Stratevolve

STRATEGY PAPER - Formulating Strategy

This paper explains how a strategy can be formulated for a firm. The approach treats the firm as a bundle of assets, in the spirit of recent advances in the resource-based view of the firm. The objective is to help executives who have a responsibility for strategy to construct a believable future direction for their firm. The paper puts into practice the principles of resource-based theory.

The strategy of a firm should set out the ways in which it intends to deliver future profits for its owners. Firms make profits if they possess attributes that give them competitive advantage. These firm attributes have been variously termed competences (Hamel and Prahalad 1994), capabilities, strategic assets (Amit and Shoemaker 1993: Markides 1997), or simply 'resources' (Wernerfelt 1984; Barney 1991). In this paper we shall use the term 'strategic assets' to describe these attributes. Strategy should aim to enhance the strategic assets of the firm, those assets that enable the firm to secure profitable business. By adopting this concept of strategy, we can simplify the strategy-making process. Through the development of a strategy that focuses on the enhancement of strategic assets, executives would then know, with some confidence, what to change in their firm, what to change it to, and also what to leave alone.

Knowing what to do strategically with an organization can derive from experience, or from entrepreneurial insight. It can also derive from analysis and this chapter describes an analytical approach that can help top teams to form their own sense of strategy. This paper opens with a discussion of the need for strategy (Section 1.2). Then Section 1.3 focuses on identifying the firm's *strategic assets*. These strategic assets are particular to the firm, and they either help the firm to win business, or they enable the firm to deliver products or services at lower costs than competing firms. They must be distinguished from assets and capabilities that are commonly found in competing firms, which can be labelled *entry assets*; these are the minimum requirement to operate in a particular industry (Figure 1.1).

Strategic assets can be identified if two questions can be answered. First, do managers understand what customers actually perceive as *value* in the products or services the firm produces? Second, can managers identify the processes and resources that are critical in helping the firm *deliver* value? Addressing these questions will help executives uncover the firm's strategic assets.

Sections 1.4 and 1.5 set out an approach to identifying where existing assets need to be strengthened or augmented in order to improve the competitive position of the firm. In order to compete in some markets, the firm may need to acquire or develop assets that are already possessed by incumbent firms. These assets would not of themselves confer an advantage, they are necessary just to enter the game. However, once these have been acquired, they can be coupled with the firm's strategic assets to deliver a competitive advantage.

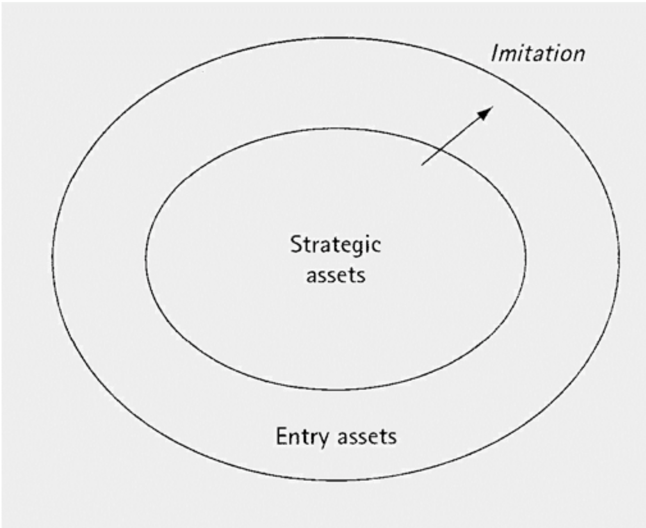

Fig. 1.1 Strategic Assets and Entry Assets

Section 1.6 addresses asset development. Some assets can be extended readily; others are severely constrained or only apply in one particular market context. Any development programme needs to understand these constraints and possibilities, and the organizational processes required to develop and augment the firm's assets. Assets can be developed internally, or alternatively they can be introduced from other organizations either through alliances, or acquisitions. These alternative means of development are explored in the final section of the paper.

There are two technical notes included in the text, which summarize some relevant concepts from resource-based theory. These can be skipped, if necessary!

1.2 THE NEED FOR STRATEGY

This paper is about formulating strategy. The first question we need to address is 'why would we need to do this?' All firms have a *realized* strategy: the firm is currently operating in various market segments, selling products or services, and, hopefully, showing some profits for so doing. So when we set

out to *deliberately* determine a strategy for the firm, we need to understand why we are doing it.

Often an outside stakeholder in the firm provokes the need for strategy. The firm's bankers, corporate headquarters, or stock market analysts demand some explicit articulation of the firm's intentions. A common response to these stakeholders can be to provide a strategic plan of some description, which may include a vision or mission statement, a 'statement of strategic intent', a list of 'shared values' and strategic objectives, which may be 'stretching' or, indeed, 'big hairy audacious goals'. But this document is an artefact, no more. Can we expect that the intentions set out in the document will be translated into action, or 'implemented'? Often, the very people that drew up the plan recognize themselves that the plan plays more of a political role; it may not be a 'real' statement of their intentions. So, when we think about developing a strategy we need to ask the question why? If it is required to satisfy a stakeholder, then it is clear that the plan should be derived to meet their expectations. If it is for the executives trying to run a complex organization, then we might approach the task in a different way. We will assume in this paper that a top team of executives are looking for some clarity in direction, which will help them make day-to-day decisions with more confidence. In other words, they are looking for a real strategy, one that helps them have a shared understanding as a top team, and one that can be communicated to the rest of the organization as the way ahead.

Before embarking on any changes to the organization, it is vital that the executives understand what makes the firm successful today. Otherwise, there is a risk that strategic changes proposed might undermine the existing sources of value. Thus, the first step in the strategy process is to understand the firm's current strategic assets, those organizational resources or capabilities that either help the firm with business, or they help it achieve lower relative costs. In determining the strategy for the firm, from an assets perspective, there must be clarity about the following:

- the firm's strategic assets
- the markets the firm intends to operate in
- the assets required to compete in those markets
- how those assets are to be developed or acquired.

1.3 IDENTIFYING STRATEGIC ASSETS

Strategic assets are likely to fall into one or other of the five categories set out in Figure 1.2. Note, however, that it is necessary to distinguish here between assets and capabilities that might be common to most of the firm's competitors, the *entry* assets, from those that are particular to the firm, those that are critical to securing profitable business, the *strategic* assets. The entry assets can be regarded as order-qualifying capabilities, required just to operate in this market. These would be similar to the 'barriers to entry' in Porter's five forces analysis. In contrast, strategic assets are unlikely to be present in the same way, or to the same extent in rival firms. However, when rival firms are able to imitate a strategic asset, it becomes an *entry* asset, one required merely to operate in the market.

So strategic assets are specific to the firm, and they either help the firm win business, or they assist in the delivery of products or services at lower costs than competing firms. The five categories of strategic assets are:

•***Tangible assets.*** This includes special equipment, locations, patents, information, buildings.
•***System assets.*** These include systems and procedures operated by the firm that give advantage, e.g. operating procedures, quality assurance processes, recruitment, cost control, incentive schemes.
•***Cultural assets.*** The special way 'things get done around here', this includes aspects of behaviour like creativity, loyalty, cooperation, team-working, commitment.
•***Knowledge assets.*** This includes technical knowledge, insight or performed knowhow, which may be tacit.
•***Relational assets.*** This includes brands, reputation, the trust of customers, power over suppliers, locked-in customers, contract

