Chapter 6
Strategy and implementation

Business objectives and strategy

Strategy is the way a business operates in order to achieve its aims and objectives.

There are two sides to strategy - the first is formulation and the second is implementation.

The formulation of strategy is basically the same thing as constructing a business plan. Implementation is putting the plan into practice.

A plan should not be rigid; it should be sufficiently flexible to allow for changing circumstances. It should include a feedback loop to regularly check if the plan is working and adapting it as and when necessary.

Businesses should attempt to create objectives which are achievable in its existing business environment (in line with the SMART model). A business that sets an objective of increasing market share from 10% to 30% in 12 months is probably being unrealistic but an increase to 15% may be more achievable, depending on the circumstances. So business strategy should always be set in relation to the environment the business operates within but also related to internal factors such as financial resources, brand strength, skills of management, employees and so on.

The setting and achievement of objectives within a large business is a hierarchical process, which starts at the top with the setting of a corporate strategy and is put into action by business functions that design strategies to fulfil objectives:

Corporate strategy

Corporate level strategy is concerned with the strategic decisions a business makes that affect the entire business. At the corporate level, strategy is concerned with setting objectives for overall financial performance, proposed mergers or acquisitions, long term human resource planning and the allocation of resources to different business divisions.

Strategic direction

Strategic direction is a course of action that ultimately leads to the achievement of the stated goals of the corporate strategy. Once the corporate strategy is established then the strategic planning that follows is used to establish the strategic direction i.e. sets out in broad terms how the objectives will be achieved. The strategic plan created will normally contain a clear mission statement but beyond this describes the businesses' objectives, which divisions or functions need to be focussed on to achieve these objectives, and makes clear methods of measuring achievement of objectives.

The corporate plan

A corporate plan is a statement of organisational goals to be achieved in the medium to long term. It will be based on management assessments of market opportunities, the economic situation and the resources and technologies available to the business. It will make clear measurable objectives and formulate strategies for achieving these objectives. The corporate plan will include methods for monitoring the achievement of objectives and the tactical decisions made to achieve these objectives.

Divisional strategy

The next level of business strategy is concerned with directing the divisions (often functional or geographical in structure) within the organisation. The overall corporate strategy will be communicated to the divisional managers. This information shapes the plans the divisional managers create. For example, if the corporate strategy focuses on rapid growth in demand for the company's products or services, the strategies the divisional managers generate would be tailored to meet this demand. In this scenario the sales division strategy may include growth in sales teams, the production strategy including increased need for inputs and production capacity.

Tactical decisions

Tactical decisions are medium term decisions made by middle managers. They follow on from strategic decisions and aim to meet the objectives stated in any strategic plan. For example, increase output may be a strategic decision but how to do this, perhaps through recruitment or alternatively through outsourcing increased production, is a tactical decision. A corporate objective may be to grow market share and in order to do this a business may have to widen distribution channels or improve web presence. Again these decisions are tactical in nature. Tactical decisions are also adaptable - the tactical approach can change to adjust to changing market conditions even though the corporate objectives have not changed.

Functional strategy

Functional strategy relates to a single functional operation such as: production, marketing or HRM and the activities involved within each of these functions. The decisions made at this level of strategy are guided and limited by the higher level corporate and divisional strategies and will support these strategies. For example the business's marketing strategy, which will be a functional strategy, will be guided by objectives established at corporate level and made clear at divisional level. It is the responsibility of the functional managers to develop the systems and applications that allow the achievement of corporate and divisional strategies.

SWOT analysis

In working out its strategy for the future it is helpful for a business to carry out a SWOT analysis. A SWOT analysis is used to identify and analyse the internal **Strengths** and **Weaknesses** of an organisation, as well as the external **Opportunities** and **Threats** created by the business and economic environment.

A SWOT is presented as a simple 2 by 2 table, showing the strengths, weaknesses, opportunities and threats relevant to a business. SWOTs are often used when developing corporate objectives, or on a smaller functional scale such as a marketing strategy. This analysis looks at both the things that the business can control, its strengths and weaknesses and the factors that are beyond its control, the opportunities and threats that it faces.

Strengths	Opportunities
Weaknesses	**Threats**

Why use a SWOT?

The objective of using a SWOT is the development of a strategic plan that considers many different internal and external factors and **maximises** the potential of the strengths and opportunities whilst **minimising** the impact of the weaknesses and threats.

The idea of a SWOT is then to gain an overall picture of all potential influences on future business success and to adapt business strategy to reflect these influences. SWOTs are often prepared as part of the process of developing a strategic plan, or planning a solution to a problem. Often carrying out an analysis using the SWOT framework will be enough to reveal changes, which can be useful to the future success of the business.

In general a business will want to know in what areas it is better than its competitors and in what areas it lags behind.

There are four distinct stages to preparing and using a SWOT analysis:

Stage 1

Internal analysis

Examining the capabilities of the business, or part of the business. This can be done by analysing the business's strengths and weaknesses.

Stage 2

External analysis

Gathering data on markets, competitor activities, economic outlook and the environmental impact of the business. Identifying those points that pose opportunities for the business and those that pose threats or obstacles to performance. Deciding whether the answers or the data collected reveal external opportunities or threats.

Stage 3

Prepare SWOT table

Entering the information collected in steps one and two into a SWOT table.

Stage 4

Using the SWOT to develop a business strategic plan or functional strategy.

