

THE STRATEGIST'S TOOLKIT



Jared Harris and Michael Lenox

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TOOLKIT

By Jared Harris and Michael Lenox

To our students, who have inspired us and taught us over the years.

Contents

- Preface* vii
- 1. Introduction to Strategic Analysis 1
- PART 1. TOOLS FOR ANALYZING THE COMPETITIVE ENVIRONMENT**
- 2. Competitor Analysis 13
- 3. Environmental Analysis 17
- 4. Five Forces Analysis 21
- 5. Competitive Life Cycle Analysis 29
- PART 2. TOOLS FOR ANALYZING COMPETITIVE POSITION**
- 6. Stakeholder Analysis 39
- 7. Capabilities Analysis 43
- 8. Strategy Maps 49
- 9. Diversification Matrices 53
- PART 3. TOOLS FOR ANALYZING STRATEGIC DECISIONS**
- 10. Hypothesis Testing 59
- 11. Payoff Matrices 63
- 12. Real Options Analysis 69
- 13. Acquisition Analysis 73
- 14. Scenario Planning 79
- 15. Strategic Analysis in Practice 83
- Endnotes* 87
- Glossary* 91
- Strategy Analytics* 99
- About the Authors* 101

Introduction to Strategic Analysis¹

Every organization needs a strategy. Be it an established business, an emerging entrepreneurial venture, or a non-profit organization, a strategy sets the direction of the enterprise, informs priorities and the allocation of scarce resources, and helps guide the myriad decisions that an organization makes every day.

But what exactly is *strategy*? Kenneth Andrews provides the following definition:

[S]trategy is the pattern of decisions in a company that determines and reveals its objectives, purposes, or goals, produces the principal policies and plans for achieving those goals, and defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and non-economic contribution it intends to make to its shareholders, employees, customers, and communities.²

Such a definition of strategy highlights its complex nature. Strategy encompasses several different sets of considerations. An organization's strategic goals, or objectives, refer to the organization's *mission*, its unique purpose and scope. The strategic plan, sometimes called strategic *intent*, is how the organization tailors its offerings and develops and leverages internal resources and capabilities to accomplish strategic goals. Strategic *actions* are those tangible actions taken to operationalize the strategic plan in pursuit of the strategic goals of the business.

Together, this triad of mission, intent, and actions defines an organization's strategy. They reveal how an organization creates unique value for its customers and other stakeholders, and how it distinctively positions itself relative to other organizations in its field.

Understanding and assessing an organization's strategy is critically important to many organizational constituents. One need not be the CEO, President, or a member of the top management team to engage in such analysis. Consultants, investment bankers, entrepreneurs, and others frequently must assess the strategy of firms, whether their own businesses, clients', or competitors'. Managers, consultants, and analysts are frequently asked to identify and assess the strategy of a business

1. This chapter was adapted from Jared D. Harris, Michael J. Lenox, Jeanne Liedtka, and Scott Snell, "Introduction to Strategy," UVA-S-0183 (Charlottesville, VA: Darden Business Publishing, 2010), which was based on an earlier technical note (UVA-S-0166) by Ming-Jer Chen, Gregory B. Fairchild, R. Edward Freeman, Jared D. Harris, and S. Venkataraman.