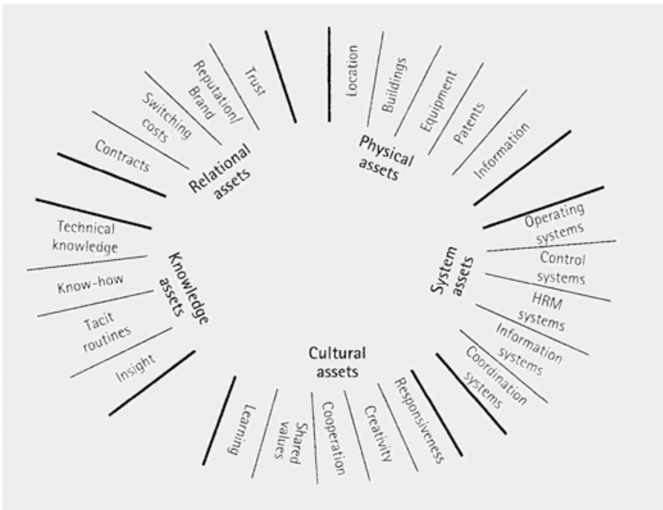

Fig. 1. 2 Strategic Assets: The Sources of Advantage

The strategic assets are combined with entry assets to deliver products or services. For example, take Metax, a petrol retailer operating in Denmark. Metax has some assets that are similar to competitors, like tanks, pumps, canopies, and car-wash facilities. These would be *entry* assets, required just to be in the business of retailing petrol. The firm's *strategic* assets would be excellent locations, e.g. on important road junctions; a swipe card payment system on the forecourt; a reputation for good value supported by distinctive and humorous marketing campaigns; and a low-cost tanker delivery system. These strategic assets enable the firm to increase market share, and to operate at lower relative costs than rival major retailers. Some of these strategic assets may be quite easy to imitate. The swipe card payment system could be adopted by competitors if they were prepared to spend the money installing it. Once this system is adopted by most competitors, it ceases to be a strategic asset for Metax; it should then be classed as an *entry* asset.

Other assets may be more difficult to copy. Their reputation for good value may be one, and the affection customers have for this local 'independent' up against the oil majors may be another. The low-cost delivery system may also be difficult to match, as it relies on a particular culture fostered within Metax by the two founders of the business, which allows the tanker drives a great deal of autonomy in determining how they replenish 'their' filling stations.

Where a firm has a dominant competitive position we would expect that the majority of the firm's assets would be classed as strategic. Where a firm has a weak position in a market it possesses few strategic assets, it is a 'me too' player that is losing share. This can come about through the firm misreading the marketplace and failing to develop appropriate assets, or through the firm failing to continually upgrade its assets in the face of more committed competitors.

So here we can see how entry assets and strategic assets coalesce, how, through competitive limitation, strategic assets get downgraded into entry assets, and how sustained advantage can be achieved through the possession of assets that are difficult to copy. In the next section we explore ways of uncovering the firm's strategic assets.

1.3.1 Uncovering Strategic Assets

1.3.1.1 Technical Note 1: A Summary of Resource Based Theory

In this brief technical section we link back to resource-based theory arguments before setting out how this approach can be made operational.

Resource-based theory (RBT) argues that resources that are valuable, rare, inimitable, and non-substitutable (the ‘VRN’ conditions) are the source of rents, which when captured by the firm rather than by resource suppliers, can lead to super-normal profits (Barney 1991; Wernerfelt 1984; Dierickx and Cool 1989; Rumelt 1984). Although these conditions (Eisenhardt and Martin 2000; Grant 1996) are often treated as a package, we need to explore them in turn to clarify the underpinning arguments of RBT.

Valuable: for a resource to be valuable it must be contributing to the provision of a product or service valued by customers (Bowman and Ambrosini, forthcoming; Priem and Butler 2001). There must be a revenue stream attributable to, or flowing from the resource. The product must deliver consumer surplus to customers otherwise a sale will not result. But this is a necessary but not sufficient condition, because before the resource can be judged valuable in the RBT sense, it must be generating rents, which form a part of the super-normal profit stream captured by the firm. A resource can make this valued contribution by either:

•enabling the firm to sell more products from the same capital base as rival firms and/or
•enabling the firm to sell at a margin greater than rival firms.

The margin advantage can result from lower unit costs combined with equivalent prices, or from higher prices at equivalent unit costs, or, of course, from a combination of these. Therefore, we conclude that resources are *embedded* in the processes of production. A key part of the RBT argument though is that the value of a particular resource may be enhanced if it is combined with other complementary resources (Dierickx and Cool 1989). Thus, there are synergies within particular resource bundles.

Rare: the relative scarcity of the resource means that the firm possessing it can generate either superior margins or superior sales volumes off of an equivalent cost base to competitors. Thus, a resource is special, and is not commonly found across other competing firms. If it is common, it should be regarded as an *entry asset,* not a resource. To judge rarity there must be a set of competing firms with, presumably, similar asset bundles, that can act as a benchmark.

These two criteria should help us identify the *resources* or strategic assets of the firm at a point in time. The next two VRIN criteria address the sustainability of the rent streams into the future.

Inimitable: the more difficult it is for competing firms to replicate the resource the longer lived will be the rent stream accruing to the asset. Barriers to imitability include causal ambiguity and path dependency (Dierickx and Cool 1989). Judging this criterion requires insight into the nature of the resource in question, and how it was *created*.

Non-substitutable implies that the use-value or effect of the resource cannot be produced using other means. Assessing substitutability may require an understanding of the *use values* delivered by the resource.

Thus, we can feasibly conduct an audit of a firm *at a point in time* and identify at least some of its resources or strategic assets by operationalizing the first two of the VRIN criteria (Ambrosini and Bowman 2001*)*. So judgements about resource value must be linked directly to the current profit streams of the firm, and the rarity of the asset can only be judged through a thorough knowledge of competing firms. As argued above, judgements about inimitability and non-substitutability require foresight, combined with some understanding of how the particular resource was created. These last two conditions are problematic. We know that at least some resources display *casual ambiguity*, that is, it is difficult for competitors to unravel how the firm operates in this superior way. This property of a resource therefore prevents competing firms from replicating the resources concerned. But as Lippman and Rumelt (1992) have argued, causal ambiguity can exist *within* the firm, and Barney (1986) points out that many resources are acquired more by luck than the exercise of managerial judgement. Reliable foresight is of course a very scarce commodity, and given the turbulence and unpredictability of many industry environments, this quality is likely to be even scarcer than it might have been in the past. To conclude, resources that pass the VRIN test are:

•embedded in productive processes at the SBU level
•involved in delivering competitive advantages to the firm
•manifested in product advantages perceived by customers or
•conferring process advantages which deliver lower unit costs.

So, adopting a resource-based approach requires insights into, among other things, what the firm provides that is *valuable* in the eyes of customers. In the next section we explain a practical tool that helps develop insights into customer-defined value.

1.3.1.2 Understanding Customer Value

A starting point in trying to understand the firm's resources of strategic assets is to figure out how it currently wins business. This can only be done by really trying to understand how customers make purchase decisions. We could make educated guesses here, but there is a strong chance that we could misunderstand our customers' behaviour. We may, as a group, share a set of assumptions about customers and their needs, which may not actually reflect their true perceptions. For example, Figure 1.3 was constructed by a group of senior executives from a major European tyre manufacturer. The tool they used is a *perceived use value* chart. They were trying to understand their position in relation to competitors. To do this they tried to model the views of a target customer, in this case a 40-year-old Italian professional man, who was evaluating alternative suppliers for replacement tyres for his BMW 5 Series.

The critical feature of this chart is the list of assumptions they made about the dimensions of value that are important to this customer, listed across the horizontal axis of Figure 1.3. In discussion with these executives it became clear that the list and weightings of these dimensions really reflected the *managers'* views rather than those of the customer. The danger here is clear. We as managers may appreciate product features that are not valued in the same way by customers. This is a particular problem in industries where executives have a strong 'technical' background. They are excited and impressed by the technical features of their products, and they assume that the customer values these features in the same way. When the firm conducted some market research this revealed that many customers assumed most branded tyres were equivalent in their performance, and many relied on dealer advice in making their choices. This research also revealed that there were important differences across national cultures in the awareness of and interest in tyre performance.

The point here is that, in the absence of market information, these executives would probably identify their technical competence in tyre development as a *strategic* asset, one that is critical to them winning business. In reality, their technical capability is matched or exceeded by their major competitors, and the real strategic assets of the firm are its brand name, and a loyal dealer network, supported by efficient distribution systems. The tyre development capability would be an *entry* asset in this case, not a strategic asset.

