Strategic Management
1st lesson

26th February 2019

Massimo Solbiati

LIUC

(Prof. Vittorio Coda)

A company with good strategy and well managed is characterized by:

- The **customers**, addressees of products and / or services, are **satisfied**.
- The **employees** are **happy** to work for the company.
- The **accounts in order**, that allow to the enterprise to meet the investment and future development.

A company with good strategy and well managed is characterized by:

- **The relationships with** all types of **stakeholders** (employees, customers, suppliers, banks, public administration) based on mutual respect and trust.
- A profound **link with the territory**: as a plant whose care can not be separated from the soil where is rooted.

A company with good strategy and well managed is characterized by:

- An **internal climate of industrious serenity**, even in the presence of market turbulence.

(Prof. Vittorio Coda)

The definition of Strategy adopted in this course

A system of choices and actions that determines the equilibrium of the company in each markets it operates in order to survive and prosper

(Prof. Claudio De Mattè, 1993)

- Choices + actions
- Company within several markets (it "buys" and "sells"), many Hypercompetitive !
- Survival and prosperity are the overall goals (profit is the means to reach them).

The definition of Strategy adopted in this course

So **Strategy**:

- Defines the *objectives* and indicates the *road map* for reaching them
- Identifies the *actions* and the *resources* necessary to reach objectives
- Put into contact the enterprise with *external enviroment*
- It’s *dynamic* and *upgradable*

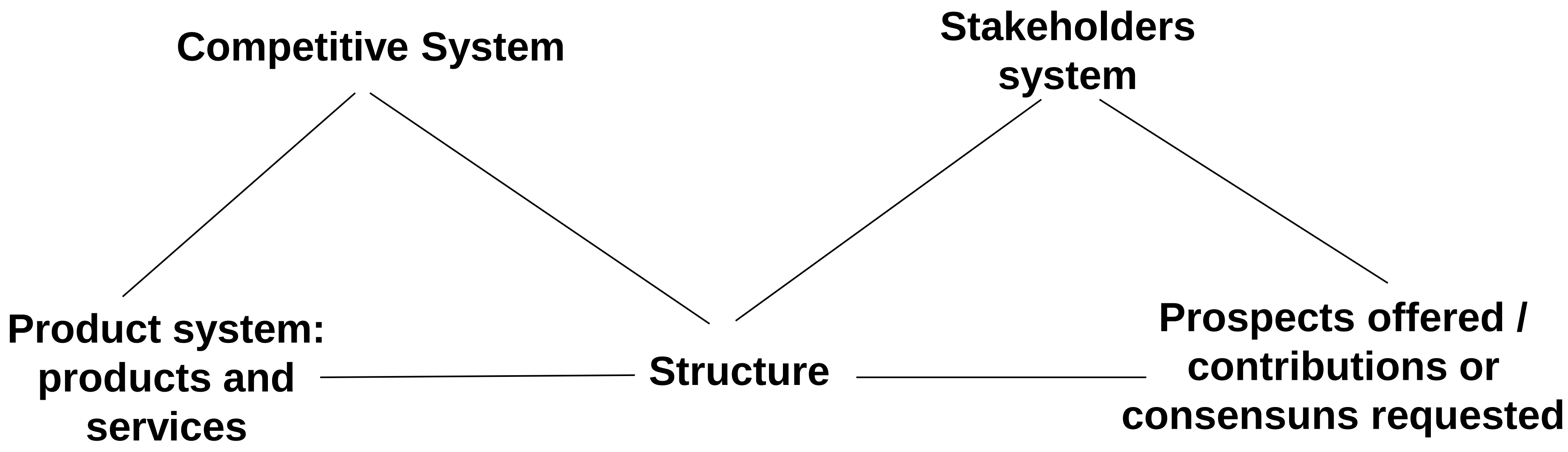
What makes a choice "strategic"

- About the long-term direction of the company
- Difficult to be reversed (investments)
- Directly and strongly related to results
- Taken by the board of directors (corporate level) and the top management team (business and functional level), but it's necessary to have the strategic aligment of all people

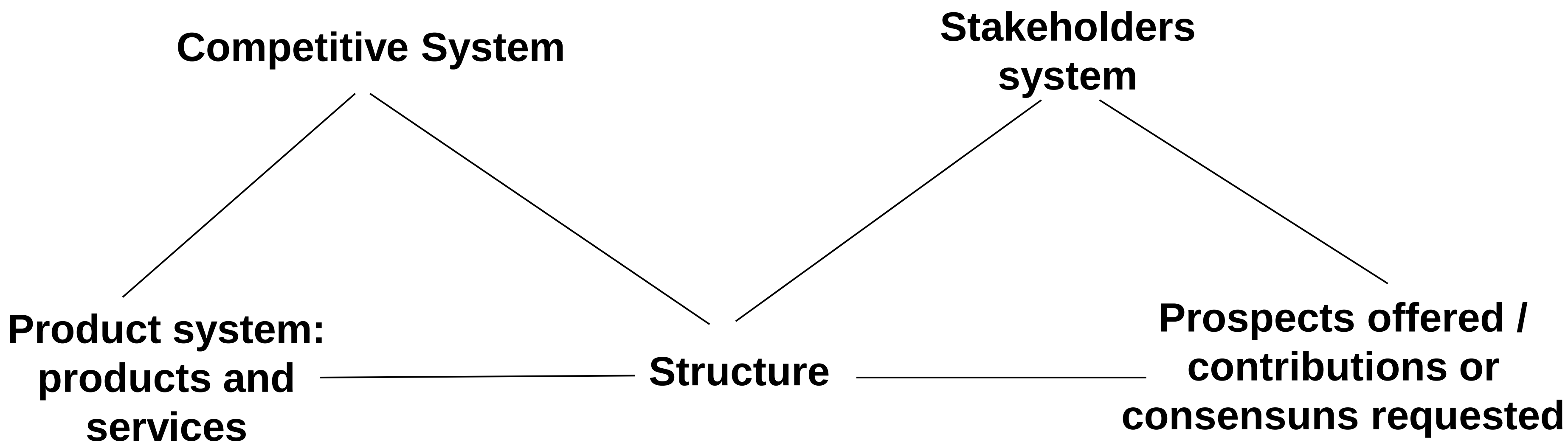
Main Stakeholders

- Customers: *product for price*
- Shareholders: *equity for dividends*
- Banks: *debt for interests*
- Employees: *time and compentencies for salaries and … self realization*
- Suppliers: *materials and services for money*

Components of the entrepreneurial formula



The entrepreneurial formula



Competitive system: the markets to target, the competitors, the rules of competition, the enviroment.

Product system: the products and related services offered, the product's features both material (quality, range, technological level, reliability, etc.) and intangible (prestige, elegance, health, safety); related services rapid and on time delivery, pre and post-sales assistance, application engineering, etc.); strictly economic terms of trade (price, terms and metods of payment, trasportation conditions, guarantees, insurance, etc.)