The four components of SWOT are:

Strengths:

These are positive features of a business identified from Stage 1, the internal analysis. A strength is only a strength when a business is good at something and also takes advantage of this strength. Examples of strengths may be having an USP, a strong band, state of the art equipment, motivated workforce, strong financial indicators, etc. When examining strengths a business will ask the questions 'What are our advantages over our competition? What do we do well compared to other businesses in the industry?

Weaknesses:

These are negative features of a business identified from Stage 1, the internal analysis. A weakness occurs when a business performs poorly in an important area of operations or when it fails to take advantage of an existing strength i.e. an unsuccessful application of an asset or the failure to exploit a critical factor that diminishes company competitiveness. Weaknesses could also include the opposite of the strengths listed above such as a demotivated workforce, poor customer loyalty and a poor financial position. When examining weaknesses a business will ask the questions 'What could be improved?', 'What is done badly?' and 'What should be avoided?'

Opportunities:

These are prospects identified in the external analysis carried out in Stage 2. An opportunity is an external condition that could positively impact on the business's performance and improve competitive advantage provided positive action is taken in time. When examining opportunities a business will ask the questions 'What are the interesting market trends?', 'Is our competition suffering?', 'Are new market niches appearing?', 'Are there opportunities for take-overs?', 'Has legislation recently changed?' and 'Is the economic climate improving?'

Threats:

These are dangers identified in the external analysis carried out in Stage 2. A threat is an external condition that could have a negative impact on the business's performance and reduces competitive advantage. When examining threats, a business will ask the questions 'What obstacles does the business face?', 'What is the competition doing?', 'Is there a new business entering the market?', 'Is changing technology threatening the business's position?' and 'Is the economic climate getting worse?'

Stage 3 would be summarising this information in a table, such as the one shown below. This then can be used to initiate a discussion when developing a corporate or functional strategy (Stage 4).

Strengths	Opportunities
Effective distribution networks Strong brand identity High staff motivation Being seen as a price leader Good industrial relations High levels of productivity	Changes in technology and competitive structure of markets Changes in government policy related to the business's field Changes in social patterns, population profiles, life style changes, fashion etc.
Weaknesses	**Threats**
Limited product range Poor investment record in technology High levels of staff turnover Failing to achieve industry benchmarks Bad debt or cash-flow problems	Economic recession Changing consumer incomes or tastes New product launches by competitors Environmental legislation New or increased taxes New technologies being used by competitors

Using the SWOT

Once the SWOT has been completed, the information can be used to help develop a strategy that uses the strengths and opportunities to reduce the weaknesses and threats and to achieve the objectives of the business.

An effective SWOT will allow a business to:

- Build on strengths
- Resolve weaknesses
- Exploit opportunities
- Avoid threats

SWOT analysis for starbucks

Adapted from MarketingTeacher. com

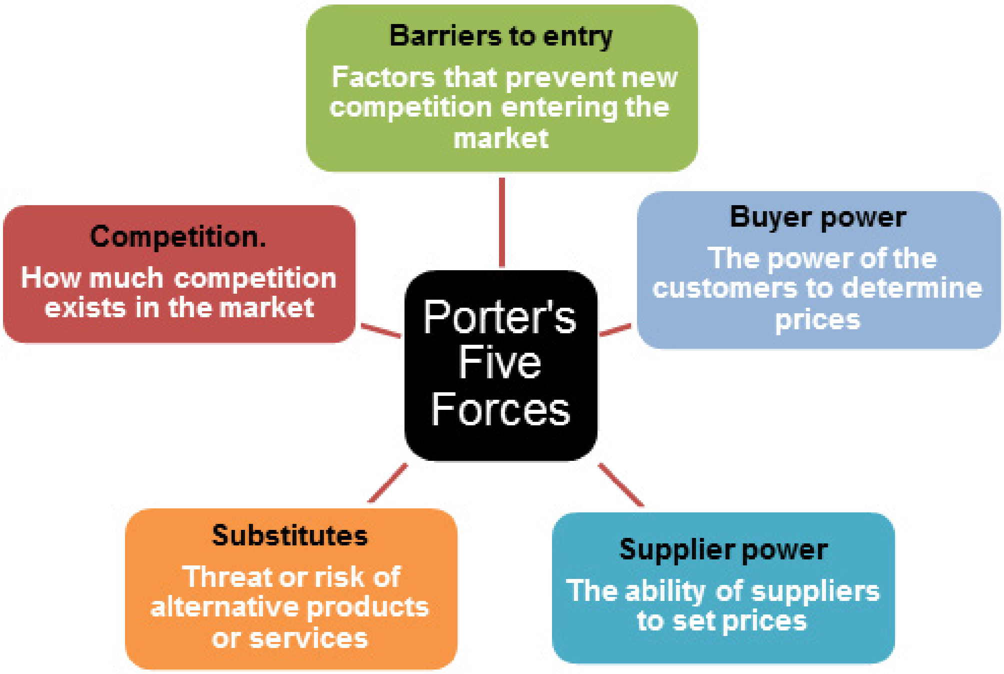
Strengths	Weaknesses
Starbucks Corporation is a very profitable organisation, earning in excess of $2billion in 2012.The company generated revenue of more than $10billion in the same year. It is a global coffee brand built upon a reputation for fine products and services. It has almost 11 000 cafés in more than 40 countries. Starbucks is consistently ranked as one of the Fortune Top 100 Companies to Work for. The company is a respected employer that values its workforce. The organisation has strong ethical values.	Starbucks has a reputation for new product development and creativity. However, they remain vulnerable to the possibility that their innovation may falter over time. The organisation has a strong presence in the United States of America with more than three quarters of their cafés located in the home market. It is often argued that they need to look for a portfolio of countries in order to spread business risk. The organisation is dependent on a main competitive advantage, the retail of coffee. This could make them slow to diversify into other sectors should the need arise.
Opportunities	**Threats**
Starbucks is very good at taking advantage of opportunities. In 2004 the company created a CD-burning service in their Santa Monica (California USA) café with Hewlett Packard, where customers create their own music CD. New products and services can be retailed in their cafés, such as Fair Trade products. The company has the opportunity to expand its global operations. New markets for coffee such as India and the Pacific Rim nations are beginning to emerge. Co-branding with other manufacturers of food and drink, and brand franchising to manufacturers of other goods and services both have potential.	Who knows if the market for coffee drinking will continue to grow and stay in favour with customers or whether another type of beverage or leisure activity will replace coffee in the future? Starbucks is exposed to rises in the cost of coffee and dairy products. Since its conception in Pike Place Market, Seattle in 1971, the success of Starbucks has led to the market entry of many competitors and copycat brands that pose potential threats. The effects of any future recession on coffee consumption are not yet known.