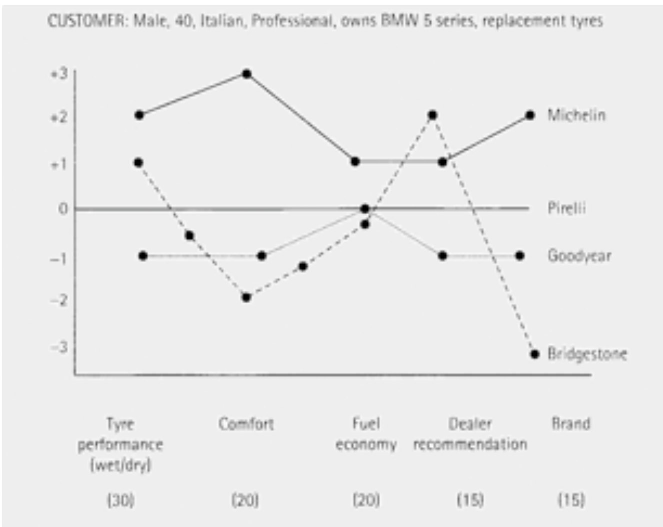

Fig. 1.3 Dimensions of PUV: Tyres

The only way to get reliable information on customers' perceptions is to engage in a dialogue with them. This can be done through focus groups, professionally conducted, that move beneath the obvious and tap into the underlying perceptions and motivations of customers. Alternatively, it is possible to glean valuable information through routine interactions. Where the organization has regular contacts with customers, these can be used unobtrusively to build up a picture of their perceptions of your performance and their views of competitors. This is especially appropriate in business-to-business selling. Note that the contact points for this intelligence may be at quite 'low' levels of the organization. This suggests some implications for how the process of formulating a competitive strategy should be managed. For example, the process may well need to involve staff involved in operations, sales, and service activities, because the required information may be at these levels, not with the senior executives.

1.3.1.3 Constructing a Cause Map

When an order-winning dimension of value is uncovered, it is useful to analyse *how* this dimension was produced. Using, for example, a recently secured sales contract as a 'critical incident', it should be possible to map out the causes of this success in a *cause map*. As explained above, to do this properly it is necessary to really understand the criteria that were important to the customer in their purchase decision. Sometimes decisions are taken on criteria that may not appear to be 'objective' or 'rational'. Furthermore, customers may not be willing, or readily able, to explain their decisions. However, some attempt must be made to establish what the firm's order-winning attributes were, and then these can be used to start the mapping process (see Figure 1.4). By carrying out the process for most major products and customer types a picture should emerge of the firm's strategic assets.

Initially, the cause map should be constructed for a particular product/customer combination. For example, Ambient Media, who sell advertising space inside grocery stores in the United Kingdom like Tesco and Sainsbury, recently secured an important contract with Nestle, beating off tough competition from three other, very credible, short-listed firms. The senior managers learned from the customer that the critical difference between their offer and those from competitors was that they had secured exclusive licence agreements with the major store groups. The team then tried to understand what had given them this advantage. Part of their cause map is included in Figure 1.4. As a 'cause' is uncovered, the questioning process then required the team to explain what caused this to happen. By digging deep inside the processes of the firm, they realized that the culture of the sales team was critical. It also surfaced how critical one member of the group was (TW).

So the cause map tries to trace back inside the organization to uncover the processes that deliver advantage. Often these maps reveal how critical particular individuals or groups are to winning business. In many markets the products on offer are perceived by the customer as equivalent, and business can be won or lost on the basis of quite subtle differences in the product *surround*.

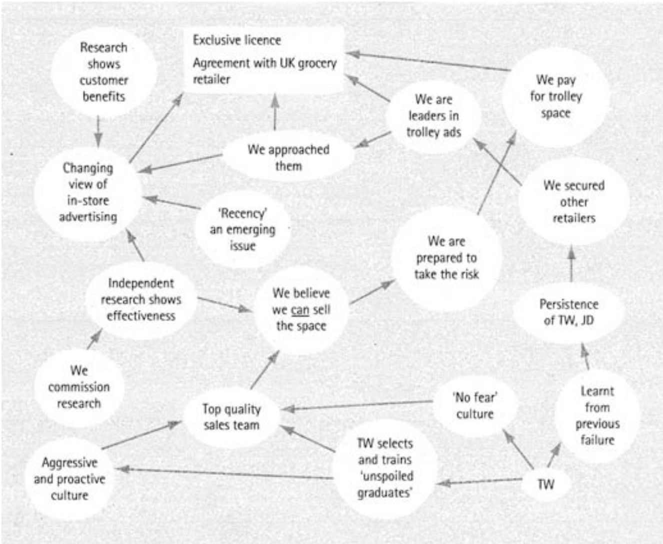

Fig. 1.4 Cause Map

From the customer's perspective, these order-winning attributes could be**,** for example: 'we established a good rapport with your lead consultant', or 'your sales people took the trouble to listen to us', or 'vou have a track record for delivering these difficult assignments'. Therefore, it is likely that through the cause mapping process strategic assets will be uncovered that fall into the *cultural*, *knowledge* and *relational* asset categories of Figure 1.2. In some cases the cause mapping process will reveal few surprises, and in others they will merely confirm the intuitive understandings of experienced executives. However, in certain situations, some important insights can emerge, which challenge received wisdom in the firm. These can take the form of:

• a challenge to implicit assumptions about why the firm wins business
• an awareness of sources of advantage that were not well understood by senior management
• an appreciation that some sources of advantage are very complex, and are not easily managed.

This is clearly a very 'fine-grained' analysis, which, on the face of it, would appear to be unnecessarily detailed, and not at all 'strategic'. The point here, though, is the need to establish a solid understanding of what gives the firm current advantage. This must be done in a way that works back from actual successes, reflecting as far as possible, customer's perceptions of relative value. Otherwise, there is a danger of the management team either making inappropriate assumptions about the nature of the firm's advantage, or, they base their thinking on broad generalizations, e.g. 'our reputation for quality'.

1.4 IDENTIFYING THE REQUIRED ASSET

As explained above, strategic assets are 'involved in securing and delivering profitable business for the firm. In Part II we explore competitive strategy and the assets required to pursue different strategies. The starting point for understanding competitive strategy, is the customer's definition of value for money, and their perceptions of the products competing for their cash. These can be explored using the Customer Matrix, which is constructed from the perspective of an individual customer.

To win a customer's business the firm must offer a package perceived to be superior to alternative offerings, to offer more 'value for money'. Value for money is a subjective judgement the customers make when they assess the use values on offer in the products or services, the prices charged, which they then compare with alternative providers. The 'value for money' ' judgement they make is the difference between what they would be *prepared* to pay for the product, less the price charged. This is what an economist calls *consumer surplus*, so another way of describing ‘value for money' is consumer surplus. We make a sale when we offer more consumer surplus than a competitor. Superior consumer surplus can come about in two ways:

- the use values or utility of our product is superior to competitors
- the use values we offer are equivalent to competing offers but the price we charge is lower.

Of course, we could also offer both of these benefits at the same time. We can use the Customer Matrix (Figure 1.5) to explore the implications of pursuing alternative competitive strategies. This device can also be used as an analytical tool, which builds on the perceived use value chart in Figure 1.3.

1.4.1 The Customer Matrix

The Customer Matrix is derived from the perceptions that customers have of the products/services being offered to them and the prices that they are being charged. The vertical axis of Figure 1.5 'Perceived Use Value' (or PUV) refers to the value perceived by the buyer in purchasing and using the product or the service; the horizontal axis is Perceived Price. Perceived Use Value and Perceived Price represent the two components of 'value for money'; the Customer Matrix separates these out to assist us in analysing competitive strategy. Perceived Price refers to the elements of price that the customer is concerned with. For example, in purchasing a heating system for a house the customer may be not only concerned with the initial cost of the installation, e.g. the price of the boiler, radiators, and installation, but he or she may also be interested in the running costs of the system over the years, like fuel costs, maintenance, etc.