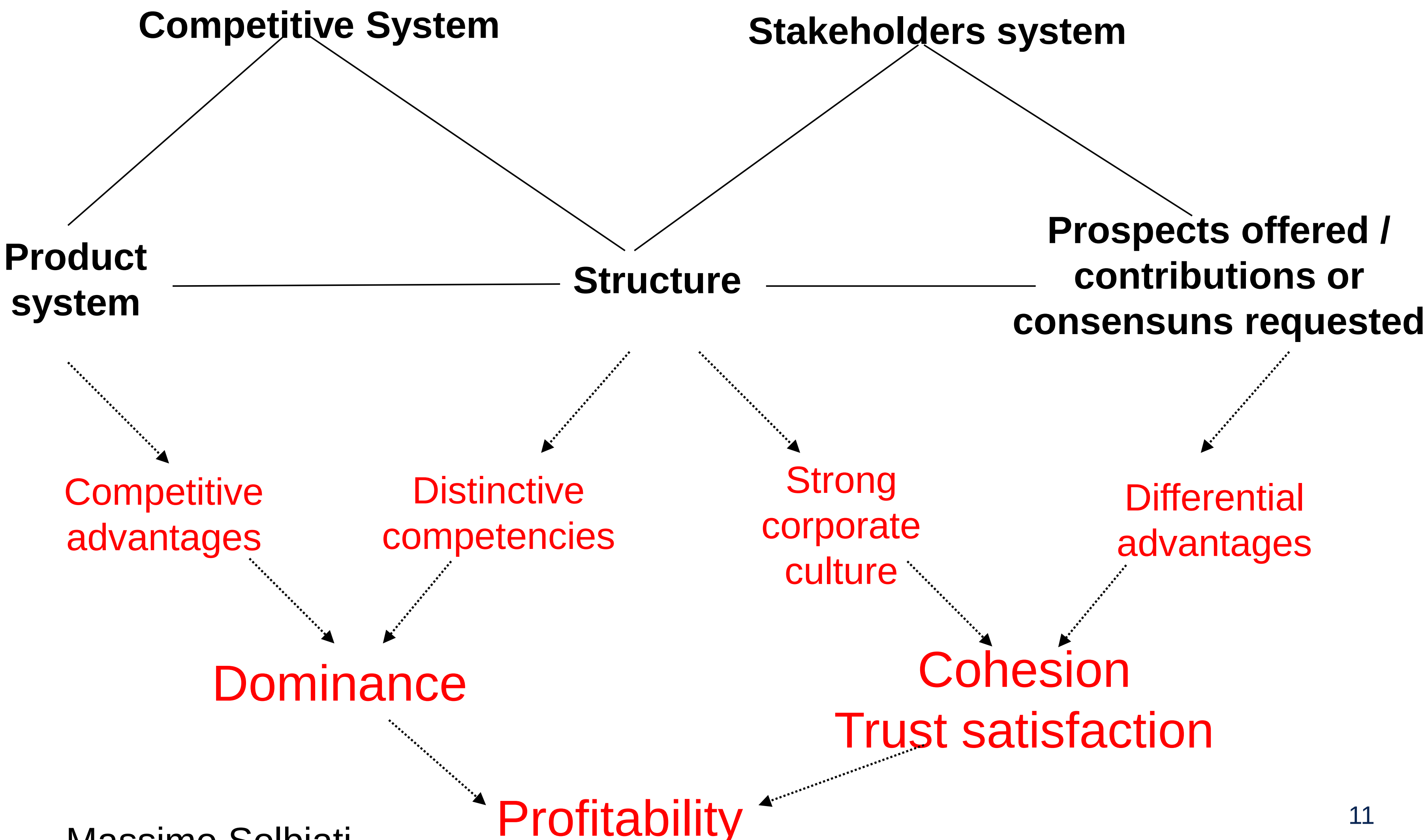
Prospects offered / contributions or consensuns requested: the project that is to be proposed to the economic and social forces with which the firm can get involved or partner for its realization (workers, managers, shareholders, lenders, union rapresentatives, financial and credit institutions, members of the local community, etc.)

Stakeholders system: the system of stakeholders with their expectations of the firm and their power of influence it.

Structure: the structure, that enables the firm to launch its offering on the market and to propose the project to the stakeholders, encompassing the organizational structure and operating mechanisms (planning and control system, human resources management system) and all of the resources which make up the technological, commercial, managerial and financial assets of the firm.

The entrepreneurial formula

Components of the entrepreneurial formula and their distinctive traits in successful firms



The entrepreneurial formula

Tool for the initial diagnosis of the strategic formula at the strategic business unit level

- Sales growth rates
- Absolute market shares
- Relative market shares
- Customer satisfaction indexes

Competitive perfromance	High (Profitability)	Low (Profitability)
High	Consistent competitive formula I	Insistent competitive formula III
Low	Profitability supported by contingent conditions II	Lack of a raison d’etre rewarded by the market system IV

High Profitability Low

The entrepreneurial formula

Tool for the initial diagnosis of the strategic formula at the corporate level

Social consensus \ Profitability	High	Low
High	Virtuous loop of profitability and stakeholder satisfaction I	Consensus achieved by sacrificing profitability III
Low	Profitability achieved by sacrificing the expectations of one or more stakeholders II	Lack of a raison d'etre rewarded by the market system IV

Massimo Solbiati

The entrepreneurial formula: strategy results

An enterprise, to be sustainable in the long run, must always respect economic principles (economic and financial results) connecting also, in equilibrium, at least to other types of performance: competitive capacity and social results.

Social success / consensus

Competitive success / consensus (competitiveness)

Economic success (profitability)

Strategic Management

Strategic planning is the process by which one defines long term objectives and elaborates the action plan

<u>Environmental Analysis</u>
Previsions:
- opportunity
- threats

<u>Objective definitions:</u>
Vision:
- mission
- long term strategic objectives

<u>Internal Analysis</u>
Diagnosis:
- strengths
- weaknesses

Strategy formation

<u>Lines of action</u>
- corporate strategy
- business strategy
- functional strategy

Planning

<u>the formalization</u>
- business plan
- functional plans
- product plan

Realization

<u>Execution and control</u>
- organizational structure
- annual operative plan

Analysis of external environment

It’s necessary to analyze the enviroment in which an enterprise competes to forsee the evolution of fenomena that is able to change the scenario and to have an influence on the management of the enterprise.

EXTERNAL ENVIRONMENT

General environmental analysis

- Political environment
- Social environment

(focus on opportunities and threats)

Market and sector analysis

(focus on opportunities and threats)

Analysis of external environment: PESTEL analysis

- **_PESTEL ANALYSIS_**

Definition of Mission

Why we do Business ?

How we do Business ?

Mission is used is used to communicate the purpose of an organization.

A mission statement is a statement which explain the purpose of an organization.

Every organizations have to update their mission statement because of environment and markets evolution.

Definition of objectives

Long term

- profitability
- growth
- leadership
- social (defence of occupation, fight against pollution, …)
- financial equilibrium

Such objectives are conditioned by internal and external factors.

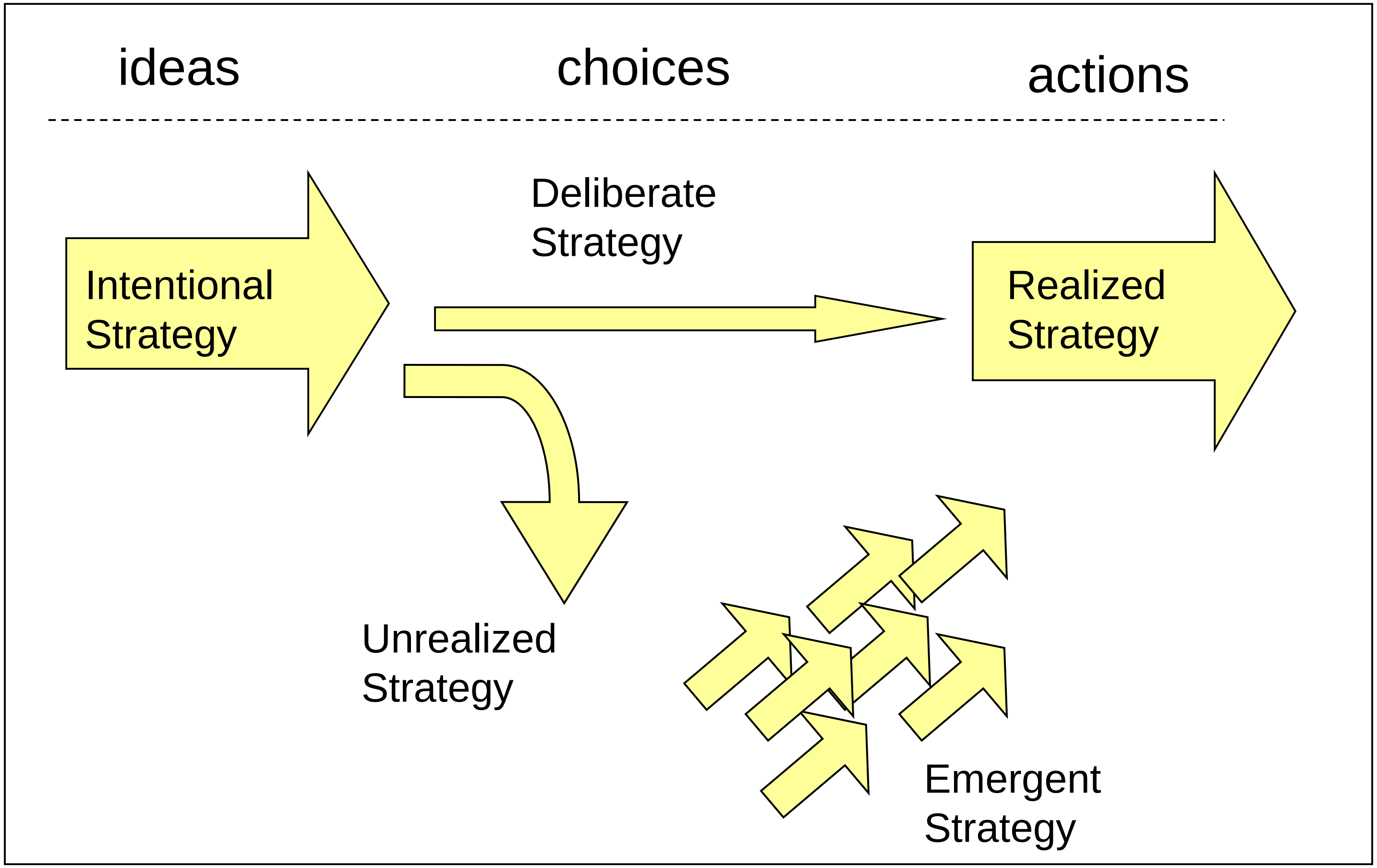
Short term
(these are intermediate goals)