Porter’s Five Forces

It has often been assumed that businesses have to operate in a certain way in particular market structures, such as monopoly, oligopoly and perfect competition. However, Dr Michael Porter, a professor at Harvard Business School, believes that large businesses can, under certain circumstances, exert an influence on the markets in which they operate. In other words they can be active rather than passive participants.

Dr Porter proposed a model of the business environment that stated industries and businesses were being influenced by 5 external forces. Porter suggested the idea that the interaction and influence of these 5 forces will determine the behaviour of businesses’ and the likely levels of profitability for a business within a particular industry.

Business owners and managers can use this model of Porters Five Forces to better understand the industry in which the business operates and to properly consider the external influences on the business’s behaviour. Understanding of how Porter’s Five Forces affect any business will demonstrate to owners and managers that there are limits on what can be achieved and therefore how to set realistic objectives. Once they have this understanding managers will be able to devise appropriate strategies, designed to maximise profitability.



Barriers to entry

These are factors that prevent new competition entering the market. If barriers to entry are high, then monopoly profits can occur. However, when they are low then normal profits can be earned. If new businesses can enter the market easily then the existing businesses will have a challenge to keep their profits high. New businesses will be attracted to the market if profits are high but if barriers of entry exist, or existing businesses attempt to create barriers to entry, then this can reduce or stop new businesses entering the market.

Examples of barriers to entry include:

- Cost advantages of existing businesses (gained through economics of scale or effective relationships with suppliers)
- Access to factors of production e.g. raw materials, skilled staff and components
- High capital/ investment requirements
- Strong brand identity of existing business's products and high levels of advertising
- Access to distribution networks
- Predictable behaviour of existing businesses e.g. retaliation through short term pricing strategies
- Access to technologies used in the industry.

Supplier power

If suppliers have high levels of power they are able to push up prices for raw materials and components, so lowering profit margins for the business (the supplier's buyer). On the other hand, with lower levels of supplier power, the situation is reversed. The buyer may be able to force prices paid for components and raw materials down, which results in higher profit margins for the business. A large company such as Tesco, with its massive buying power, is able to exert power over its suppliers. It will pay its suppliers less money for their products, which is only to be expected, since bulk purchasing is an economy of scale. As a result, Tesco will reduce its costs and increase its profits. Businesses may attempt to reduce the power of suppliers to improve their position. Examples of factors that determine supplier power include:

- The number of alternative suppliers – competition amongst suppliers
- Importance of volume of orders to supplier
- If inputs make up a large proportion of costs
- If inputs (raw materials or components) help create differentiation of products made
- The costs of switching to a new supplier
- Availability of alternative (substitute) inputs
- If backward vertical integration exists.

Buyer power

Buyer power concerns the ability of the customers within an industry to affect/ determine the price they pay. The higher the buyer power, the lower the potential for the business to set the price themselves. If buyer power is low, then the business is able to set the price high and therefore achieve more profit. Examples of factors that determine buyer power include:

- The amount of bargaining leverage the buyer has. For example, does the customer buy a large proportion of the business' products/ services?
- Whether the customer buys in bulk. The larger the order the greater the level of negotiated discount
- Whether the buyer has information on costs/ availability of alternative suppliers
- Product USP and exclusivity
- Brand identity and loyalty of the product bought. If the product is branded, the buyer has less control over price paid, they may even be told the price that they can sell the product at

- Price sensitivity of the product. How changes in price affect demand levels (PED)
- If forward vertical integration exists.

Degree of competition in the market

The level of competition in a market can in theory vary between a pure monopoly to perfect competition. As a general rule we can say the lower the level of competition, the higher the profit margins (and vice versa). The extent of the rivalry between competing businesses within a market will determine the prices set for products and the profit that is made. Examples of factors that determine the number of competitors in a market include:

- The level of collusion in the market i.e. do the businesses act together to control price and share out the market between them?
- Maturity of the market i.e. is the market stable with established brands and market leaders, or is the market immature, with new entrants being able to join?
- Industry concentration i.e. is the market a monopoly or an oligopoly with a few businesses dominating the market, or even more like perfect competition with many businesses each having small market shares?
- Product differentiation in the market i.e. is the market full of virtually identical products (cereals), or are the products identifiably different (car market)?
- Strength of brands in the market (levels of brand loyalty). Are customers easily tempted to switch brands?
- The existence of patents and licenses to operate in the market. Patents can give companies monopolies of production for specific products, and licences offered by governments or regulators will limit the numbers of competitors
- If horizontal integration exists.