A Customer Matrix can only be derived from the perceptions of a single individual. We would all have slightly different perceptions of the same collection of, say family cars. What we would be looking for in terms of perceived use value, or utility, from the purchase of a car would be different from one customer to the next.

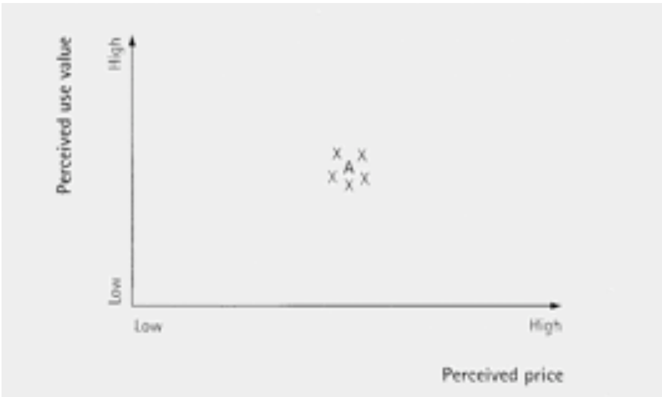

Fig. 1.5 Customer Matrix

What elements of price we pay attention to would also vary. For example, one customer might regard insurance and running costs as a vital cost element, whereas another customer would be more concerned with initial purchase price, and the likely rate of depreciation over two years of ownership. How we individually assess alternative products will also vary. This means that, in trying to understand customer behaviour we must be prepared to recognize that there may be important differences between potential customers.

In order to develop an argument about competitive strategy, we will show the positions of products from the perspective of a representative customer in a segment. In Figure 1.5 the 'Xs' represent the positions of products in the matrix. As far as this customer is concerned all the firms are offering more or less equivalent products, and are charging very similar prices. This situation can be found in many industries, not just those that are supplying obvious 'commodity' products like gasoline or car insurance.

If Firm A is facing the situation depicted in Figure 1.5, what are the options available for improving its competitive position? The firm could cut price by moving westward in the matrix, or it could raise the perceived use value of the products or services it offers (moving northwards), or indeed do both at the same time, a move north-west. These basic strategy options will now be explored.

1.4.2 Cutting Price

Here the firm moves *west* in the customer matrix, offering the same perceived use value as the competition, but at a lower price (see Figure 1.6). Such a move should lead to Firm A gaining share. This move may not only increase sales for Firm A; it may expand the market as a whole, if new consumers are attracted by the lower prices. However, other firms are likely to respond to the move by cutting prices to match Firm A to preserve their share of the market, or they may even undercut Firm A. Other things being equal, the net result of the competitors moving west with Firm A is to reduce average price and profitability in the industry

Competitors can, then, imitate Firm A's price-cutting strategy very rapidly, overnight if necessary. How then can Firm A hope to gain an enduring advantage from competing on price? In order to achieve a sustainable advantage, Firm A must be able to continually drive down prices and be able to sustain lower prices for a longer period than its competitors. This can only be achieved if Firm A has either the lowest costs in the industry or if the firm is able to sustain losses for extended periods, through subsidies from another part of the corporation, or from a government. If a firm is not the lowest cost producer, then the competitor that *is* lowest cost can always cut prices further, or sustain low prices for longer than Firm A. So, if a firm chooses to compete on price it needs to have lower costs than its competitors. This involves exploiting all sources of cost reduction that do not affect perceived use value, e.g. economies of scale, learning from experience, 'right first time 'quality, just-in-time manufacturing. Thus, the strategic assets that are required to pursue this strategy are likely to be:

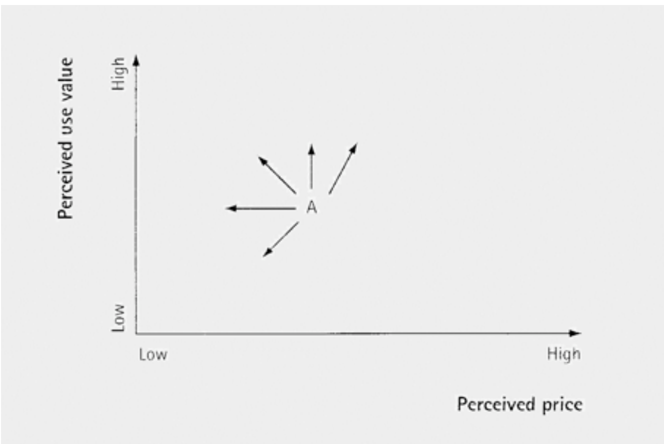

Fig. 1.6 Moves in the Customer Matrix

- ***Tangible assets:*** efficient scale production facilities; access to low-cost labour.
- ***System assets:*** quality assurance, cost monitoring and control, efficient procedures, low-cost support services.
- ***Cultural assets:*** an emphasis on lean production, efficiency highly valued.
- ***Relational assets:*** power over suppliers.

If a firm is able to achieve the lowest cost position, it could choose to drive out competitors by sustaining very low prices. If, in the course of pursuing this strategy the firm is able to establish strategic assets that prevent other firms from competing effectively, it could then opt to raise prices, and hence profits, confident of its ability to see off any potential entrants. But, if not, a subsequent rise in price would lead to re-entry by previously defeated competitors and perhaps by other new entrants.

1.4.3 Adding Perceived Use Value

The second basic strategy indicated in the Customer Matrix is the move *north*: gaining advantage through adding more perceived use value for the same price as the competitors' offerings. The starting point for this strategy must be the target customer, and the target customer's perceptions of value. In order to effect this move north, rather than it resulting from luck, or trial and error, we must be clear who our target customers are. We must then have a thorough understanding of the target customer's needs, and how that customer evaluates different product offerings.

The customer uses various criteria to evaluate the extent to which a particular product can deliver a particular dimension of PUV. For example, how is 'performance' in a car evaluated? For some customers acceleration is critical, which may be assessed by inspecting the 0-60 mph statistics; for others it is top speed that counts. More interestingly, how is 'build quality' assessed? The customer may make inferences about build quality by interpreting the sound the car door makes when it is closed. Build quality might also be assessed by inspecting the alignment of body panels, or the paint finish. These may actually be very poor indicators or poor proxy measures of build quality. However, as customer perceptions are paramount, it is essential that the firm understand what criteria the customer does use in making these evaluations, even if the customer is 'wrong'.

By systematically exploring customer needs and perceptions through market research and by continually listening to customers, firms can discover what is valued in their products and services and what could be added to them to improve perceived use value.

In Figure 1.7 a car manufacturer's product is the benchmark against which the three closest rival cars are compared. The

customer is our Italian BMW owner. It appears that the firm's car (product V) is seen to be inferior to the competition on the really important dimensions but it performs well on the less

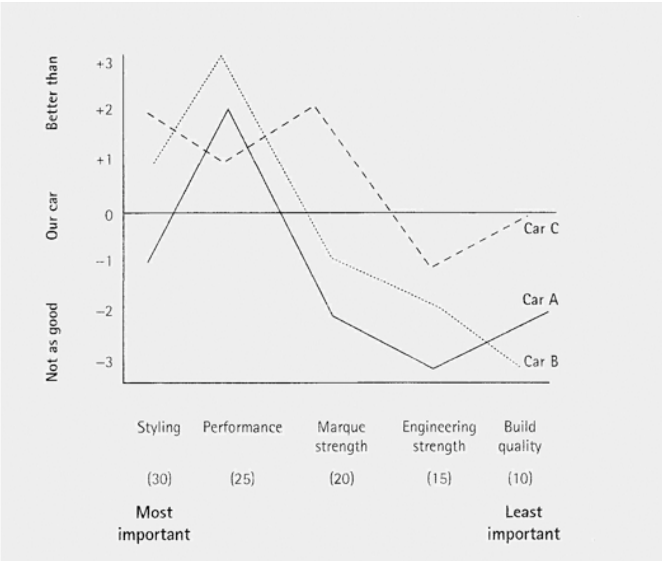

Fig. 1.7 Dimensions of Perceived Use Value: Car

valued dimensions. If this firm is to move north in the customer matrix, then it either has to significantly shift the consumers' perceptions of its car's performance and styling, through changing the product, or through changing perceptions through better advertising. A more ambitious strategy might be to try to shift consumers' perceptions of the dimensions of use value. For example, it may possible to persuade the target customer that reliability is more important than styling. Either way, unless the firm improves its position relative to the competition on these dimensions of perceived use value it will lag behind its competitors. In a below average position in the Customer Matrix, the firm may find itself forced to cut price to try to preserve sales.