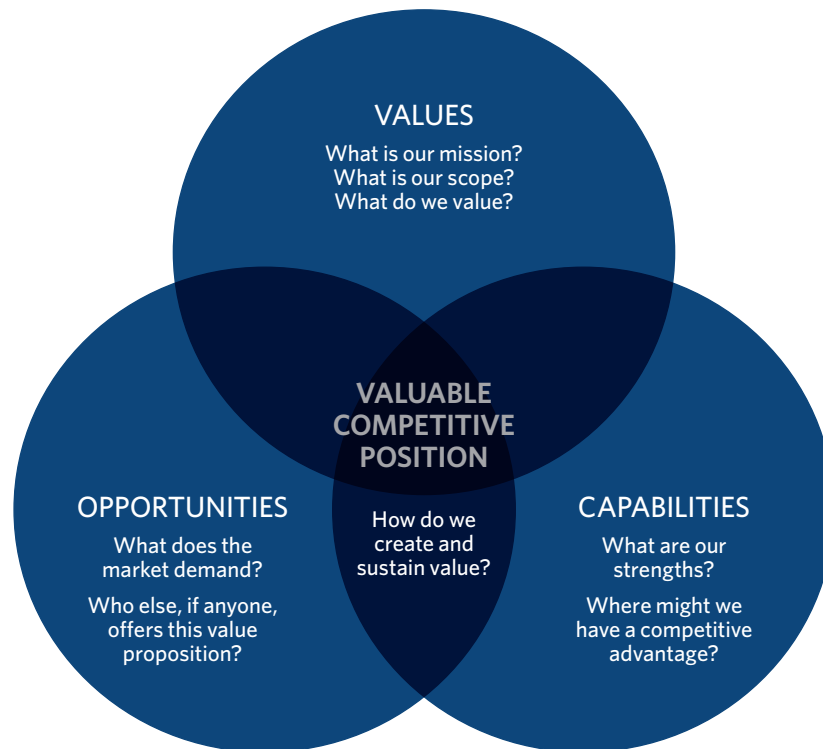
2. Kenneth Andrews, *The Concept of Corporate Strategy* (Homewood, IL: Richard D. Irwin, 1971).

or an organization. Whether it is to properly value a business or acquisition target, undertake a new corporate initiative, or enter a new market, one needs an understanding of an organization's strategy to formulate an informed and robust recommendation.

The purpose of this book is to provide an organized framework and a set of tools to aid those who wish to analyze the strategy of an organization, be it their own or another organization they are interested in. This book explains a number of basic tools necessary to be an effective strategic analyst, or *strategist*, an individual skilled in the art of assessing an organization's strategy. Strategic analysis is a powerful tool for analyzing the competitive context in which an organization operates. An effective strategist makes reasoned and reasonable recommendations for how an organization should position itself relative to its peers and for assessing what actions the organization should take to maximize value creation for its various stakeholders. While our bias is towards analysis of business organizations operating in market environments (e.g., corporations, small and medium size businesses, entrepreneurial ventures), the tools presented here could be applied to organizations in the non-profit and governmental spheres (e.g., schools, advocacy groups, community organizations, municipal governments).

The Strategist's Challenge

The strategist's challenge is to balance the intersection between three critical factors: values, opportunities, and capabilities.



Values refer to the mission of the organization. What is the organization's purpose, its reason for existing? What is the organization's scope; what markets or arenas does the organization operate? What do the organization's various stakeholders expect of the organization? What do the organization's leaders expect of the enterprise? What values and beliefs does the organization hold? The answers to these questions are critical for understanding the strategy of an organization and provide the baseline for any strategic analysis. Indeed, the most fundamental question a strategist must initially ask and understand is: what are the organization's values? An understanding of firm values is the foundation that can give meaning and provide context to the strategic decisions an organization makes.

Opportunities refer to the potential to create value for stakeholders. What does the market demand? What needs may be identified? Who else in the market is satisfying these needs? There are a variety of external forces—competitive, economic, and technological—that influence an organization's opportunity set. Factors such as the rapid development of information and communication technologies, the increased global reach of businesses, the multinational distribution of labor pools and supply chains, and the worldwide interest and influence of stakeholders of all types have all had a profound impact on the opportunities facing organizations. The strategist requires clear thinking about the economic, technological, and societal environment in which the organization operates as well as an acute consideration of the activities and capabilities of one's competitors.

Capabilities refer to the organization's existing and potential strengths. To evaluate an organization's strategy, one must have both a clear picture of what makes the organization distinctive and a sense of the organization's ability to marshal resources and leverage capabilities toward desired organizational objectives. This requires, of course, clarity about organizational capabilities: What capabilities do we currently possess? Are these capabilities unique and do they provide the basis for a competitive advantage? What capabilities do we need to possess in the future? How will we develop them?