- they are assigned to specific organizational areas
- they must be measured quantitatively
- they must be realized within a definite timeframe

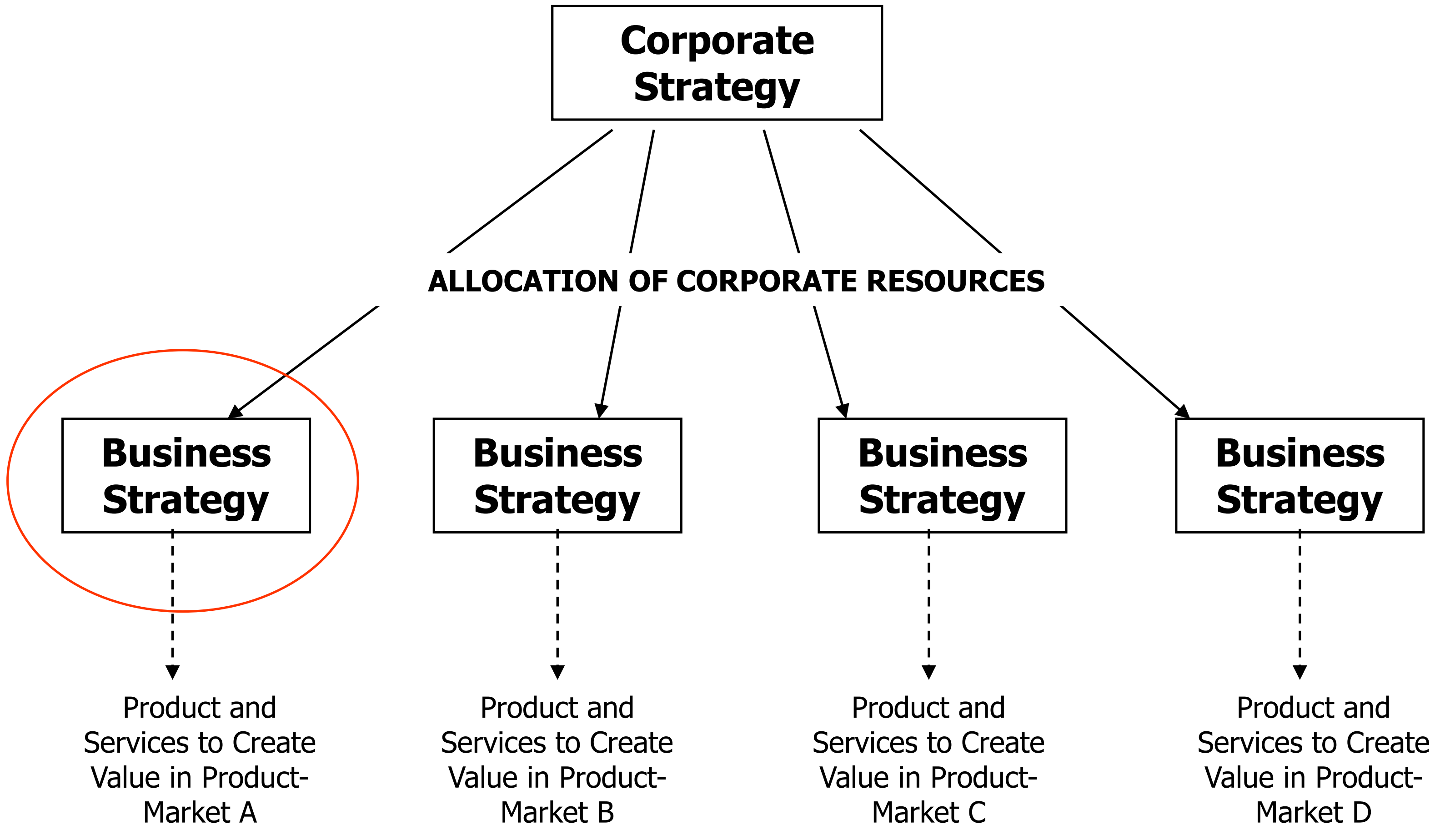
Internal Analysis

- Profitability analysis (ROE, ROI or ROCE, ROS, etc.)
- Cost analysis (fixed costs, variable costs)
- Financial analisys
- Portfolio products analisys (positioning, life cycle, sales, margins)
- Organizational analysis
- Strenght / Weakness analysis
- **Critical Success Factors** (CSF)

Deliberate and emergent strategies



Corporate strategy and business strategy



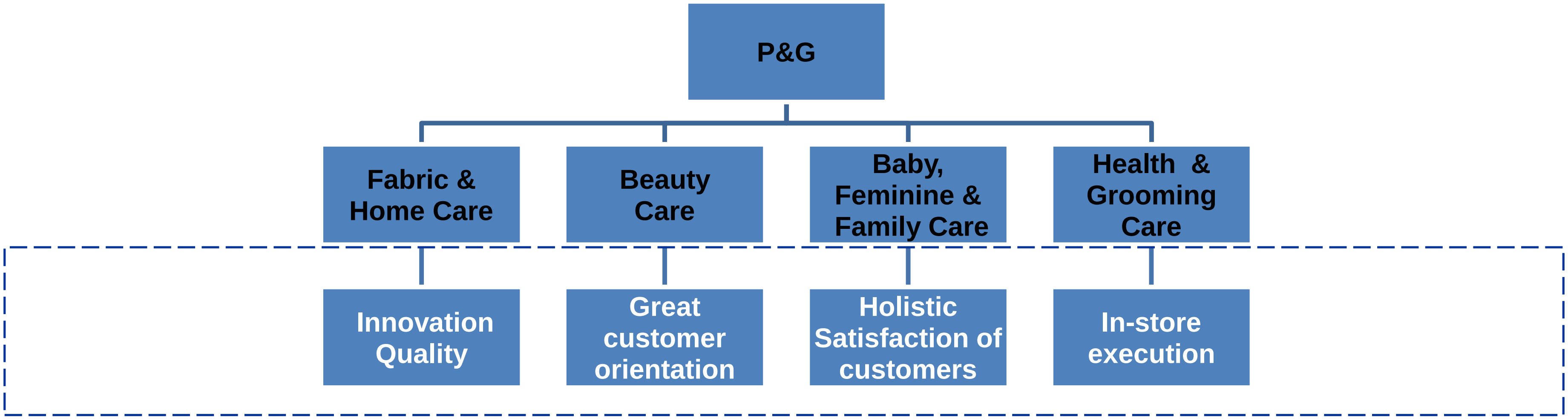
Corporate strategy and business strategy

Procter & Gamble

Procter&Gamble is one of the biggest multinational companies in the world. Founded in 1837, it started by producing soaps and candles. **2017 revenues $65,1 billions**.