1.4.4 What Happens Next?

As with the price-cutting strategy, the key issue facing a firm pursuing a strategy of adding perceived use value is the case with which competitors can match its move north. As a firm moves north by increasing perceived use value ahead of its competitors, it should be rewarded with an increased share of the market. The duration of this enhanced position will depend on how easily the added perceived use value can be imitated. Over time, it is likely that competitors will be able to imitate the move north by either acquiring or developing the required assets, and as they follow the innovator northwards, the *average* level of perceived use value in the market is ratcheted upwards.

Thus, in most industries the minimum acceptable standards of PUV are being continuously shifted upwards as competitive moves become imitated: 'order winning' features become 'order qualifying' features. For instance, anti-lock brakes and air bags are features of cars that were once order winning, that are now required just to be in the game. So the assets that now deliver these features are entry assets, not strategic assets. Thus, the issue of sustainability of competitive advantage needs to be considered against this backdrop of continual northward shifts in the competitive arena. What can the innovator do once the competition has caught up? There are two basic options: keep moving north by staying one jump ahead of the competition through innovation, or move west through a cut in price.

But we argued earlier that, in order to compete on *price* the firm needs to be the lowest cost producer in the market. So, can you move north by adding perceived use value, and simultaneously achieve the lowest cost position? If the move north increases market share, and if these share increases are translated into lower unit costs, through developing scale and experience assets, then there is no reason why the move north could not result in a low relative cost position. Strategic assets like 'right-first-time' quality systems can deliver higher PUV and simultaneously lower costs.

Furthermore, if *you really* understand what it is that customers perceive as value in your products or services, you can confidently strip out everything that does not feed through to perceived use value. There is no point in offering a range of costly options, if this is not really what customers want. Of course, if you are not confident about what customers' needs are and how they evaluate alternative products then, to play safe, the tendency is to leave everything in the product, because you are not sure which parts of the total package are the valued features.

Thus, the strategic assets that are likely to be critical to a strategy of adding perceived use value are likely to be:

• ***Tangible assets:*** customer information.
• **Systems assets:** quality assurance, operating systems, service delivery systems, to enable valued products to be delivered at low cost.
• ***Cultural assets:*** innovation and creativity, and a genuine customer orientation.
• ***Knowledge assets:*** special expertise or know-how.
• ***Relational assets:*** loyalty, reputation, strong brand.

1.4.5 Other Competitive Moves

If the firm offers higher perceived use value, but demands a price premium for this added value, then this moves the firm's product position to the *north*-east in the matrix

(Figure 1.6). The success of this strategy depends upon the existence of a group of buyers who are prepared to pay higher prices for the added perceived use value. It also depends upon the case with which the added perceived use value can be imitated. If it can readily be imitated by competitors, then the price premium maybe rapidly competed away. One other point to note with this move to the north-east is that it may well be shifting the firm's product into a new segment, where customers have different dimensions of use value, and where then, may perceive your firm to be competing with different competitors. Moving into this unfamiliar ground can prove to be risky.

The move east in Figure 1.6 has the firm increasing price without adding perceived use value. This move can succeed in increasing profitability only if competitors follow suit. If the move is not followed by competitors, then market share will fall.

Moving *south-west* by cutting price and perceived use value, is a diagonal move, which may well shift the firm into a new market segment. For example, if a car manufacturer located in the middle ground of the car industry (e.g. Ford) took this route, it would be moving to a down market position. Whereas Ford's competitors might have been Toyota, Nissan, General Motors, and Daimler-Chrysler, they would now find themselves being compared by potential customers with Hyundai, Daewoo, and Proton. This may be a viable shift as long as the relative cost position of Ford enabled them to operate profitably against these low-price competitors.

The only direction that is guaranteed to deliver an increased share is a move *north-west*, adding value and cutting price. The firm must be the lowest cost producer, and it must be able to move faster than the competitors to sustain its relative position. Typically, however, a competitive firm will move north initially by adding value, then when competitors imitate the added value the firm shifts west by cutting price. The share advantage gained through moving north may well enable the firm to become the low-cost producer through the achievement of scale and experience economics, making the price-cutting strategy feasible. So the north-west position is reached by moving north, then west.

Movements in the Customer Matrix are determined by changes in customer perceptions of price and perceived use value. Shifts of particular products in the matrix can occur even when the producing firm does nothing. If a competitor is able to move its product north by adding PUV, then this has the effect of pushing other competitors' products *south* in the eyes of the customer. Products can be repositioned through changes in customer tastes and preferences, which can alter the dimensions of PUV seen to be important by the customer. This may result in products well endowed with the preferred dimensions of PUV moving further north.

1.5 IMPROVING COMPETITIVE POSITION

The Customer Matrix analysis should reveal dimensions of PUV the firm may need to improve. Currently the firm is combining its strategic assets with the common entry assets to deliver a package of value to customers. In relation to the Customer Matrix, strategic assets either help the firm to differentiate itself from competitors by adding PUV or they help to deliver equivalent PUV to competitors, but at lower cost. Clearly the same asset could provide *both* advantages, e.g. a strong brand or operating systems that deliver 'right first time' quality.

To attract more customers, and to retain current customers will require these assets to be augmented in some way. In Figure 1.8 three categories of assets are depicted which need to combine to deliver future advantage in this particular market. The three classes of asset are *entry*, *strategic*, and *required assets*. What assets specifically need to be

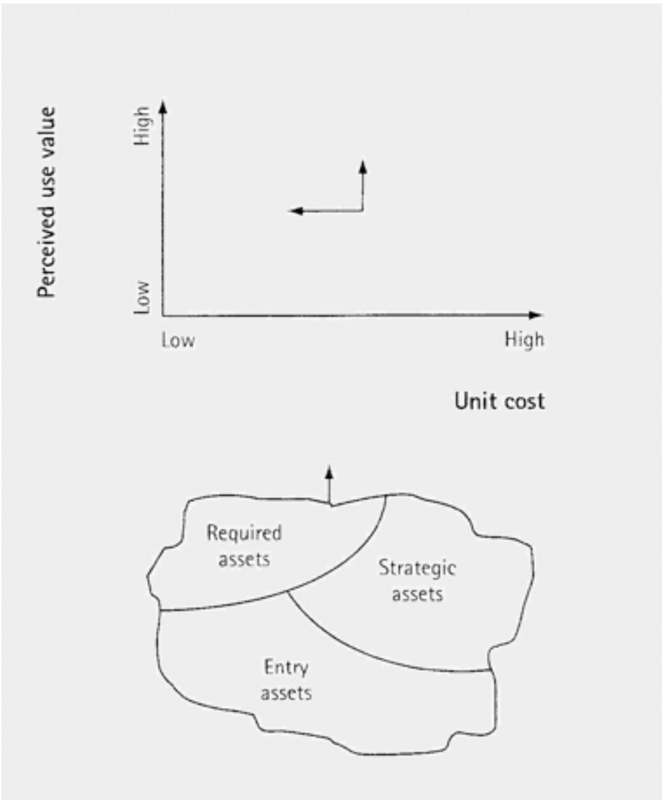

Fig. 1.8 Required Assets

developed could be gleaned from a further cause mapping process. By identifying dimensions of value where the firm

lags behind competitors, a cause map can be constructed which combines actions and resources to close the perceived gap.