Threat or risk of substitute products or services

This concerns the availability of alternative products that customers could switch to. The more substitute products available the weaker the position of the business, and vice versa. For example in the telecommunications market, for a long period there was no risk of substitute products to fixed line phones and for terrestrial TV – but now we have mobile phones, smart phones, tablets, satellite and cable TV. Examples of factors that determine the likelihood of availability of substitute products include:

- Rate of change of technology – the faster the rate of change of technology, the more quickly substitutes are likely to occur
- Availability of capital for investment – are potential producers of substitutes likely to be able to raise the capital required for research and development and production
- Switching costs for customers – cost of changing to substitute
- Level of substitution effect – how close is the substitute, how easily does it replace the original product or service
- Price-performance trade-off of substitutes – how effective are the substitutes in cost and performance e.g. at the moment electric cars do not offer an effective substitute for petrol engine cars so few people consider them as effective substitutes
- The existence of patents and licenses to operate in the market.

Discussion themes
Explain how a business' mission statement should relate to its aims.
Describe the relationship between a business's objectives and its strategy.
Why should a business have a corporate plan?
SWOT analysis: https://www.mindtools.com/pages/article/newTMC_05.htm
Explain how carrying out a SWOT will help a business.
Porter's Five Forces: https://www.mindtools.com/pages/article/newTMC_08.htm
Supplier power: http://www.bbc.co.uk/news/business-35408064
For each of Porter's Five Forces identify and explain how a business may improve its position in the market.
Select two businesses operating in two different markets. Apply both a SWOT analysis and Porter's Five Forces to each business. Compare and contrast your findings.

Chapter 7
Strategy and implementation – business growth

The Ansoff matrix

The Ansoff matrix considers a business's product portfolio from a different point of view to the models such as the product life cycle analysis and the Boston matrix. Instead of focusing on profitability or sales, the Ansoff matrix outlines the options open to businesses if they wish to grow, with a view to increase profitability and revenue. These options indicate how to manage the development of the product range by looking at options according to 'products' and 'markets'. The matrix can help businesses determine their strategy.

The Ansoff matrix is a strategic tool used by businesses to achieve growth.

The Ansoff matrix considers whether the marketing strategy is targeted at existing customers or new customers and if existing products should be used or as an alternative, new product should be developed. The matrix below shows that a business wishing to grow has four options (strategies). A business can use any number of these options depending on its products and product range.

	Existing products	New products
Existing markets	Market penetration	Product development
New markets	Market development	Diversification

Market penetration
- Concentrating on sales of existing products to existing markets

Market development
- Finding and developing new markets for existing products

Product development
- Developing new products for existing markets

Diversification
- Developing new products and new markets

Market penetration – existing products for existing markets

This growth strategy focuses on existing products for existing markets. This involves the business aiming to increase sales within its present market. To be successful at market penetration a business must be aware of what has made the product a success in the first place.

There are several market penetration strategies open to businesses, including:

- Attracting customers who have not yet become regular users, but are occasional users by increasing brand loyalty. This can be a successful strategy where there is fast market growth and new consumers are just 'testing the water'.

- Attacking competitors' sales. This will often happen in mature markets, where increased sales for a business will have to be captured from competitors. The strategy in this case will be an adjustment of the marketing mix, altering one or more of the elements such as price or promotion techniques. Tesco has been successful in this type of strategy over the last 10 years, taking customers from all its supermarket rivals. Internet service providers are continually trying to win customers from competitors through pricing strategies and promotional activities.

- Increasing consumption amongst existing users perhaps by reducing the price or offering promotions. This can work very well with services, consumption goods and consumer durables. For example, Sky offers packages or bundles to get existing customers to increase their monthly subscription and food producers offer convenience packs, lunch size, maxi size etc. In consumer durable markets, the introduction of new and rapidly changing technologies can encourage further purchases. This is now clearly seen in the mobile phone market, where a model only remains on the market for as little as six months.

Market development – develop markets for existing products

If the business takes the option of market development, the objective will be to find new markets for the businesses' existing products. There are two broad market development strategies. These are:

- Identifying users in different markets with similar needs to existing customers (the market could be in a different country, but generally concentrates on a new geographical market, such as Europe or North America). This strategy can be risky as different counties have different tastes and needs – the product may have to be adapted. Also new distribution channels may have to be used.

- Identifying new customers who would use a product in a different way. For example using Lucozade as a sports drink rather than something to have next to your bed when you have flu or measles. Repackaging and resizing the product may open up a new market. For example a business selling food to the hotel or restaurant market may start selling to consumers by repacking the product in small quantities. Looking at different distribution channels may also introduce new customers to the product. A good example of this is how high street retailers started selling online and now achieve a high proportion of their sales via the internet.

Product development – new products for existing markets

In the case of product development, the business will attempt to increase profitability and growth by introducing new products targeted at the existing customer base. This involves creation and development of new products that are similar to those that the business already sells to existing customers. An example is with Mars producing ice cream and drinks in addition to their chocolate range. Another example is with Tesco and Marks and Spencer offering financial services as well as places to shop.