Now it commercializes over 100 brands, with **30 top brand**, from beauty to baby care, from house cleaning to health care, and it has five billion customers in 180 countries in the world.

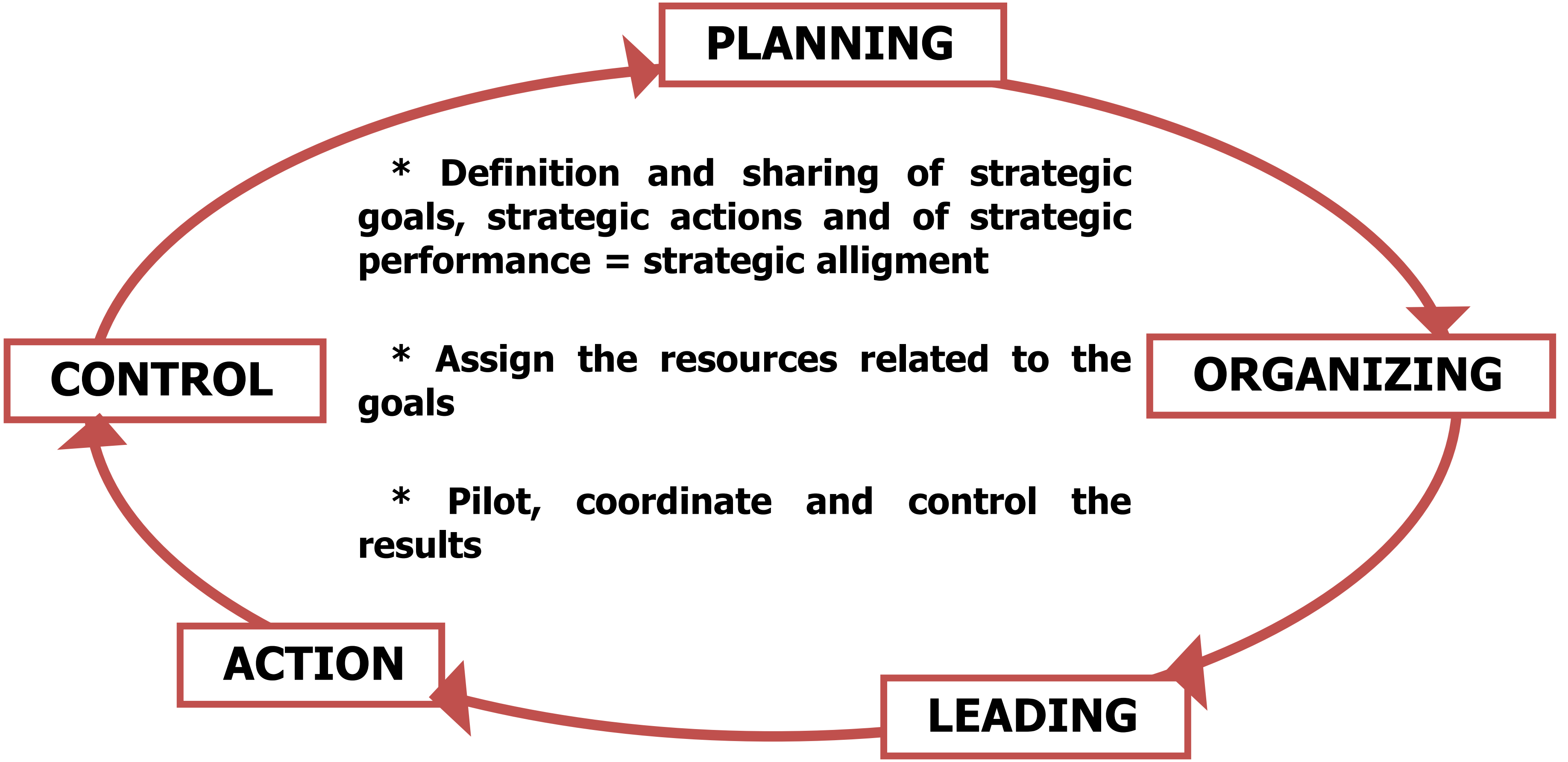
Corporate strategy and business strategy



P&G applies in all its businesses some common features:

- Drive replenishment based on consumer demand
- Business relationship based on a principle of Partnership
- High flexibility in adopting new ideas and work process changes
- Promotion of innovation, in both senses: internal development and external acquisitions

The Strategic Planning Process



Strategic Planning Process

The **Profit-Plan** (business plan / budget) is a principal managerial tool to:

- **price** the business and operating plans
- make trade-offs between **different courses of action**
- set **performance** and **accountability** goals
- evaluate the extent to which **business performance is likely to meet the expectations** of different constituencies

Strategic Management

Strategic Planning Process

To translate the strategy of the business into a detailed plan to create value

"Profitability"

Set of assumptions about the future

How will markets evolve in the future?
How will customer respond to our offering?
What can be the reaction of competitors if we introduce a new product?
….

To evaluate whether sufficient resources are available to implement the intended strategy

"Feasibility"

Economic resources available and needed, cause-and-effect relationships and trade-offs

Is the production capacity enough to support the market demand?
Does the organization have enough cash to fund new R&D?
What is the impact on sales if we increase the days in receivables for our customers?
….

To create a link between economic goals and leading indicators of strategy implementation

"Accountability"

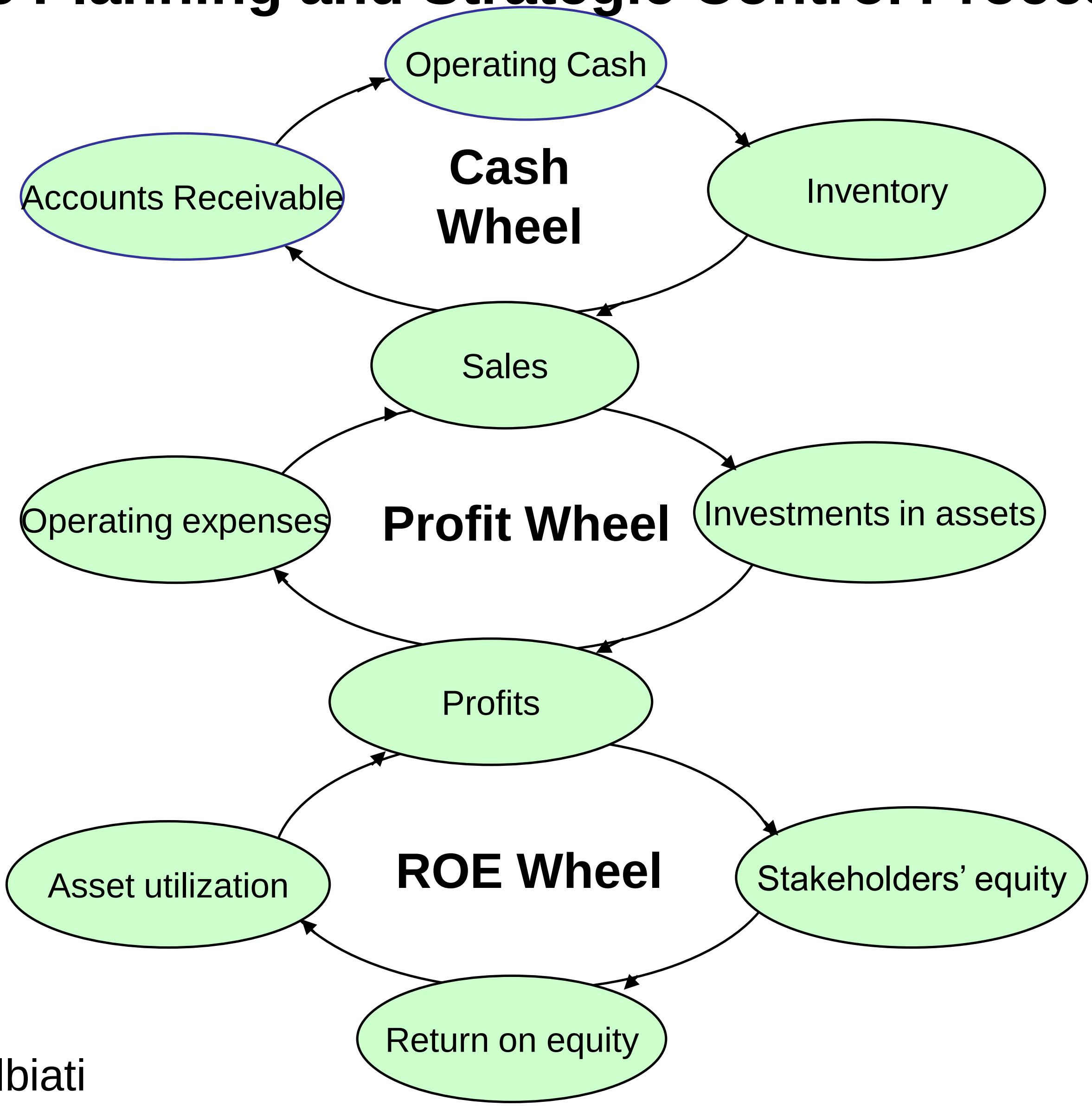
Definition of targets for performance evaluation of managers in accordance with the firm's objectives