Where the firm is in a strong competitive position attention must be focused on the *future* of this market. Markets are in a continual state of flux: customers' needs change, competitors improve their positions, and new firms can enter the market. Managers need to form a view about the likely nature and direction of change in each of its major markets. This involves some form of forecasting, a notoriously treacherous exercise even in relatively stable markets. But nevertheless some views of the future need to be formed that are convincing to the managers involved. Outside agencies can help here. Scenario building can be used as well as more conventional PEST analysis. The critical point here is that the future view of the market must be credible otherwise it will not cause the managers of the firm to change what they do.

Recently, a good deal of attention has been focused on discontinuous or catastrophic changes in markets. The advent of e-commerce might be an example, except of course, that this is now with us, and firms must find ways of adapting to this new environment and exploiting it. If discontinuities are forecast which require 'transformational changes' to the firm, it may well be the case that the firm is unable to effect these changes. Moreover, by diverting resources in an attempt to achieve radical changes, the firm may find itself suffering difficulties in its current operations. Few organizations are able to completely transform themselves. This type of radical change would probably require the development of new entry assets and new strategic assets, whilst simultaneously funding these developments from the existing asset base. Rather like the answer to the traveller's question 'how do I get to Limerick?' the answer may well, rightly, be 'well, I wouldn't start from here if I were you!'

1.5.1 Identifying Required Assets: An Example

A global engineering group (we shall call it EngCorp) recently conducted an analysis of its markets and the assets it required to compete in the future. The executives realized that they had few strategic assets. Although they had large R & D departments, excellent manufacturing facilities, and a broad range of up-to-date products, so did their two main global competitors. So these were *entry* assets. Through the cause mapping process, based on analysis of recently won contracts, they identified three strategic assets:

• a reputation for never walking away from a customer's problem
• excellent 'fire-fighting' or trouble-shooting skills
• a strong safety culture that pervaded the whole organization
• the workforce were proud to work for EngCorp
• good relationships with governments.

However, they believe that much of their basic engineering and manufacturing work will be undercut by lower cost producers in developing countries particularly, India, and South-East Asia. Their conclusion is that the engines they make will become a commodity, and they need to transform themselves from being manufacturers to being system integrators, providing complete solutions to their customers rather than just good engines. To achieve this new assets will need to be developed. Specifically, they need:

•a common platform for all their engines
•common systems across the four divisions
•a culture of collaboration to share know-how across the divisions
•excellent quality assurance processes, particularly with suppliers as basic engineering and manufacturing is outsourced
•programme management capability.

The first three assets can be developed, if there is the political will to do this. They have excellent QA systems in-house, but because they have traditionally manufactured over 80 per cent of the components in an engine, they do not have great experience of establishing strong QA systems with their suppliers. Programme management is an essential skill if they are to be credible providers of integrated systems to their customers. A recent acquisition contains some of this capability, but this know-how relates to the construction industry. We shall now explore how a firm, like EngCorp, can augment its asset base.

1.6 AUGMENTING THE ASSET BASE

Adding to the firm's stock of assets raises issues of corporate-level strategy. For example, the resource base may be augmented by acquiring another firm, or it may be developed by processes that transfer expertise from one part of the organization to another. These activities are usually conducted by the headquarters or corporate centre. Within the resource-based theory, asset development processes have been described as dynamic capabilities. The technical note which follows summarizes the argument.

1.6.1 Technical Note 2: Dynamic Capabilities

This note explains recent developments in resource-based theory that address the processes of resource creation. The term *dynamic capabilities has* been coined by the Teece, Pisano, and Shuen (1997) to describe organizational processes that are designed to enable firms to adapt to rapidly changing competitive environments. These

processes could be viewed as operating at both business unit level and corporate level. The essential differences between a corporate structure and a single firm is that the corporation comprises more than one line of business, and that there is usually a distinction made between business level (or SBU) activity and activity performed at the centre or headquarters.

If corporate-level activity is to be valuable, it must in some way impact positively on SBU resources. Teece et al. (1997) explain that dynamic capabilities have three roles: coordination/integration, learning, and reconfiguration (Teece, Pisano and Shuen 1997: 518). These capabilities have been built rather than bought in the market, and they therefore tend to be embedded in the organization. These capabilities are path-dependent *routines*.

Following on from the original Teece et al. paper, Eisenhardt and Martin (2000) argue that the value of dynamic capabilities for competitive advantage lies in their ability to alter the resource base: create, integrate, recombine, and release resources. They suggest examples of such capabilities: product development routines, strategic decision-making, routines for copying, transferring, and recombining resources, resource allocation routines, connecting webs of collaborations to generate new and synergistic resource combinations among businesses, matching or realigning businesses to changing markets, knowledge creation routines, and alliance and acquisition routines.

RBT explains the resource stock of the firm at a point in time. If the firm's environment shifts, the value of its resource stock will change; it may increase or decrease. Dynamic capabilities are an organizational response to the problem of environmental change, whereby the resource stock is refreshed in line with the environment. But these change processes themselves are stable routines, embedded in the organization. This is a key feature of the dynamic capabilities argument. So we can distinguish between *resources that* are stable (the standard RBT argument), and *resource development* processes that are stable (dynamic capabilities).

From the discussion of RBT and dynamic capabilities, we can distinguish between the stock of resources at a point in time and processes that add to this resource stock. Dynamic capabilities either create new resources or leverage existing assets, which in essence means that a 'new' resource is introduced into another SBU context. We can therefore surmise that the centre can either be involved in creating resources through *leveraging* existing resources or by *creating* new ones. Or, putting it more starkly, for the centre to be valuable it must either *be* a resource or *create* resources in SBUs.

If the centre's role is that of a resource, or a collection of resources, the problem of resource management at the centre is the same as it would be at SBU level: how to ensure that these resources remain valuable. Thus, the stock of resources is maintained, maybe by incremental improvement projects that ensure the resources remain relevant to the changing market environments. The more challenging role of the centre is the creation of new resources. This would be where the centre displays dynamic capabilities. We now focus on these asset creation possibilities, using the examples of capabilities offered by Tecce, Pisano, and Shuen, and Eisenhardt and Martin. We group this exploration under the headings of:

• consolidation
• leveraging existing assets
• developing new assets
• acquiring new assets.

We shall now consider the first of these, consolidation. We refer to *sub-units* below. These may be strategic business units, divisions, or product lines that form part of the larger organization.

1.6.2 Consolidation

Some assets are either presently underutilized in their existing deployment, or they can be extended at relatively low cost to other product markets. For example, the firm may have a production facility that is currently operating at 50 per cent of its potential capacity. By extending the market reach of the products produced, this capacity can be absorbed, thereby lowering unit production costs. Or there may be a pool of expertise in, say, procurement that is not fully extended. By acquiring a similar firm and consolidating the two procurement activities, this expertise can be fully deployed. Similarly, information about customers can be readily leveraged to other business opportunities.

Underutilized entry assets can be made into strategic assets through consolidation or growth. For example, various support activities (human resources, legal, public relations) which are necessary requirements to operate in the market may be underutilized in most competing firms because of indivisibilities. Through consolidation by acquisition, the acquiring firm can develop a *strategic* asset that confers a cost advantage over competitors. Some mergers achieve this consolidation, which can thus transform some support activities from entry assets into strategic assets. However, this is unlikely to be a source of *sustained* advantage as all it would take to nullify this gain is the consolidation through merger of two rival corporations.

Some resources can be shared across sub-units. One major source of cost advantage that can accrue here is economies of scale. Here the activity is a core process, not a support

activity, and it is conducted centrally to benefit from economics of scale. These activities could be involved in any part of the core processes that would otherwise be performed at sub-unit level. For example, this could be manufacturing, distribution, back-office, call centre, or sales and service.

Clearly, though, there are strong conditions of relatedness attached to this strategy, and there must be few diseconomies of coordination involved for this to be worthwhile. Moreover, the tension between the cost advantages of centralization and the typically more subtle benefits of tailoring the activity to the context of a particular sub-unit are a fertile ground for disagreement between sub-unit management and the centre. Sub-unit activity can be neglected here if the strategic significance of consolidated core activity dominates management attention. Sub-unit staff may find themselves baffling to maintain or extend differences across sub-units in the face of pressures to standardize.