Product development strategies require businesses to innovate and look at new ways of extending the product life cycle of their existing products. Some businesses such as Apple, Dyson, Cadbury and Samsung are recognised as innovative companies who are continually developing their products.

Diversification – develop new products for new markets

Developing new products for new markets involves changes to both a business's product and market. Diversification may be attempted if a business sees a new opportunity and has investment funds available. Alternatively, a business may be forced into this type of action because of pressures in existing markets or on existing product ranges, such as sales declining in existing markets or for certain products.

Diversification carries the greatest level of risk (compared with market penetration, which is low risk and the other two options considered as medium risk strategies) because it involves changes in both the market and the product. Virgin's move into train travel has not been as successful as was initially hoped, and the criticisms of the service provided may have some effect on the overall strength of the brand. However, Virgin also diversified into Virgin Money, which has been more successful.

Diversification can also spread risk for a business as it allows a business to reduce its reliance on existing markets and products. If sales are falling for existing products or in existing markets then a successful launch and growth of a new product in a new market can help to maintain the overall performance of the business.

Organic and external growth

The ways in which businesses grow can be broadly categorised as 'organic' or 'external'.

Organic growth

Organic growth, also referred to as internal growth, is the expansion of the business by selling more of its products. In order to grow organically a business will use its existing resources to grow and will not involve any other business. Businesses who follow an organic growth strategy may typically take a longer time to expand the business. Although this strategy is less risky, it can also lead to the business remaining too small to compete with its competitors.

As organic growth is achieved by the selling of more products, the most used method is through the opening up of more factories (for manufacturers) to increase capacity or retail outlets to sell more products. Other organic growth strategies include:

Expanding the product range	Targeting new markets	Expanding the distribution network	Benefiting from economies of scale
Once a product is established, further related products can be introduced. For example Ministry of Sound, which was once just a nightclub, now releases CDs, puts its brand on hi-fi equipment, owns a radio station and sells holidays.	This means selling your products to new market sectors. Mobile phones were once just sold to business people, then the market become all adults, then teenagers were actively targeted.	Make your product available in more places such as the internet, more retail outlets, through agents and distributors.	Economies of scale reduce costs, meaning that prices can be reduced, which should gain new customers.

Success in organic growth is a good indicator of how well management has used its internal resources to expand profits. Organic growth also identifies whether managers have used their skills to improve the business.

External growth

Growth can also be achieved through external methods. This type of growth is sometimes called 'inorganic growth'. External growth is achieved in two ways:

Takeover (Acquisitions)

or

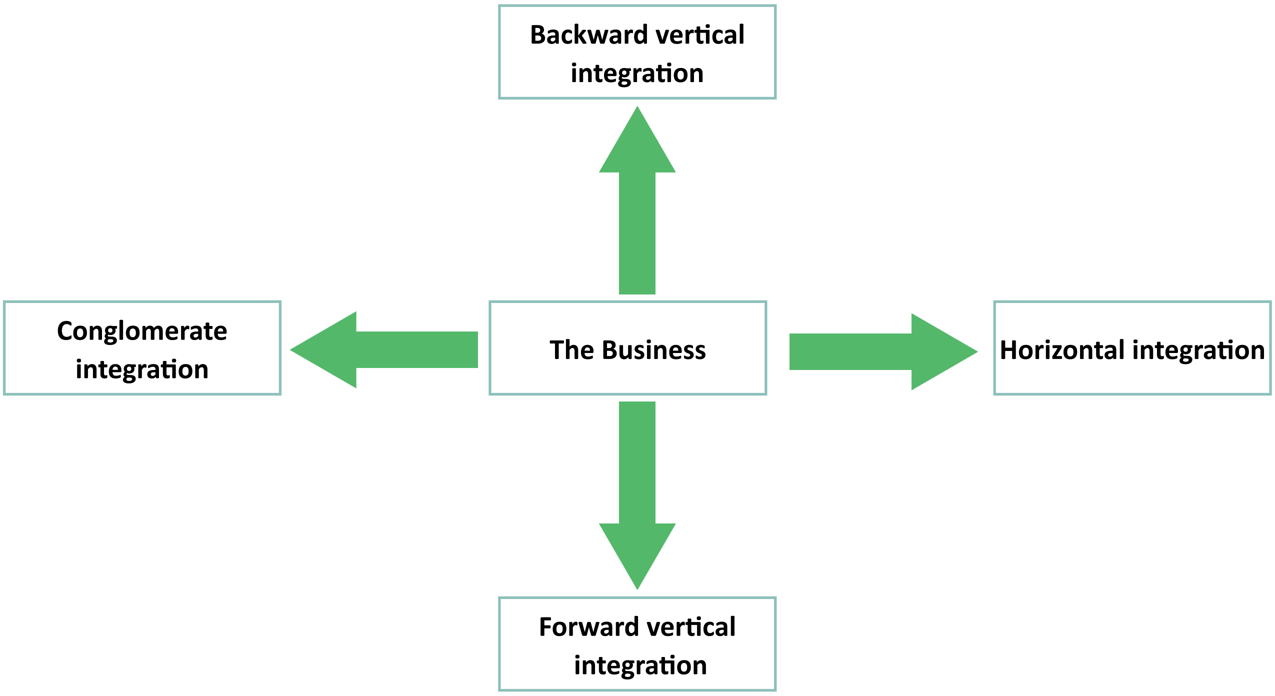
Merger

A takeover is the acquisition of one business by another, either on an agreed or hostile basis. The vulnerability of a company to takeover depends on who controls the majority of shares, which shares have the voting rights, the value of the shares and the performance of the business. A takeover will take place when a business sells more than 50% of its shares. Public limited companies are vulnerable as shares are bought and sold on the stock market. Private limited companies are less open to takeovers, especially hostile takeovers, as shareholders have to invite and agree to the selling of their shares.

