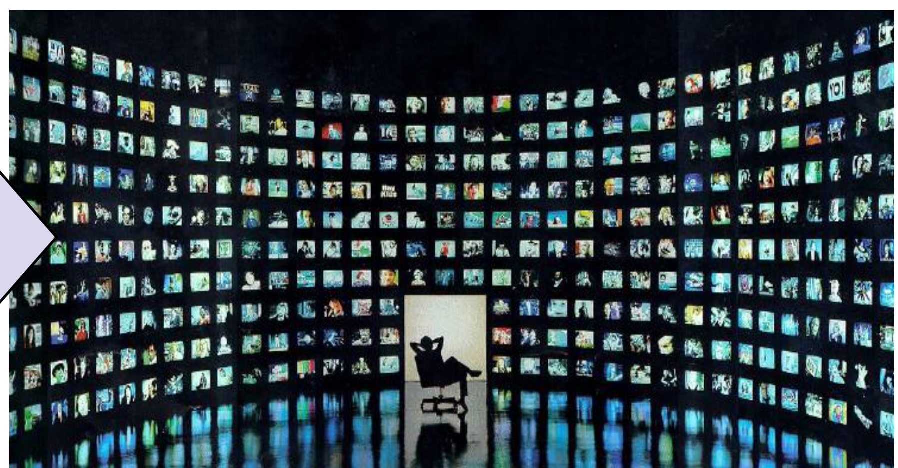
Choice based on
- Feasibility
- Accept

↓

Implementation

Strategy development calls for analysis

…when competition for the customers' attention is intense



Strategy alternatives

Strategic analysis

Evaluation (of suitability)

Filtering

Choice
- Feasibility
- Accept

Implementation

STRATEGY ALTERNATIVES

STRATEGY-
ALTERNATIVES

(a) What basis?
(generic strategies)

(b) What direction
(development directions)

(c) How
(development methods)

IDENTIFICATION OF ALTERNATIVES

- Creativity vs. structure
- Time vs. completeness

Identification (ctd.).

- Basis
  - Open minds
  - Internal evaluation
  - Ability to play with ideas and concepts
- Hard stoppers
  - Experience
  - Motivation
  - Culture

Hard stoppers in practise

- ”We have tried this before”
- ”This is too new”
- ”NIH-syndrome”
- ”You are five years too early”
- ”It’s too late”
- ”We have managed well without”
- ”It’s impossible in practical life”
- ”We haven’t got the time”

(a) *Basis* for strategy alternatives

- Starting point:

  To achieve a sustainable competitive position on the competitive arena

- Generic strategies (according to Porter)
  - *Cost leadership*
    (lowest cost)
  - *Differentiation*
    (uniqueness to defend a higher price)
  - *Focus*
    (niches based on low cost/differentiation)
  - ...and «stuck in the middle» is for losers

(b) *Development directions*

Ansoff's (1968) product-/market matrix

		PRODUCT	
		Current	New
MARKET	Current	- Withdrawal - Consolidation - Market penetration	Product development
	New	Market development	Diversification (related/unrelated)

Market development

- In new segments (branches)
- New applications of the same product
- New geographical areas
  - export
  - production/distribution/sales organisation abroad

Market development (ctd.)

- In capital intensive businesses with heavy investments in product and technology
  (e.g. from Fiat via Polski Fiat to Lada)
- In R&D-intensive businesses
  (e.g. IT and telecommunication)
- In service industries where customers are abroad
  (e.g. insurance and banking)

Product development

- Takes several forms
  - Inventions (such as the first car)
  - New categories (like P&G’s 1st shampoo)
  - Additions to product lines (e.g. light beer)
  - Product improvements (as Windows 2003→XP)

- Demands both innovation and market orientation

(c) *Development methods*

- Organic growth (internal development)
- Mergers and acquisitions (M&A)
- Alliances

Organic growth

Typically preferred by:

- Players in a market that is characterised by high uncertainty and need for standards
- Strong players who can choose between partners that can help him harvesting scale, synergy, and competence advantages
- Small players that do not have the resources to do acquisitions or are not attractive for alliances (”beggars can’t choose”)

Mergers and acquisitions, M&A

- Tend to vary in ”popularity”
  - Over time
  - Between branches

- Preferred because of the potential to achieve
  - Speed
  - Competitive advantages
  - Financial profit

Alliances

- Increased «popularity» because of
  - Scarcity of internal resources
  - More and more complex business environment

- Vulnerable method
  - How real is the need to share resources
  - Whether or not resources can be shared
  - Protection of resources from exploitation

Strategic choices related to innovation - radical change

- ***Characteristics***
  Collapse, break trough – or disruption in a development process – related to market, technology and/or regulations
  - Sustaining innovations: improve the existing and addresses today's (profitable) customers
  - Disruptive innovations: improve performance along some dimensions and reduce performance along other, and give cheaper and simpler products that are initially adopted by others than today's (profitable) customers
- ***Follow-up question***
  "Why do established players fail in situations with radical change despite abundance of competence and resources?"
- ***Answer***
  They typically focus on sustaining innovations