The challenge for the strategist is to balance these three factors and identify the space where they converge. It is at the intersection of values, opportunities, and capabilities that valuable competitive positions that create and sustain value for stakeholders emerge.

Ultimately, strategic analysis is an *integrative* exercise. Whereas the functional areas of an organization—finance, marketing, accounting, operations, human resources—often bring specific paradigmatic views to bear on organizational problems and considerations, strategy is about how all the underlying insights of these disciplines are brought back together. Managers do not typically encounter challenges as isolated, atomistic problems with narrow disciplinary implications; rather, they must navigate issues encompassing a whole range of complex, cross-disciplinary considerations.

Strategy is also integrative in the sense that its success involves value creation for its investors, employees, customers, suppliers, and communities. Commonly invoked business axioms such as “maximize shareholder returns” can be useful to the extent that such shorthand phrases imply value creation for investors *by way of* creating value for key stakeholders—creating goods

customers want, work environments that energize employee contributions, and so forth. On the other hand, shareholder profit maximization as an organization's formal objective provides little strategic direction if it implies adherence to the naïve notion that shareholder value is somehow exogenous to creating value for customers or employees or communities. Strategy involves putting these considerations together in an attempt to align stakeholder interests and create value in an integrative and sustainable way.

At the same time, tradeoffs must sometimes be made, and a strategist often faces difficult choices. Tradeoffs between costs and quality and between various customer segments are frequently confronted when considering strategy. The most difficult strategic tradeoffs are often temporal, as between strategic long-term investments and short-term performance. An integrative, enterprise perspective is necessary to think clearly and to exercise sound judgment about how to best create long-lasting value. Individual analytical frameworks and tools, grounded in both theory and practice, can help, but any device used to help analyze strategic problems will prove insightful in some ways, but blunt in others. The key to strategic analysis is to integrate these frameworks and tools to form a comprehensive understanding of the competitive context in which the organization operates.

The Art of Strategic Analysis

Strategic analysis can be a powerful tool when executed well. Effective analyses explore the competitive situation, define key issues, recognize critical assumptions and tradeoffs, and propose strategically sensible recommendations. In any analysis, it is important to be prepared to articulate your major conclusions and provide evidence and analysis in support of them. You should be prepared to not only present your own analysis and conclusions, but also respectively challenge and extend the viewpoints of others. There is rarely one “wrong” or “right” answer to a strategic analysis. However, some answers are assuredly better than others. Thus, strategic analysis requires the honing of your skill in logic and argumentation, so that you can advance your hypothesis or viewpoint and logically provide support through both qualitative and quantitative analysis.

Even in the most ambiguous scenarios, it is important to examine whatever data is available as well as your key reasoning and assumptions that make some recommendations better than others (see sidebar, Gathering Strategic Intelligence). Once research is undertaken, one of the challenges of strategic analysis is to pull from the diverse and often incomplete data available to support your arguments and conclusions. Strategic analyses are far more focused, productive, and persuasive when informed and supported by specific data and quantitative analysis. Similarly, quantitative analysis, no matter how elegant, is far more reliable and robust when critiqued within a broader strategic context that involves a range of relevant considerations that are more difficult to quantify.

Data and quantitative analyses may be used to focus discussion by identifying key issues and to back up arguments. Calculations should be conducted, therefore, in the context of specific questions or beliefs. For example, deciding whether or not to make a particular acquisition should be guided by fundamental questions like “How will the combined enterprise be better positioned to create value?” and “How will we create that value?” In turn, believing that an acquisition is very important leads us to ask “How much of an effect would the acquisition have on the market value of the firm?” and perhaps “How much will market prices fall if competitors made the acquisition

instead?” If the focus of an analysis revolves around a risky investment, you may want to calculate a quick calculation of the net present value of the investment and do a sensitivity analysis to identify a few key uncertainties for discussion. This might entail predicting the future discounted cash flows that will result from a given strategic action. Alternatively, you might calculate the break-even for the investment or recognize that the risky investment can be made in stages and put together a decision tree that shows the possible outcomes and values at each stage.