+

Coordination

Estimated Incomes Statement + Balance Sheet + Cash Flow Statement

Strategic Planning and Strategic Control Processes



Strategic Planning and Strategic Control Processes

The Profit Wheel: DOES THE ORGANIZATION'S STRATEGY CREATE ECONOMIC VALUE ?

Step 1: **Estimate the level of sales**

Step 2: **Forecast operating expenses**

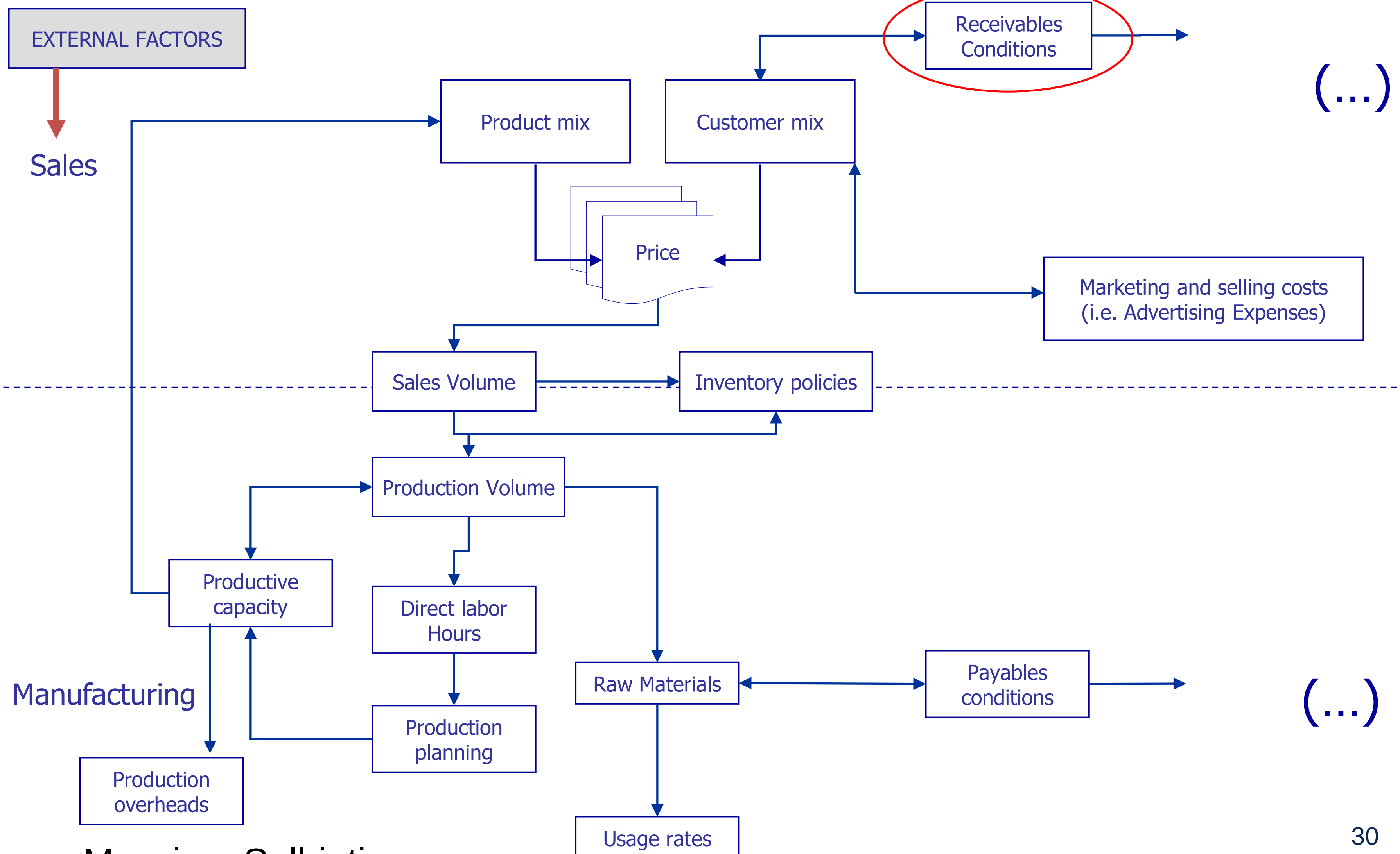
Step 3: **Calculate expected profit**

Step 4: **Price the investment in new assets**

Step 5: **Close the profit wheel and test key assumptions**

Strategic Management

Strategic Planning and Strategic Control Processes



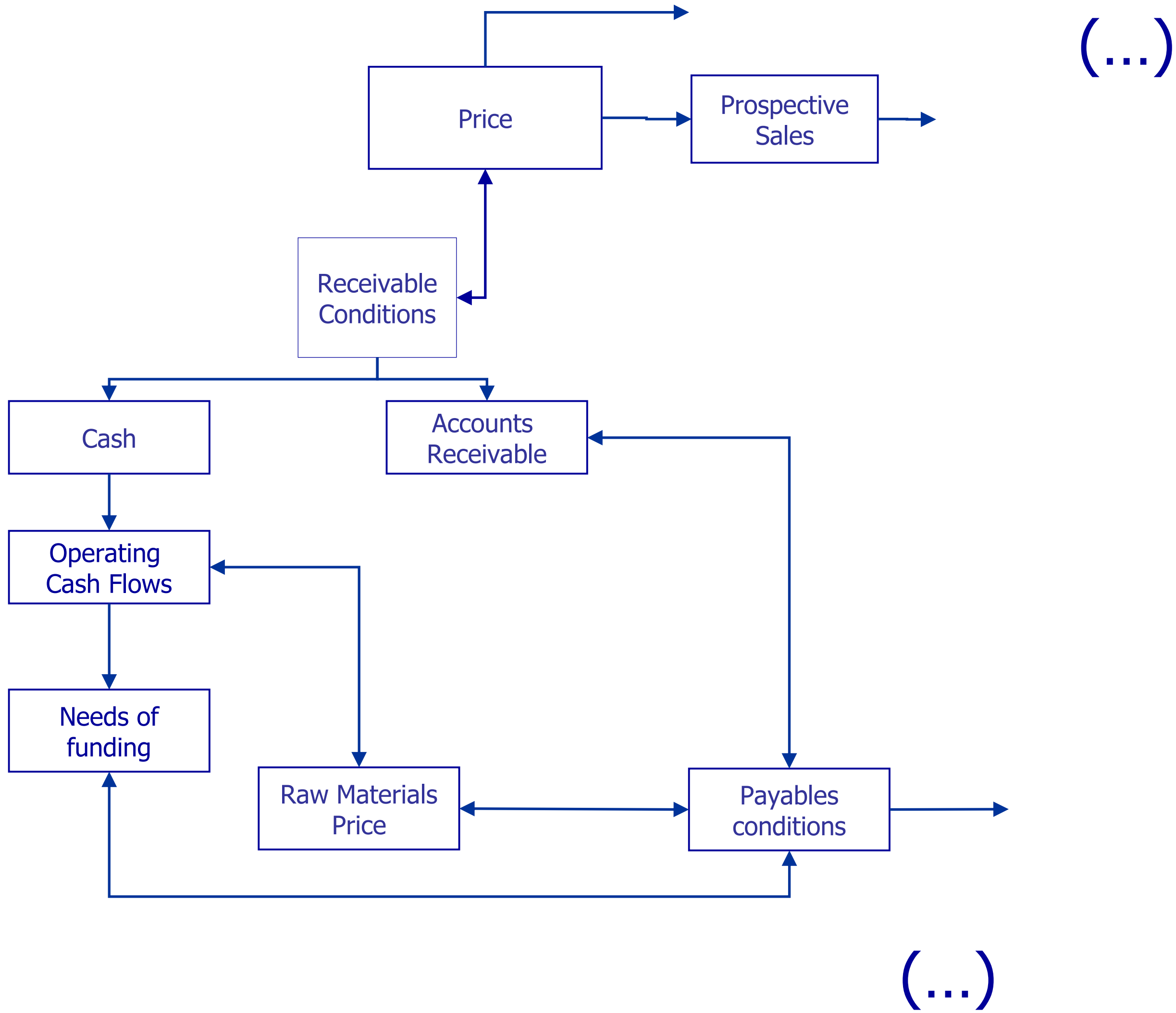
Massimo Solbiati

Strategic Management

Strategic Planning and Strategic Control Processes

Sales

Manufacturing



Strategic Planning and Strategic Control Processes

The Cash Wheel - DOES THE ORGANIZATION HAVE ENOUGH CASH TO FUND THE STRATEGY AND REMAIN SOLVENT?

Step 1: **Estimate net cash flows from operations**

Step 2: **Estimate cash needed to fund growth in operating assets**

Step 3: **Price the acquisition and divestiture of long term assets**

Step 4: **Estimate financing needs and interest payments**

Strategic Planning and Strategic Control Processes

The ROE Wheel - DOES THE ORGANIZATION CREATE ENOUGH VALUE TO ATTRACT THE FINANCIAL RESOURCES IT NEEDS TO FUND LONG-TERM INVESTMENTS?

Step 1: **Calculate overall Return on Equity**

Step 2: **Estimate Asset Utilization**

Step 3: **Compare Projected ROE with Industry Benchmark and investor expectations**

Strategic Planning and Strategic Control Processes

ROCE = OI / CE

- ROCE (Return on Capital Employed)

- OI (Operating Income) = Revenues – Operating expenses
- CE (Capital Employed) = Debt + Equity

ROE = NP / E

- ROE (Return on Equity)

- NP (Net Profit) = Revenues – All costs
- E (Equity)

Strategic Planning and Strategic Control Processes

The return on equity (R.O.E.) is the internal measure for shareholders' return on investement. The objective for any managers is to use equity investement of the company wisely.