Network effects
- speed matters

”But after all…”

- **The established players have a lot of advantages:**
  - Ownership of infrastructure
  - Knowledge of how to work with regulators
  - Resources
  - Have historically survived disruptive threats
  - Unchanged and un-challenged vertically integrated business model with centralised control and coordination
- **Even if they in principle can meet any change,** they will meet competitive threats in niches- that in sum can represent a major threat
- **Worst scenario:** sudden change where the established player remains king in an old world that will be more and more irrelevant
- **Winners and losers**
  - The winners will be those who take the opportunities early and seek to exploit opportunities for new growth
  - The losers will be those who sit and wait too long

To see what is next…

- Prepare along three dimensions
  1. *Signals of change*
     - Are there any signs that current or new players exploit new opportunities related to over/under served customers or “non-consumers”?
  2. *Competitive battles*
     - How do new entrants penetrate the market (based on asymmetrical motivation and skills) without reaction from established players, and how will they manage in direct competition?
  3. *Strategic choices*
     - Do the players make decisions related to resources, competence and network that influence their chances of success?

- Organise for separate units
  - Small enough to celebrate small victories, but with enough resources to survive
  - Do not expect to succeed at once

Strategic analysis

Strategic alternatives

Evaluation of suitability

Filter

Choice
- Feasibility
- Accept

Implementation

Evaluation of alternatives

- ”Suitability” defines if a strategic alternative is realistic and matches the situation the business is in, and contributes to improve its competitive position

- Approach
  - (a) Strategic logic
  - (b) Cultural match
  - (c) ”Empirical support”

(a) Strategic logic

- Portfolio analysis
- Relation to product life cycle
- Potential synergies
  related to value creation logic

(b) Cultural match

- Head vs. heart
- Matures over time

(c) ”Empirical support”

- Companies in the same industry
- Other industries
- Other regions

Filter – from “long list” to “short list”

Short listing

- Prioritisation
- Decision trees
- Scenarios

Strategic analysis → Strategic alternatives

Evaluation of suitability

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Implementation

Key criteria

Given the evaluation of the logic in the strategic alternatives and the potential for <u>suitability</u> and match with current strategy

(a) <u>Feasibility</u>

- Funding
- Break-even
- Resources

(b) <u>Accept</u>

- Return on investments
- Risk
- Key stake holders' expectations

(a) Feasibility as criteria

- Is the strategy realistic to fund?
- Is the organisation capable of perform?
- Can necessary competence and resources be secured?
- Can necessary market position be achieved?
- How can response from competitors be handled?
- Is necessary technology available?

Analysis of feasibility

- Funding
  - Necessary capital investment
  - Accumulated profit
  - Increase in working capital
- Break-even
- Alternative ways of utilising resources

(b) Accept as criteria

- *Owners* will consider
  - Return on investment (cost/benefit)
  - Financial risk
  - Effects on capital structure
- Influence the *organisation's (*individuals and groups) expectations
- Effects on other *stake holders*
  - Creditors
  - Suppliers
  - Customers
  - Government

Evaluation of return on investments

- Analysis of profitability
  - Pay-back time
  - Discounted cash-flow
  - Market valuations

- Analyses of cost/benefit
  - Qualitative
  - Quantitative (if possible)

Evaluation of risk

- **Financially**
  - Influence on capital structure
  - Time to break-even
  - Influence on lquidity
- **Sensibility analyses**

  “What if” critical assumptions are changed
- **Scenarios**

  Situation in pessimistic, optimistic, and realistic cases
- **Heuristic models**

  «Good enough»