A merger is the process by which two companies become one. Usually the businesses are of equal size and will agree on the share ownership of the new business. In recent years the numbers of mergers that have taken place in the global economy have increased.

Types of mergers and takeovers

Growth through mergers or takeovers can be achieved in a number of different ways:



Horizontal integration

This occurs when a business merges with or takes over another in the same industry at the same stage in the production process. Examples include the amalgamation of Daimler-Benz and Chrysler (car industry), the food giants Heinz and Kraft merger and Lloyds Bank taking over TSB Bank. Often the objective is to benefit from economies of scale, and so reduce costs and increase profits. Sometimes the word synergy is used in this type of growth –synergy implies that the 2 merged businesses will be more profitable together than apart. A good example of this synergy was the merger of Guinness and Grand Metropolitan (a hotel chain) to form Diageo. Another benefit for the business is the removal of a competitor so there is a reduction in the competition which can lead to greater market power.

In the UK the Competition and Markets Authority (CMA) investigates mergers and anti-competitive practices in markets that could potentially give rise to a substantial lessening of competition. They have the power to stop mergers or impose restrictions and conditions on the merged business.

Backward vertical integration

This is when a business merges with or takes over another business at the previous stage in the production process within the same industry. In other words this is when a business merges or takes over a supplier. The objective here is to reduce costs or secure supplies. Examples of backward vertical integration include Starbucks buying a coffee farm in China, and Dunlop owning rubber plantations. Another benefit includes having more control over the quality of the product and the supply chain.

Forward vertical integration

This is when a business merges with or takes over another business at the next stage in the production process. In other words this is when a business merges or takes over a customer. Examples include a manufacturer buying a retailer and oil companies buying up service stations. Forward vertical integration allows the business to be closer to the end use or consumers, gives the business greater control in the marketplace and can guarantee outlets for its products. The Booker Group (the leading UK food wholesaler) acquired the convenience stores Londis and Budgens for £40million in 2015.

Conglomerate

This is when a business merges with or takes over another business with no connection to the product or the market. In other words it is when a business merges or takes over another business that is involved in totally unrelated business activities. Conglomerate integration takes place when businesses wish to diversify. For example a parent company may own a number of subsidiary companies that include concrete producers, a chain of hotels and a pharmaceutical company, all under the same overall ownership. Conglomerates can arise by the wish of directors to seek rapid growth or asset-stripping a business and selling of assets, or even the desire just to operate in different markets.

Due to the risky nature of diversification, conglomerate integration is the most likely form of integration to fail; can managers transfer their knowledge and experience of one industry to a completely new industry?

Wider effects of mergers and takeovers

As well as the direct effects on the business, mergers and takeovers can have a more general impact on management and the workforce.

Senior managers in businesses who are potentially the subject of a hostile takeover or a merger may see this as a threat because takeovers generally result in a change of executives and some redundancies. The workforce may also suffer job losses; it is very likely that most job losses will come at operational level and not management level. The joining of two separate workforces as one may also affect morale and result in a workforce that is demotivated.

Reasons for mergers and takeovers

Mergers and takeovers allow businesses to grow rapidly and can remove competition from the market. In most cases, by using mergers and acquisitions, a company can develop a competitive advantage and ultimately increase shareholder value. The main reasons for mergers and takeovers include:

- Access to new markets – especially overseas
- Increased market share leading to increased market power in the market
- Diversification
- Acquiring new products and technology. A takeover is one way of acquiring technology that may be protected by patent, or may be expensive or time consuming to develop internally
- Economies of scale are derived from becoming larger

- Synergy – the idea that 2+2=5. The synergy argument is that by combining two businesses, total profits can be increased by reducing duplicated services such as head office costs, or the two businesses fit together in a way that allows costs to be reduced and profits increased
- Cost Savings – takeovers are often followed by significant numbers of redundancies in the short term. In order to convince shareholders that a takeover is in their interests, managers in the bidding business often promise that cost savings will result from the merger and shedding staff is a principal way in which this is achieved. Currently, this pattern of cost savings through redundancies is most evident in the financial sector where a wave of mergers and takeovers are associated with large-scale job losses
- Underperforming management teams can be removed giving an immediate boost to performance
- Higher returns to shareholders.

UK tech firm swoops on HP software unit in £6.6bn deal

UK tech firm Micro Focus will buy Hewlett-Packard's software business in a deal worth $8.8bn (£6.6bn).

Hewlett Packard Enterprise (HPE) includes the assets of Autonomy, the UK software group that HP bought in an ill-fated deal in 2011.

The deal makes Micro Focus one of the UK's biggest tech companies, with total annual revenues of $4.5bn (£3.4bn).

Micro Focus was promoted to the FTSE 100 last week, replacing ARM after it was bought by Japan's Softbank.

A string of acquisitions has turned Micro Focus, based in Newbury, England, from being a relatively small player to being worth over £5bn, with revenues doubling in 2015.

Shares in Micro Focus soared 18% in morning trading, making it the biggest winner on the FTSE 100.

Kevin Loosemore, Micro Focus executive chairman, said: "Today's announcement marks another significant milestone for Micro Focus."