Of course, any calculation is simply a reorganization of available information; as such, calculations are not insightful on their own. But quantitative analyses can *support* a larger strategic analysis that *does* shed light on key issues in a particular situation. For instance, a simple ratio (e.g., return on assets) may transform some raw numbers about competitors into a clear picture of which firms are outperforming their rivals and why those firms are doing better. Alternatively, a few calculations may transform ratios and raw numbers (e.g., spending per person and number of consumers in the segment) back into data that may be more relevant to certain key decisions (e.g., total market size). Because such calculations are often necessary but not sufficient for good strategic analysis, you should be prepared to discuss any relevant financial data, but also be ready to discuss the relevance of that data to the key strategic issues under consideration.

In the appendix of this toolkit, we provide a list of common financial measures and mathematical tools that may be useful when analyzing a firm’s strategy. The list is not intended to be a comprehensive treatment of these tools; rather, it is intended to summarize, remind, and encourage you to apply your existing knowledge when conducting strategy research.

A Framework for Strategic Analysis

At the very least, a full-blown strategic analysis includes (1) an identification of the organization’s current competitive positioning and an assessment of the strengths and weaknesses of that position, (2) a consideration of the pros and cons of a relatively small set of strategic actions to help improve that position, and (3) the advancement of a set of recommendations based on this analysis. Collected in this toolkit are a number of common frameworks and tools that are useful when conducting such a three-part analysis. Note that none of the tools presented is sufficient, in and of itself, for conducting a strategic analysis. The tools *work together* to paint a complete picture of the competitive context of an organization. The key to an effective strategic analysis is the *integration* of these tools into a compelling argument for action moving forward. Many of the tools included here are most useful as “back office” support to your analysis rather than an end product in and of themselves. In other words, a client or boss for whom you are preparing a strategic analysis is less concerned about seeing that you conducted a “Five Forces Analysis” or “Stakeholder Analysis” than the actual insights you gain from completing these analyses and how those insights influence your recommendations. As such, you may only perform them in the “back office” to advance your own thinking and analysis.

As a way to organize these tools, it may be useful to think of a classic strategic analysis framework, the SWOT *analysis*. SWOT stands for strengths, weaknesses, opportunities, and threats. Although perhaps the most basic of all strategic frameworks, SWOT emphasizes two main components of any strategic analysis: consideration of the external competitive environment (opportunities and threats) and the internal strengths and weaknesses of the focal organization under scrutiny.

Gathering Strategic Intelligence

One of the biggest challenges of any strategic analysis involve (1) gathering information, (2) determining which pieces of that information/data are useful and relevant, and (3) employing gathered information as part of a fruitful strategic analysis. You are often challenged with either too much or not enough information. The big question is often how to find and utilize the right data. Fortunately, there are many resources at your disposal to help gather data on particular organizations and industries.

There are a number of places you might look for information relevant to your analysis that are available to anyone on the Internet. For example, an obvious place to start is an organization's own website and it's most recent annual report. You might pay attention to recent media coverage of a certain organization or industry as you regularly read business papers, publications, and blogs, especially pertaining to the organization's strategy and competitive position. Certain hard copy publications, like S&P's *Industry Surveys*, can be found in research libraries. *Industry Surveys* provides useful information on market share and sector-specific issues, and is updated up to several times a year. *Value Line's* loose-leaf print publications also provide detailed information on 1,500 stocks in roughly 100 industry groups, updated quarterly. *Value Line* updates industry sector reports weekly, and can be found in research libraries or larger public libraries. In addition to such print resources, there are a number of online research databases and resources available through university subscription that you might also find helpful as you gather relevant information.