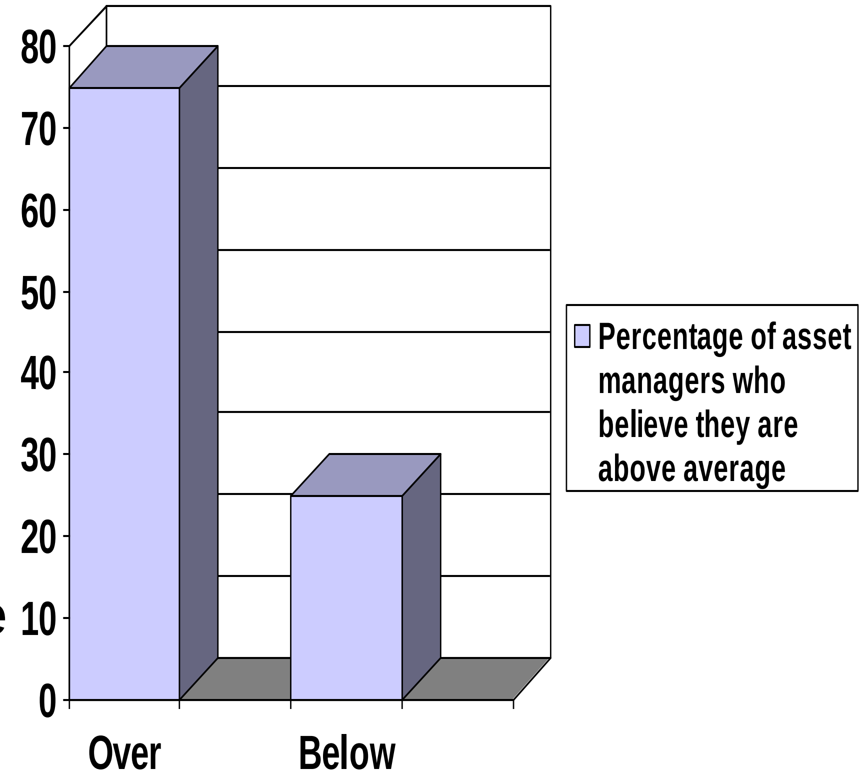
The practical choice

- Criteria are not always established
- ....and they are not always used
- Higher authorities play a more ore less visible role
- Implementation is more or less intense
- External conditions often play a role…

Why do estimates often fail?

- Momentum driven
  - Over-optimistic in bull times
  - Over-pessimistic in bear times

- Too self-confident
  - ”I know that everyone believe that they are above average, but i know that I AM.”
  - Experts (especially in finance!) over-estimate their knowledge more than others



Kilde: DrKW/Macro Research/Finansavisen

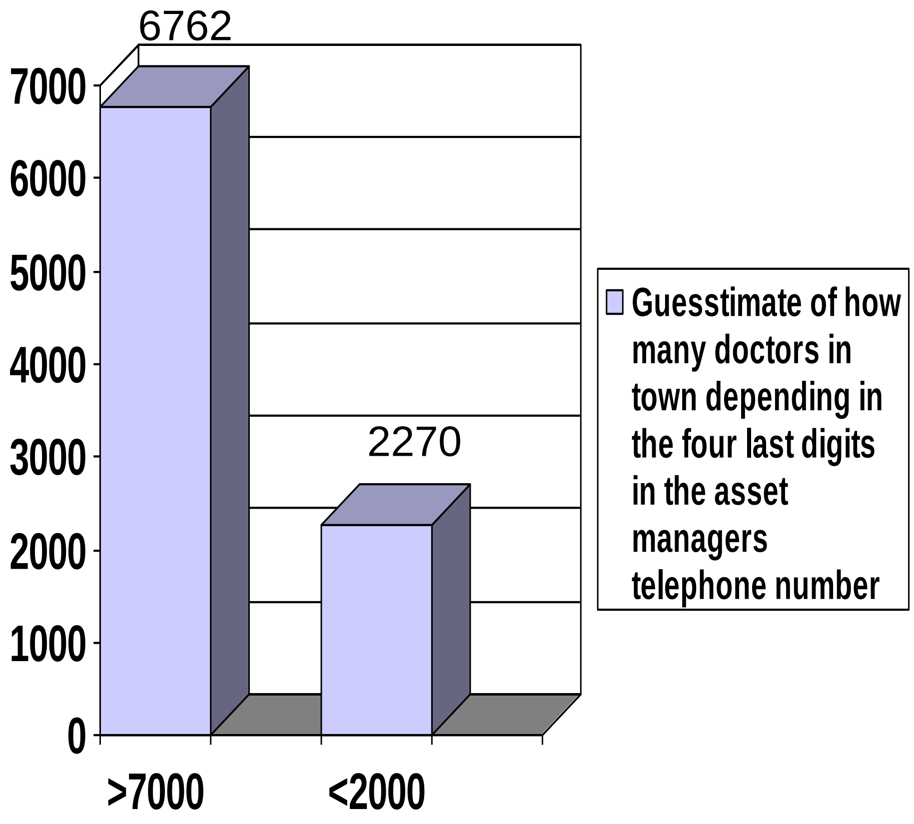
Why are estimates followed anyway?

- Lack of skills
  - The ability to produce the right answers are practically the same as those to evaluate the answers
  - If people lact the abililty to give the right answers, the are also cursed with a lack of ability to know if answers are right or wrong

- Pride and bad excuses
  - If only (”…Norges Bank had increased the interest rate earlier”)
  - Everything else equal (”but imports from China made clothes cheaper”)
  - I was almost right (”But the market was up just before it closed”)
  - It has not happened yet (”But the market will crash soon”)

So why are estimates used after all?

- The hope of beating efficient markets through information others don't have
- Anchoring: with uncertainty you will stick to what is known, although irrelevant
- What else can we do?



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