Micro Focus executive chairman Kevin Loosemore sees a "rare opportunity" in the HP deal.

Mr Loosemore said he approached Hewlett-Packard in February about a deal and was not put off by the market turbulence that followed the Brexit vote in the UK.

HPE has more than 50,000 customers including many of the biggest US companies.

http://www.bbc.co.uk/news/business-37303066

Describe Micro Focus's strategy for growth.

Explain the reasons why Micro Focus has used this strategy to grow the business.

Franchising

Franchising is a growth strategy used by some businesses.

A franchise is the legal right to use the brand name, products and business style of an existing business. McDonald's restaurants, for example, often operate as franchises: a business person has paid McDonald's a fee to open a franchise of McDonald's. The franchisee (the person who has bought the franchise) now has the right to use the business model, brand, business style etc. in a specific area.

The British Franchise Association is an organisation that promotes and supports franchising; the following information is taken from their website:

What is franchising?

Business format franchising is the granting of a license by one person (the franchisor) to another (the franchisee), which entitles the franchisee to own and operate their own business under the brand, systems and proven business model of the franchisor.

The franchisee also receives initial training and ongoing support, comprising all the elements necessary to establish a previously untrained person in the business. The legal contract, or franchise agreement, between the two parties sets out the obligations and rights of both franchisor and franchisee, and determines how long the franchise arrangement will last (including renewal options).

The principle is simple – rather than developing company-owned outlets, some businesses instead expand by granting a franchise to others to sell their product or service. There are clear advantages to both franchisors and franchisees, just some of which are:

- You don't have to come up with a new idea - someone else has had it and tested it too!
- Larger, well-established franchise businesses will often have national advertising campaigns and a solid trading name
- Good franchise businesses will offer comprehensive training programmes in sales and, indeed, all business skills
- Good franchise businesses can also help secure funding for your investment as well as, for example, discounted bulk-purchases for outlets when you are in operation
- If customers are aware that you are running a franchise business, they will understand that you offer the best possible value for money and a consistent quality of service - although you run your 'own show', you are part of a much larger organisation
- You grow the business and, when you are ready to move on, can sell it for a profit

Who is in control?

Each franchise business outlet/unit is owned and operated by the franchisee. However, the franchisor retains control over the way in which products and services are marketed and sold, and controls the quality and standards of the business.

What are the cost implications?

The franchisor will receive an initial fee from the franchisee, payable at the outset, together with ongoing management service fees - usually based on a percentage of annual turnover or mark-ups on supplies. In return, the franchisor has an obligation to support the franchise network, notably with training, product development, marketing and advertising, promotional activities and with a specialist range of management services.

http://www.thebfa.org/about-franchising

Franchising is a method of achieving growth, often in a quick way since the business model is duplicated by selling the rights to other people to run the business rather than the owners having to organically grow the sales. In the UK, the franchise industry is worth £10 billion a year to the economy and now employs over 360 000 people.

The option of growth through franchising is only possible if the business has a successful business, with an efficient business model, a good reputation, a recognisable brand and a good supply chain.

The advantages from the franchisor's (the person selling the franchise) point of view are:

- Fast growth – with lower risk. The franchisee finances the growth. Franchisees have to pay the franchisor for the right to join the franchise
- Economies of scale can happen quickly; the franchisor now is involved in bulk buying for the franchises
- Increased income from franchise fees, this includes upfront payments and on-going royalty payments
- The franchisees who are committed to the success of the business and are likely to be hardworking, helping to give a greater chance of successful growth, not least because they have had to pay for the franchise.

However, there can be problems with using the franchise model of growth. These include:

- Loss of control – franchisees may be harder to manage than appointed managers
- Not all profits return to the franchisor, representing an opportunity cost
- Potential loss of reputation if franchisors act unprofessionally
- Growth may occur too quickly, with the possibility of diseconomies of scale.

Examples of businesses who have used franchising as a growth strategy include Dominos Pizza, Autoglym, Marston's, Thorntons, Cash Converters, Toni&Guy, CeX, Clarks Shoes, Stagecoach and Subway.

Growth and risk

The major objective of growth is to increase profitability, and improve profit margins. This is what businesses desire as they grow. But all types of growth have problems and carry some degree of risk.

Simple organic growth (internal) can mean that managers or owners are forced to spend more time on managing people or paperwork, and less time on what made the business successful in the first place. There will be increased distance between business owners and managers (divorce of ownership and control), other stakeholders will be impacted by increased pollution, traffic or a business may lose its distinct local identity. Money also needs to be raised to pay for growth (unless profits are reinvested). Money can come from banks, shareholders or venture capital companies. All these methods imply some loss of control, possible high borrowing costs and increased risks. Also shareholders may receive less in dividends if profits are used to pay for costs of investment.

Mergers and takeovers can be mistimed, misjudged or too high a price can be paid. The global business environment is very complex and forever changing. External growth will always have an aspect of the unknown, even with thorough research and expert analysis no one can predict the future and how the new larger business will perform. Added to this, the economic climate along with technology, consumer tastes and fashion are forever changing. BMW paid over £500m for Rover group, after several years of massive losses they sold it for £10. In 2005 eBay bought Skype for $2.6billion, in 2009 they sold it for $1.9billion. The risks associated with growth are one reason why many businesses prefer to stay small.

Mergers and takeovers can bring fast growth, and can be especially useful in achieving growth in new product or geographic markets. On the other hand, there have been plenty of examples in recent years where incredible rates of growth have been achieved organically e.g. Google, Facebook, and Apple.