$$\text{R.O.E.} = \boxed{\frac{\text{NET INCOME}}{\text{SHAREHOLDER'S EQUITY}}}$$

We can decompose R.O.E. in some parts if we will understand how to maximize this measure

$$\text{R.O.E.} = \frac{\text{NET INCOME}}{\text{SALES}} \times \frac{\text{SALES}}{\text{SHAREHOLDER'S EQUITY}} =$$

$$= \frac{\text{NET INCOME}}{\text{SALES}} \times \frac{\text{SALES}}{\text{ASSETS}} \times \frac{\text{ASSETS}}{\text{SHAREHOLDER'S EQUITY}}$$

Strategic Management

Strategic Planning and Strategic Control Processes

R.O.E.

$$\frac{\text{NET INCOME}}{\text{SALES}}$$

This profitability ratio give us the information: how much profit a company can generate for each € of sales

$$\frac{\text{SALES}}{\text{ASSETS}}$$

This assets turnover ratio give us the information: how much money from sales we can generate for each € that is invested in assets of the business

$$\frac{\text{ASSETS}}{\text{SHAREHOLDER'S EQUITY}}$$

This financial leverage ratio give us the information: what percentage of total assets employed are covered by shareholder’s equity and what percentage by debt

Strategic Planning and Strategic Control Processes

The return on capital employed (R.O.C.E.) is the measure to understand the assets utilization for generating sales in a **unit** managers (**division** or **profit center** managers). The objective for any managers is to generate sales with efficiency in the utilization of the business assets.

$$\text{R.O.C.E.} = \boxed{\dfrac{\textbf{EBIT div}}{\textbf{CAPITAL EMPLOYED div}}}$$

where Capital Employed = part of the total assets invested in the business (unit, division of profit center)

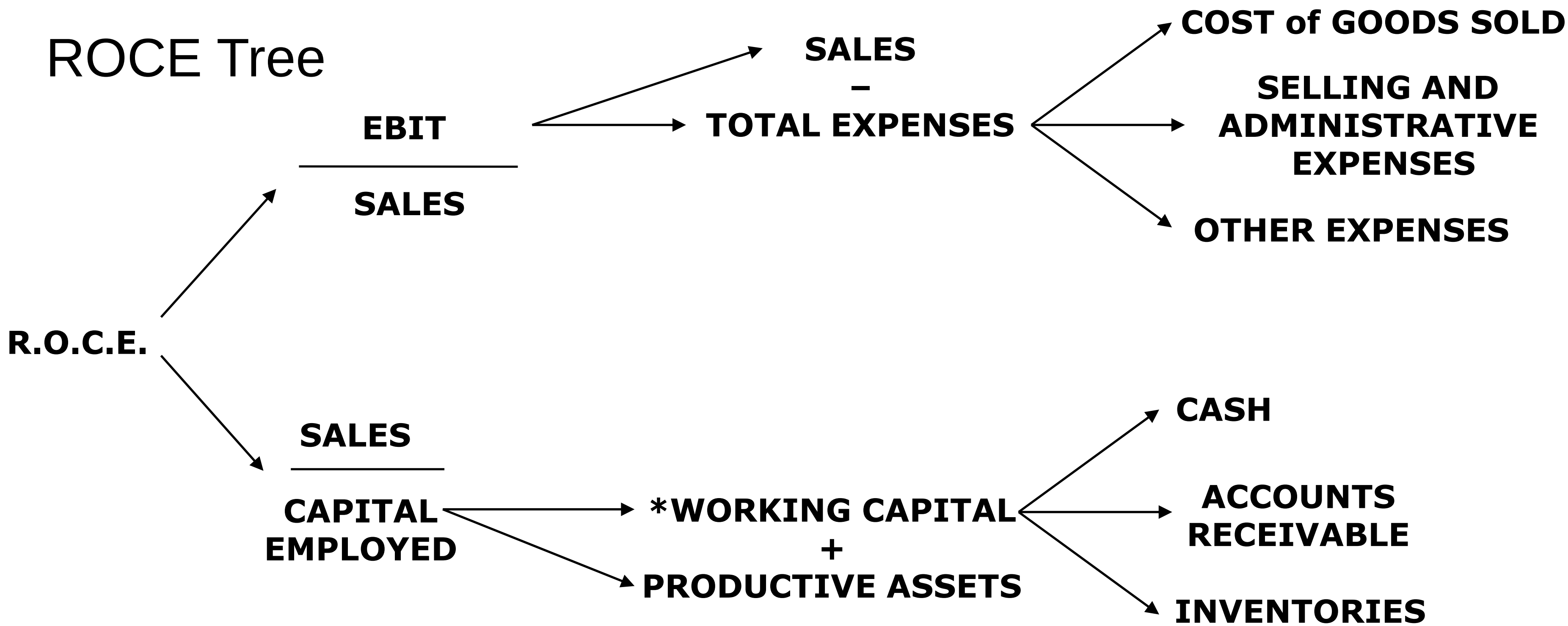
We can decompose R.O.C.E. in some parts if we will understand how to maximize this measure

$$\text{R.O.C.E.} = \frac{\textbf{EBIT div}}{\textbf{SALES div}} \times \frac{\textbf{SALES div}}{\textbf{CAPITAL EMPLOYED div}}$$

And we can consider the capital employed as the assets within a manager’s unit direct span of control (tipically accounts receivable, inventory, plant and equipment). It is tipically used to evaluate managerial performance.