But the basis of this strategy of asset consolidation is that these centralized activities are *generic across the sub-units involved*. So although they may be performed differently in another firm, within this grouping of units, they are performed in the same way. The advantage is one of cost savings deriving from scale, consolidation to increase capacity utilization, and achieving 'critical mass'.

Firms pursuing consolidation of support activities need not require a great deal of relatedness across the sub-units. However, there are dangers if the definition of support activities is overextended into tasks that require a stronger element of tailoring to a particular sub-unit context. For example, if we centralize all human resource activities in the interests of efficiency, we may reduce the effectiveness of a particular sub-unit that previously benefited from its own particular approach to training and induction.

The consolidation strategy is played out when there are no further consolidation advantages accruing. This happens when the capacity is fully utilized. As this constraint emerges there may be an effort from the apex to eliminate some support activities from the hierarchy through outsourcing. This can, usually, be readily achieved, as these activities tend to be generic (so writing contracts is easier), can be readily sourced from outside, and by their nature, these activities are loosely coupled to the organization.

1.6.3 Leveraging Existing Assets

Systems assets can be extended by training, or through the introduction of procedures and protocols into new business areas. Performed know-how, e.g. the skill of an experienced project manager, can only be extended if it can be codified and trained into others. However, if it is difficult to extend it because the know-how is tacit, then this form of know-how is a finite resource, which if transferred from one application to another would be lost to the former application. Two conditions need to be met if the firm is considering leveraging its assets:

- whether the asset confers an advantage in its new deployment
- whether the asset can be leveraged at low cost.

An existing asset should be extended if it can confer an advantage in another product market domain. Preferably the asset should be *strategic* in this new domain, but it is possible that the asset acts merely as an entry requirement. If this is the case, other strategic assets must be developed and deployed alongside this entry asset. In determining whether the asset can confer advantage, it is necessary to have a sophisticated understanding of the market being entered. This requires an insight into customers' perceptions of product value, current competitive offerings in the market, and a view of how the firm expects to position its product against these incumbent firms. These questions can be answered through a structured analysis of the market, using the Customer Matrix.

The second criterion, extension at low cost can be achieved where:

- the asset can be extended without damaging its effectiveness in existing deployments
- the asset is currently underutilized, as in the case of consolidation above
- the know-how involved is in the form of a system which can be readily applied in the new domain
- the asset does not have any physical constraints, e.g. a brand, information, a relationship.

We shall now explore in more detail the issues involved in leveraging the different categories of strategic assets set out in Figure 1.2.

1.6.3.1 Extending Operating Systems

This leverage strategy is based on the application of knowledge across a range of sub-units. This knowledge exists in a form that can be trained in or accessed across the units. Thus, the knowledge must exist in the form of explicit, codified systems. This strategy captures the advantage of accumulated learning and experience in the form of proprietary systems.

The knowledge has to be *applied in the context of the sub-unit;* it cannot be executed centrally. The source of advantage derives from the ability to apply this knowledge across a number of different sub-unit contexts. So, for

example, the firm may have particular skills in quality assurance: these can be trained into sub-unit quality staff who can then apply the processes within their own units. Or there may be accumulated expertise in new product development processes, which sub-units can benefit from, or the centre may have excellent management control systems that all units could implement.

This is procedural knowledge, systems and operating protocols that have to be adopted within the sub-units. Clearly, these procedures may be imposed onto sub-unit contexts where they may not confer advantage. The pressures to conform are often resisted at sub-unit level and cases for exception may 'fall on deaf cars' at the apex. These procedural requirements may be enthusiastically adopted at sub-unit level, or they may be treated as an irritant, preventing the unit from really focusing on the critical tasks. This tension can persist, and the sub-units may be able to resist the requirements to adopt standard procedures, partly because of the firm's short term dependence on these line activities.

This asset leverage strategy suffers from few inherent constraints. Codified knowledge can be leveraged almost without limit. The constraints are likely to stem from the process of implementation. The wider the spread of sub-units, the greater the likelihood of processes being imposed in an inappropriate context.

1.6.3.2 Extending Financial Control Systems

Probably the simplest source of firm-level advantage is the establishment of a rigorous financial control regime. For this to be a strategic asset, this regime must deliver superior financial performance to rival firms. The top management group exerts control over sub-groups through the setting of tough financial targets, monitoring performance, and rewarding or penalizing sub-unit management. Here top management is concerned with ends not means. They need have no detailed knowledge of the product lines within the firm, and they act as demanding majority shareholders. The sub-units within the structure need not be related in any operational sense, they are only similar in that they report through to the same top management team. The relationship between the top and the sub-units is likely to be remote, and there is little interchange across the sub-units.

The imposition of cost discipline gives the advantage of reducing inefficiency that can occur in large corporate structures buffered from the rigours of the market. But more typically, the benefit accruing here is an amelioration of agency problems caused by managers pursuing their own interests, rather than those of the shareholder. Setting tough performance targets and the imposition of appropriate rewards and punishments can help to align the interests of the sub-unit managers with those of the shareholder. This comparative advantage will persist as long as competing firms tolerate lax regimes. In resource-based theory terms, the tough control regime encourages or provokes the creation of resources in the business units.

The dangers here are an emphasis on cost-cutting and an overemphasis on the short term, which discourages the development of new products and capabilities. Moreover, this strategy can tend to encourage a game playing with budgets, where, for instance, sub-unit managers will 'hold back' potential performance improvements to give them some leeway in the following year. *In extremes,* this strategy can actually destroy some other strategic assets. If the senior management are unaware of the particular routines and behaviours, which confer sub-unit advantage, the crude imposition of cost-cutting targets can result in the elimination of or severe disturbance to these subtle, and often informal routines.

1.6.3.3 Extending Cultural Assets

The values, norms, or culture of the firm can be a strategic asset that can not only endure, because it is difficult to imitate, but it can be an asset that can be leveraged. These values can be inculcated across many sub-units, and can perform as strategic assets within different product market contexts. Where all competing firms have access to the same technologies, produce similar products, and develop new products at the same pace in the same ways, then competitive advantage is likely to derive from assets like culture that are very difficult to imitate. Culture is likely to be difficult to describe, explain, and pin down in a way that can be copied by rival firms. The advantage may be a 'can do' attitude that pervades the sub-units, or it could be shared beliefs about excellence and quality of service. It could be an immensely strong performance orientation, hitting quantifiable targets and getting rewarded. It could also be an informal social network, or wide set of external contacts. The corporate culture is likely to flow from the top: the leadership set the tone and values not so much through artefacts like 'missions statements' and value statements, but by their behaviour.

This strategy has constraints not on scope but on its longevity. It may have emerged from the leadership behaviour of a particular executive, and, if the processes of inculcating and preserving the culture are not understood, this strategic asset will be vulnerable once this charismatic leader departs.

1.6.3.4 Leveraging Know-How

Here the strategic asset does not reside in a generic activity that is performed at the centre, nor does it derive from generic procedures that can be applied across a range of sub-unit contexts. Here advantage derives from the *performance* of the activity in different sub-unit contexts. The basis of the asset is not codified knowledge, but *know-how*, which has to be *performed* to derive its benefit. This can be achieved either by moving the performers around the sub-units, or by centralizing the activity. Because this is performed know-how, it is a very constrained resource that cannot be stored. Moreover, if the know-how is being performed in one sub-unit, then the other units are simultaneously deprived of this scarce resource.

This performed know-how could take many forms. It could be a gifted sales team, a brilliant negotiator, a creative brand development unit, a highly experienced project manager, or a 'trouble-shooter'. If the sub-units are able to benefit from this expertise, they have to be related in terms of *their* source competitive advantage.

1.6.3.5 Extending Strategic Insight

Entrepreneurial insight can be a highly valuable asset. This might take the form of direct intervention into the strategic development of the sub-unit, e.g. 'do it this way' or it may be performed in a more reactive style, e.g. 'yes, that looks like a good idea, do it'. This advantage can, however, only accrue where someone at the centre has a deep understanding of the sub-units, their markets, and their strategic assets. This is genuine strategic leadership, which is likely to flourish where sub-unit managers have great respect for the expertise of the executive(s) at the centre.