You should search in various publications for articles and news items that touch directly or indirectly on the industry and company you have selected. A good place to start is by searching through the library indexes and databases for your industry and company. You should attempt to locate articles that go back several years, rather than focus exclusively upon the most recent ones. Try to begin with magazine articles that may provide more general background information before you consult newspapers that deal with specific recent developments. Business or trade publications and company documents filed with the SEC will provide you with even more useful information. The Internet is a valuable resource for collecting information, but please proceed wisely. The information that is posted on the Internet varies widely in terms of its validity and quality; pay the most attention to information posted by the firms themselves, established news or media firms, and universities. You should be able to find a wealth of information even if you limit yourselves to these sources. We summarize a number of specific research databases that may be useful for conducting research in support of analyzing a firm's strategy:

Dow Jones Factiva. You can check for articles in major publications such as the *Wall Street Journal*, *BusinessWeek*, or even in relevant trade journals using *Factiva* (<http://global.factiva.com/>), a database that contains full text articles for regional newspapers, magazines, press releases, and newswires. The company "Snapshot" under the Companies/Markets tab in *Factiva* provides Reuters business descriptions and Datamonitor analytics.

Lexis-Nexis Academic Universe. Much like *Factiva*, *Lexis-Nexis* (<http://web.lexis-nexis.com/universe>) can be helpful for identifying news articles from U.S. regional newspapers, magazines, trade publications, newswire services, and major international newspapers. In addition, *Lexis-Nexis* provides access to SEC filings, company summaries from *Hoovers*, and company financial ratios for the past three years. You can also access biographical information, U.S. federal and state court cases, law review articles, U.S. patents, and legal cases from a selection of countries.

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Mergent online. *Mergent Online* (<http://www.mergentonline.com>) is a very useful and comprehensive database containing detailed financial information and highlights, company histories, and data on joint ventures and alliances. The database has direct links to EDGAR for public filings. *Mergent Online* can be a very useful if you are interested in information on a firm's board of directors, key personnel, and institutional shareholders. You can also research company earnings estimates and *Mergent Online's* own equity research reports.

Mergent Horizon. *Mergent Horizon* (<http://www.mergenthorizon.com>) can be quite useful in providing stakeholder data, such as financial and other data for a focal firm's suppliers and customers. In addition, the database contains a "Merger and Acquisition Scenario Report Builder" function, allowing you to see what a hypothetical merger or acquisition between two public firms would look like, with a particular focus on overlapping and complementary product lines and key business relationships.

Research Insight. This database requires special software installed only on select workstations, found in research libraries. *Research Insight* gives you access to the Compustat database, the most comprehensive source of financial data available on market-traded firms. It provides annual, quarterly, and monthly financial information, ratios, growth rates, line of business, monthly stock prices, and other market data for over 10,000 active public companies that trade on U.S. exchanges and 7,000 companies that no longer file with the SEC.

SDC Platinum. This database also requires special software installed only on select workstations, found in research libraries. *SDC Platinum* focuses on initial public offerings, venture capital, private equity investment, and mergers. For instance, it provides information and data on all types of new security issues, including both equity and debt issuance.

Bloomberg Financial Markets. This database is only available on *Bloomberg* terminals, found in research libraries. *Bloomberg* provides real-time and historical data on a wide range of investment vehicles including stocks, bonds, commodities, currencies, indices, etc. You can access price and other data on international securities, recent newswire articles and press releases, information about corporate executives and directors, and features that allow you to compare securities.

Investex Plus. Thomson Research's *Investex Plus* (<http://research.thomsonib.com/gaportal/ga.asp>) gives you access to analyst reports on particular firms by various contributors, and analyst information on industries.

CareerSearch. While typically used as a tool for job hunting and career services, *CareerSearch* (<http://www.careersearch.net>) can also occasionally be helpful in doing strategy research—especially for smaller firms that are difficult to find in the larger research databases. *CareerSearch* contains information about companies from a number of company directories and database providers, including CorpTech, Grey Hose Publishing, Thomson Financial Publishing, and Thomson Nelson.