Strategic Planning and Strategic Control Processes

ROCE Tree



* Some companies use the Net Working Capital = cash + accounts receivable + inventories – noninterest bearing liabilities (as accounts payable)

Strategic Planning and Strategic Control Processes

The return on net assets (R.O.N.A.) is the measure to understand how much earning before interest and taxes (E.B.I.T.), or operating profit, a company can generate with the net assets. The objective for any managers is to generate E.B.I.T. with efficiency in the utilization of the business net assets.

$$\text{R.O.N.A.} = \boxed{\frac{\text{EARNING BEFORE INTEREST AND TAXES}}{\text{NET ASSETS}}}$$

where Net Assets = Total assets less payables, tax debts, pension funds and other NON financial liabilities

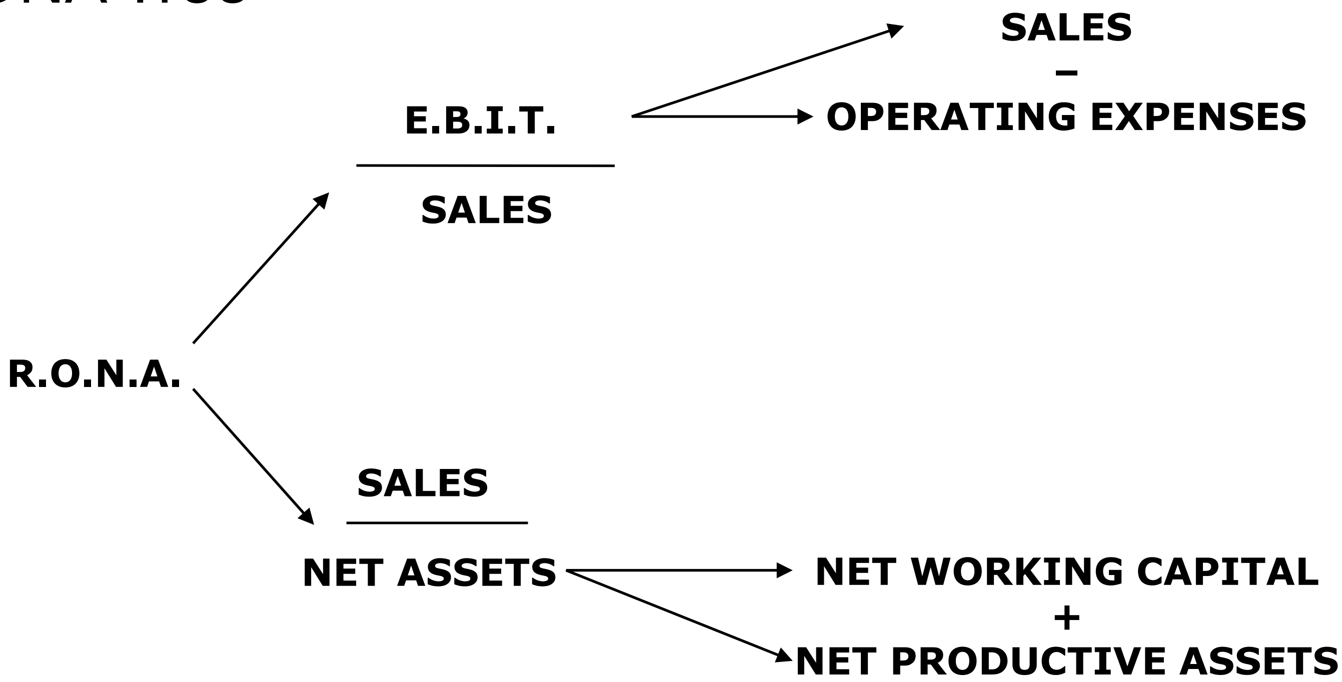
We can decompose R.O.N.A. in two parts if we will understand how to maximize this measure

$$\text{R.O.N.A.} = \frac{\text{E.B.I.T.}}{\text{SALES}} \times \frac{\text{SALES}}{\text{NET ASSETS}}$$

Return on sales (R.O.S.) ↑ **Net assets turnover (N.A.T.)** ↑

Strategic Planning and Strategic Control Processes

RONA Tree



Intangible resources

1. **Distinctive internal capabilities**: special resources and know-how possessed by a firm that give it competitive advantage in the marketplace.
   - » *Functional skills*
   - » *Market skills*
   - » *Embedded resources*

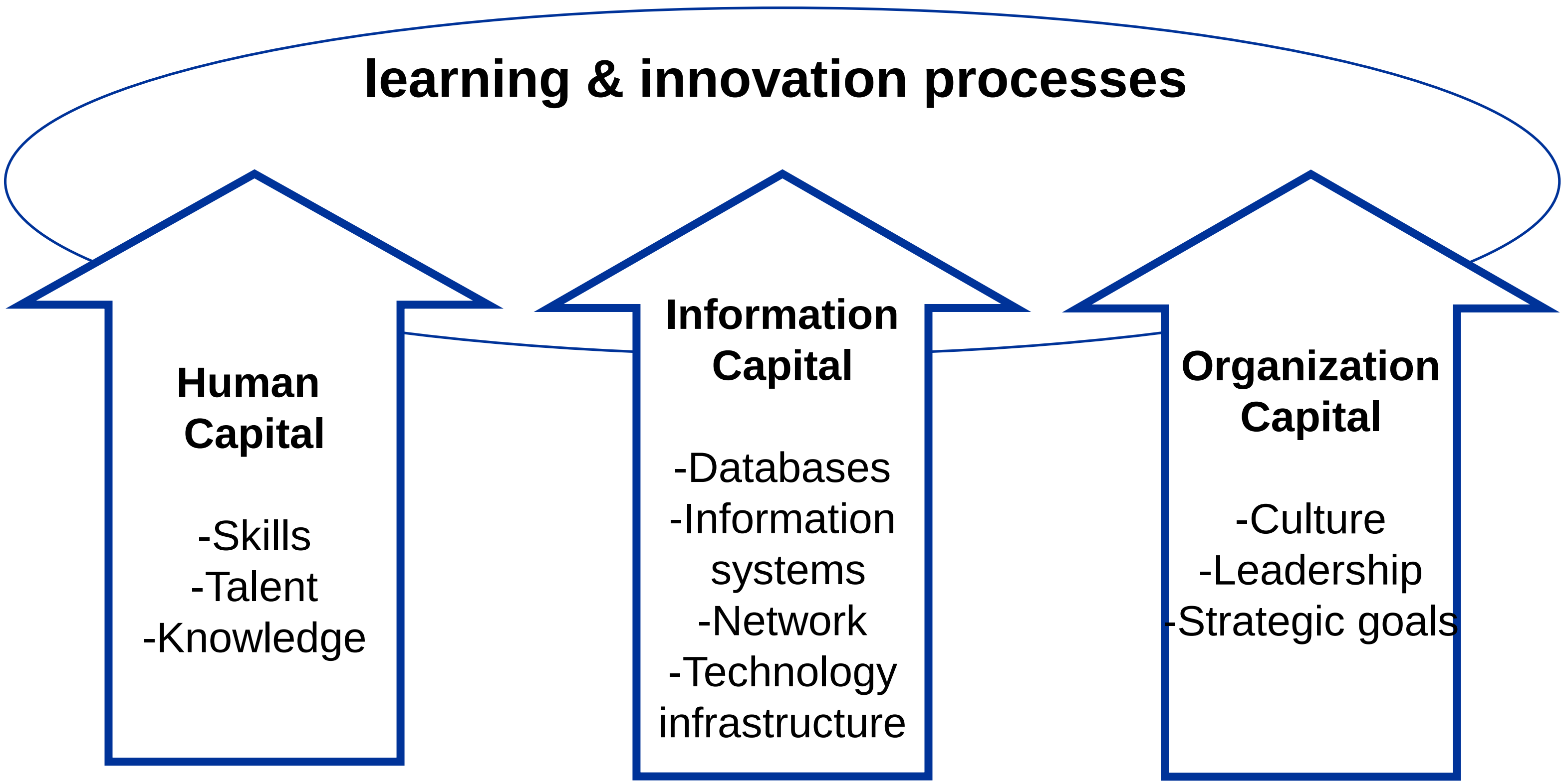
2. **Market franchises**: a business's distinctive ability to attract customers who are willing to purchase the business's products and services based on marketwide perceptions of value