1.6.4 Developing New Assets

So far we have considered ways in which existing assets can be leveraged or extended to provide advantages in other product markets. Often this extension will require the acquisition or development of complementary *entry assets*. Depending on the scarcity and complexity of these assets, the firm will find it more or less difficult to acquire them. In some industries these assets are easily acquired. For example, if one wished to enter the used car business, acquiring a vacant plot of land may be quite straightforward. However, the know-how to buy well at car auctions may be a scarce asset that could be expensive to develop in-house. Poaching an experienced buyer from a rival firm may be the answer here.

The most challenging assets to develop are, unsurprisingly, strategic assets: these are firm specific, often complex, and may involve *tacit routines,* i.e. routines that have not been explicitly set up, they have evolved. This would suggest that it would be difficult to set out an explicit action plan to develop these scarce and valuable firm resources. What is more likely is that they will emerge from a process of experimentation which may be funded and guided from the centre, but may just as likely emerge from ideas and initiatives undertaken spontaneously at many levels of the structure. For this haphazard and ad hoc development process to be stimulated requires the leadership to develop a culture which encourages this behaviour. This would involve introducing many of the precepts of the 'learning organization', empowering individuals and teams, supporting pilot tests of new ideas, and expecting failures to occur. In contrast to this type of organization, the scarce resource in many firms would seem to be the drive to challenge and change the status quo. Thus, we should encourage the pockets of energy, emotion, and conviction to try things, to experiment, to pilot test concepts and ideas.

1.6.4.1 Experiments and Pilot Tests

Most organizations are not well designed to deliver innovations and change. They are designed to operate routines efficiently. Most innovations do not emerge from these structures. At an industry level often the real innovations stem from individuals or organizations that are, in some sense 'outside' the industry, certainly in their thinking. These individuals or organizations are not constrained by the predominant mindset or recipe in the industry. They are able to think outside the bounds of what is conceived as possible by industry insiders.

For an insider, the range of possibilities for the organization is a restricted set. Even when 'radical' solutions are proposed they are most likely to be marginal adjustments around a whole host of assumptions about the way things must be done in the industry, the taken-for-granted recipe. Moreover, in many cases the senior management may not clearly understand the elements of the organizational mix that really matter. Changing things is especially risky if you are not sure what makes the organization work in the first place.

So change is seen as a risky activity. If we can reduce the perceived risks of change, then it is more likely to occur. Pilot testing, experimenting with new ideas helps build belief and confidence in the new concepts, structures, processes, or products, in a low risk way. The information that flows from these experiments gives the senior managers confidence to make resourcing, decisions. Seeing is believing: pilot tests build commitment and conviction.

So in the case of the development of new strategic assets, the change process begins with *action*. These actions have the nature of experiments. They are tentative explorations of possible futures for the organization. When these experiments produce tangible evidence that things could be done differently, a vision emerges incrementally. The potential of the organization to enhance its performance becomes believable, which encourages dissatisfaction within current

levels of performance, increasing the momentum for change. From the perspective of a national economy, thousands of small businesses are started every year. Within two or three years only a percentage of these start-ups will be thriving. The rigours of the competitive environment will weed out the marginal projects and ill-conceived schemes, permitting only the fittest to survive. The message for the corporation should be clear. You need to generate a sufficient number of experiments. You must expect many of them to fail and you must shape the emerging organization around the fittest survivors.

So the role of the centre becomes that of a promoter of experiments, and an arbiter of which partially developed schemes should be encouraged. The experiments will inevitably be driven off of the current concerns and strategic assets of the organization. It is unlikely that this process of experimentation, evaluation, and further resource commitment will generate quantum leaps in the organization. This will be incremental change, but it will be evolutionary, adaptive change, rather than the catastrophic crisis-driven lurches experienced by many organizations.

1.6.4.2 Acquiring Assets

Assets can be acquired simply by spending money in the marketplace. Equipment, locations, brands can all be purchased. Expertise can be hired, and star performers can be lured from rival firms. Some assets cannot be readily separated from the organization they currently operate in. Therefore, to acquire the asset the whole firm must be purchased. An alternative would be to form an alliance with another organization so the required assets can be brought together. Issues surrounding acquisitions and alliances are dealt with in far more depth in other papers, but here are some observations that stem from their role in asset augmentation.

Typically the easiest assets to acquire are physical resources. Moreover, we would expect entry assets to be more readily available than strategic assets. If a firm requires a particular collection of entry assets to enter a particular market, these may well be acquired relatively cheaply, and readily. For example, when Virgin entered the cola market, it managed to secure bottling plants and expertise to manage these fairly easily.

We would expect competitive bidding for *strategic* assets, which may well result in their value never being realized: the acquiring firm simply bid too much. Guile helps here. If the acquiring firm spots an undervalued asset, it may well be able to pick it up cheaply, or it may be a 'fire-sale' bargain.

Cultural and knowledge assets can be acquired by acquiring an organization. The difficulties can often lie here in the processes required to integrate these intangible assets into the corporation. Often, subtle differences between the two organizations are revealed post-merger which were not apparent prior to the deal being struck, despite the best efforts of accountants and consultants.

Alliances are a way of acquiring assets without owning them. They can be viewed as a pooling arrangement of complementary assets. This may enable an *entry* asset in one firm to operate as a strategic *asset* in the alliance.

Finally, the cost of acquiring an asset may be higher if the sellers of the asset realize its value to the acquirer, and are able to bargain up the price. For example, now that soccer players can be free agents at the end of their contracts, they are able to capture a higher proportion of the value they create through salaries and golden handshakes.

1.6.4.3 Augmenting Assets: An Example

Ambient Media, our in-store advertising firm, assess their strategic assets as follows:

- long-term contracts with all major UK retailers
- special insights into the media buying process
- proactive, aggressive sales team
- trust-based relationships with media buyers
- willingness to take the financial risk off of the stores.

At present their attention is focused on getting the most return they can from these assets. However, they have recently explored the in-store advertising markets in Japan, Germany, and United States. They see a substantial opportunity in these relatively underdeveloped markets, but to exploit this rapidly requires a significant enhancement of their assets. Specifically, they need to have a credible presence in these markets as a basis for building trust with stores groups and advertisers. They have concluded that the most timely way to build the required presence is through the acquisition of existing media and poster firms in each country. The first acquisition has taken place, and now the Ambient team are selecting and training the new sales team to operate in Germany. This team is led by the most experienced sales-person from the United Kingdom. So through a combination of acquisition, and leveraging existing know-how Ambient intend to spread their unique concept into other markets.

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1.7 SUMMARY AND CONCLUSION

In this paper the process of strategy formulation has been considered from a particular perspective which conceives of the firm as a bundle of assets. The formulation process begins with the identification of the firm's current set of strategic assets. This is achieved through an analysis of value from the customer's perspective, and the internal processes and resources that deliver value. The three tools explained in the chapter that can assist here are the Dimensions of Perceived Use Value chart (Figure 1.3), the Customer Matrix (Figure 1.6), and the Cause Map (Figure 1.4).

Strategic assets fall into one of five broad categories: tangible, system, cultural, knowledge and relational assets. When a strategic asset is imitated by competitors, it is converted into an *entry* asset. Physical assets are usually more easy to copy than intangible assets like culture and know-how.

Looking to the near future, the strategy process needs to then identify the asset stocks required to compete in the firm's chosen market arenas. Thus, a third category of asset enters the analysis: *required* assets. The final stage of the process addresses how the existing stock of assets can be augmented. Four basic approaches can be adopted here: consolidation, asset leverage, asset development, and acquisition. Thus, a strategy for a firm would contain a statement of:

- the firm's strategic assets
- the markets the firm intends to operate in
- the assets required to compete in those markets
- how those assets are to be developed or acquired.

Armed with this clear view of the future direction of the firm, managers should be able to make tactical and operational decisions with a good deal of confidence.

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