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This interplay between external and internal is at the heart of any good strategic analysis. Some tools, such as competitor analysis, environmental analysis, and Five Forces Analysis, are useful for understanding the external competitive environment. Others, such as capabilities analysis and diversification matrices, are useful for understanding the internal strengths and weaknesses of the firm. Still others, such as strategic maps and stakeholder analysis, are useful in combining external and internal assessments and understanding the positioning of an organization among its peers and competitors. Finally others, such as scenario analysis and payoff matrices, are useful to consider how the dynamics of competition effect strategic positioning.

The remainder of the toolkit is organized into three parts. Part 1 presents a collection of tools that help with the analysis of the external competitive environment, the 'opportunities' portion of the strategist's challenge. These tools will help you answer questions such as: What industry is the organization in and who are the players in this industry? Is this an attractive industry? Are there barriers to competition? What are the major trends impacting this industry? How is the competitive structure of the industry likely to evolve? What is the underlying competitive game being played?

Part 2 presents a collection of tools that help with the analysis of competitive position highlighting both the capabilities portion of the strategist's challenge and the integration across values, opportunities, and capabilities. These tools will help you answer questions such as: Who are the organization's relevant stakeholders and what do they expect of the organization? How does the organization create value for its stakeholders? What are the organization's unique resources and capabilities? How sustainable is any advantage the organization may have from these assets? Can the organization leverage these assets across markets so as to improve their position in a market? Given all this, how should the organization position itself in the market relative to its rivals? How can the organization secure and sustain favorable positions over time?

Part 3 presents a collection of tools that aid in the analysis of specific strategic decisions and provide guidance on how to assess whether a potential action will improve an organization's creation of value. These tools will help you answer questions such as: How can we best improve the position of the organization in their competitive environment? How will competitors react to specific strategic actions? What is the value in investing in various opportunities and building certain capabilities? What potential futures may the organization face and what is the value of specific actions in each of those futures? Ultimately, these tools provide guidance for recommending specific strategic actions.

We conclude with Chapter 15, "Strategic Analysis in Practice," where we return to our discussion about integration and present a step by step process by which to conduct a strategic analysis utilizing the various tools in the toolkit.

Ultimately, executing a well-done strategic analysis is a skill that requires application and will develop over time through repetition. An expert strategist can conduct a compelling analysis in a number of situations: the multi-week project, the rapid follow-up to an urgent late-night call from the client looking for quick suggestions, or even the elevator ride with the boss who asks for thoughts on some pressing strategic issue facing the organization. The tools in this toolkit provide the foundation on which to conduct a strategic analysis in all its forms. The key is to integrate these frameworks and tools into a compelling argument and analysis.

It is important to note that *strategic analysis* is only the first step in executing a winning business strategy. While we reserve the term strategic analysis to refer to the assessment of strategy, *strategic management* refers to the process by which strategy is formulated and implemented within an organization. While strategic management is often the responsibility of the chief executive of an organization, its execution often involves many levels of the organization and may include internal *and* external parties such as suppliers, customers, and consultants. Both formulation and implementation are important aspects of strategic management. So while Michael Porter argues that strategy is not merely operational effectiveness,³ neither is it solely armchair theorizing and strategic planning.⁴ Strategic management is a dynamic endeavor that involves both content and process, both planning and action. Strategy can be emergent and is often the realization of both intentional strategy formulation and tactical responses to unexpected stimuli encountered by the organization as it acts on those plans.

3. Michael E. Porter, "What is Strategy?" *Harvard Business Review* 74, no. 6 (November–December 1996), 61–78.

4. See Gary Hamel and C. K. Prahalad, "Strategic Intent," *Harvard Business Review* 67, no. 3 (May–June 1989), 63–76; or Henry Mintzberg and Alexandra McHugh, "Strategy Formulation in an Adhocracy," *Administrative Science Quarterly* 30, no. 2 (June 1985), 160–97.