3. **Relationships and networks**: long-term relationships with important suppliers and customers

Strategic Management

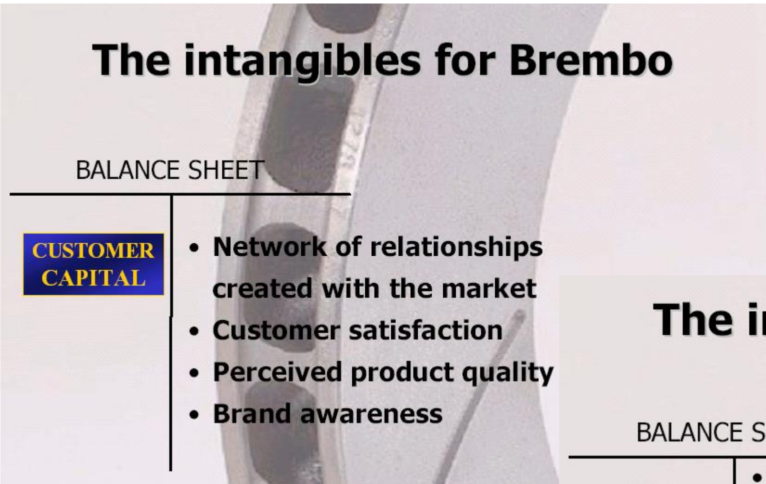
Intangible resources

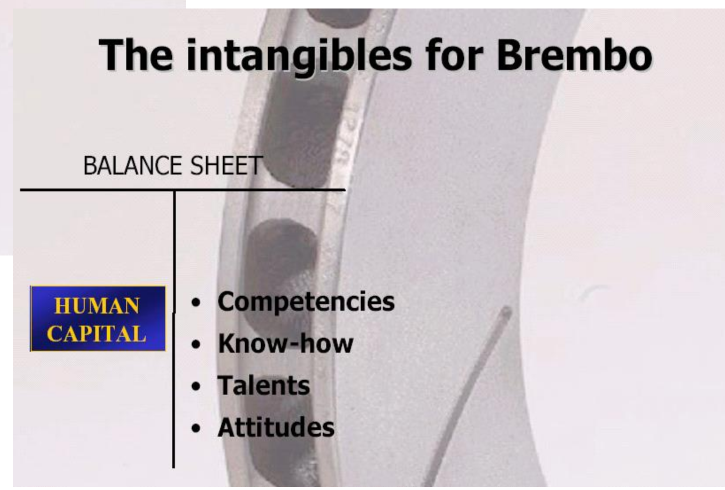
In particular intangible assets are the building blocks for all learning & innovation processes



Strategic Management

Intangible resources



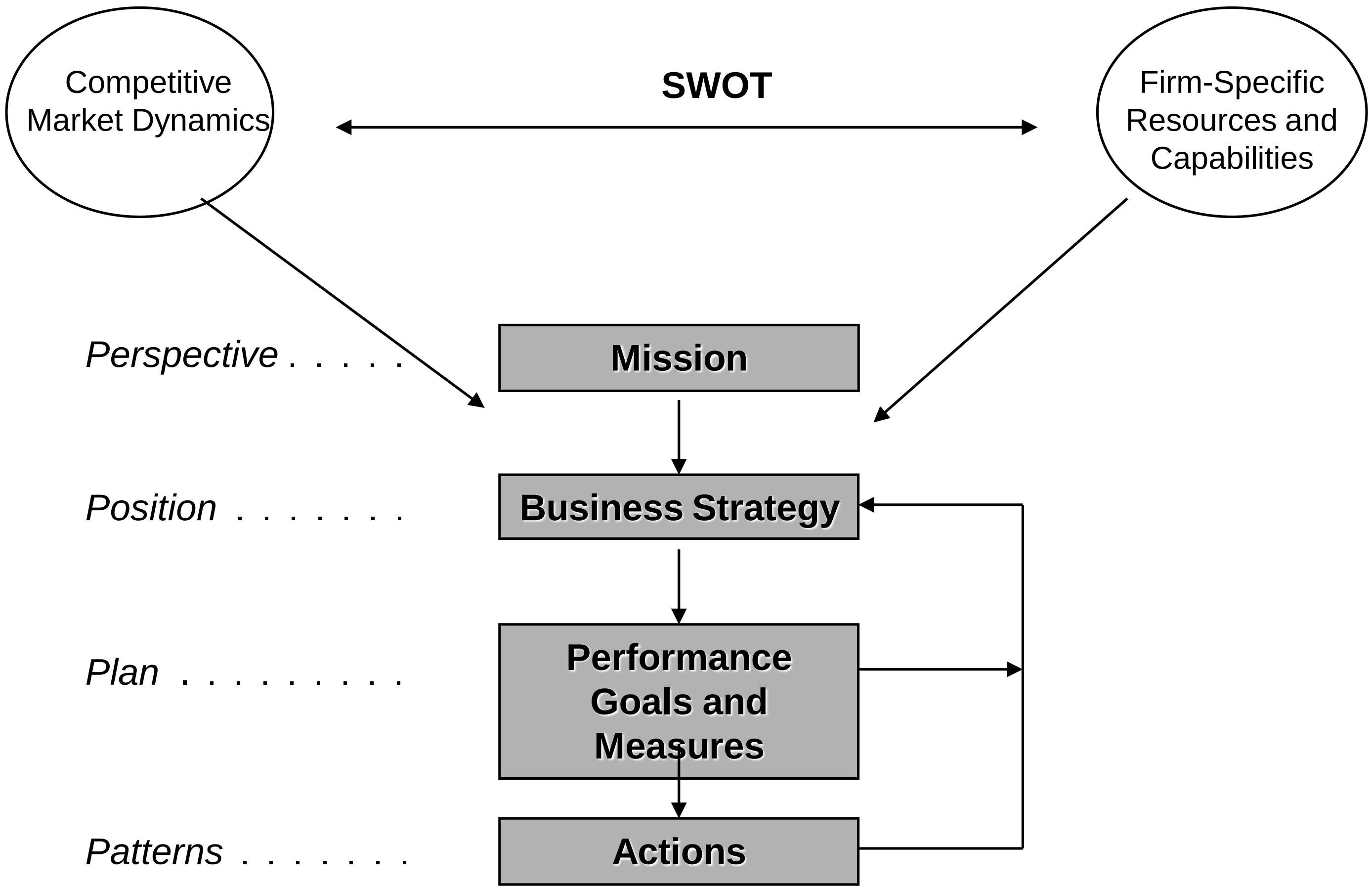


The intangible balance sheet includes the difference between the market value of a company and its book value. It depends essentially on: intellectual capital and elements like brand, image, R&D, people.

The system of strategic choices

Hierarchy of Business Strategy

- Sales growth rates
- Absolute market shares
- Relative market shares
- Customer satisfaction indexes



Massimo Solbiati

The system of strategic choices

- Social Strategy: what do we ask to employees and suppliers? What do we give back?
- Financial Strategy: investments, financial sources and dividends
- Organizational Strategy: structure and operating mechanisms

The system of strategic choices

- Portfolio strategy:
  - How many businesses? Which ones?
  - How do we allocate resources among businesses?
  - How to create sinergies?

To plan sistematically, esplicitly and globally all the proper activities is necessary for all the enterprises.

And so, we must:

- Understand the current situation
- Manage the present well
- Imagine the future …

The system of strategic choices

A strategy is valid and good if is:

- Practicable and feasible.
- In line with the system of values and resources in the company.