Franchising can also bring about fast growth, but can also result in a loss of control and a danger of losing the business identity that made the business a success in the first place.

Rationalisation

The business environment is not always positive and at times growth is not the correct strategy to follow. In addition, after a sustained period of growth it is likely that inefficiencies will start to appear in even the best managed businesses (these inefficiencies may be in the form of diseconomies of scale). Some part of the business may be less profitable than others, economies of scale can be lost because of problems with location of factories and markets change over time meaning the business may be left with redundant resources as they change their products and services to match market trends. All of these factors can lead to the need for 'rationalisation'.

Rationalisation is the reorganisation of a business in order to increase its efficiency. This reorganisation normally leads to a reduction in business size, a change of policy or an alteration of strategy relating to particular products.

Examples of rationalisation include:

- Closing of branches. Barclays Bank recently closed a number of underperforming rural branches
- Transferring of production. Ford stopped production of the Fiesta in the UK, instead using its Dagenham factory for engine production only
- Trimming of product ranges. Growing businesses can end up producing large ranges of products, but find that many of these have little profitability. Businesses will discontinue less profitable products and ranges and focus on those that maximise sales. Boots the chemist stopped selling pet food and increased sales space for organic products
- Incorporation of IT systems to replace paper systems. The government is currently trying to increase efficiency of the NHS by computerising all its patient records.

Although rationalisation is supposed to achieve increased efficiencies in a business it can result in uncertainty, resistance from staff, loss of jobs and cause insecurity for employees. Rationalisation schemes are often fought against by those likely to lose out from the changes and this reaction can lead to industrial action. Rationalisation schemes must therefore be well planned and thought through. The objectives must be clear, as well as the means of achieving these objectives.

Factors affecting business location/relocation

Location was considered in the AS content (Chapter 8). These AS notes should be referred to in conjunction with the following notes.

The main determinants of choosing a business location or relocation are:

Regional Location

- **Access to markets**

For some businesses it is the availability of, and access to, markets that is the prime consideration that determines the location of the business. This is most obvious when we look at retailers of consumer goods. For most bricks and mortar retailers the business has to be near customers. It used to be true that retailers had to be in the city centre if they wished to access a mass market, but the increased availability of private transport in the 1960s and 1970s led to the growth of out of town shopping centres. More recently this locational relationship between retailer and customer is being broken down by the growth of e-commerce and online purchasing.

Manufacturers of components in many industries (suppliers) need to be located close to the users of their products. This has become increasingly true with the increased use of just-in-time systems, where being 'on the doorstep' is now the expected norm.

Access to markets can be limited because of trade restrictions, or the existence of 'trading blocks', such as the EU. To overcome these restrictions, it is often necessary to set up a manufacturing base within the trading block.

Type and quality of infrastructure also affect access to markets. Infrastructure used to mean roads, rail, and shipping. But a more modern definition includes electronic communication systems, training agencies, financial services as well as the traditional components. For many modern businesses such as those that are e-commerce based or the rapidly growing call centre industry, quality infrastructure has a very different meaning from that understood by road hauliers and steel manufacturers.

Sometimes existing access to markets can change and businesses may be forced to relocate because, for example, of external diseconomies of scale such as congestion and wage rate increases (especially in areas where competition for labour is high).

- **Cost and nature of factors of production**

When businesses use bulky, difficult to handle raw materials, then location close to the source of these raw materials can substantially reduce costs. This is why the world's major paper manufacturers are located close to where the wood is logged and pulped.

As a factor of production, 'labour' can be a deciding factor in determining location. This includes the cost, availability and skills of labour. For example, many of those in the finance services industry can be found in two main areas in the UK: London and Edinburgh. A business with a need for this type of skilled labour might well do better to attract skilled labour if they located in these cities. The cost of labour is also a determining factor. International location has a habit of following low cost labour to wherever it is available. Shipbuilding moved from the Clyde and the Tyne to Japan in the 1950s and then to Korea in the 1970s, and is now moving to Indonesia. Over the last 10 years, call centres have moved to India and manufacturing of clothes and electronics to China.

The cost of labour can be affected by the availability of government grants, giving incentives to move to particular regions of a country and by government taxation policies. Availability of grants can reduce the cost of all factors of production – but most especially labour and land.

The availability of land is also an important factor. Most large investments are based on 'green field' sites. Local government, along with development agencies, often work hard to ensure that planning permission is available to allow large developments to proceed.

- **Social reasons**

Managers might want to live in an environment that suits them and their families. They want leisure facilities, good schools and low crime. This is why it can be difficult to attract businesses to depressed areas. Alternatively, managers can often retain a commitment to their existing work force even when it makes economic and business sense to relocate a business.

- **Historical reasons**

The original reason for choosing a business location might have disappeared, but they still remain in the locality where they were originally established. For example, around the country there are steel and tin plate plants that had their historical origins in the availability of local raw material – raw materials that were exhausted decades ago. But the plants remain.

Regional location of business is then dependent upon the interaction of several traditional factors. However, it is worth noting the changing nature of industry in the UK and the increased reliance upon and the availability of telephone, internet and other communication networks has, in recent years, made location decisions a great deal more flexible.

International location

Large businesses, though still influenced by the same factors that dictate regional location of business, do have the alternative of locating their production facilities virtually anywhere in the world. As long as there is a stable political background and an available work force, most countries will offer the possibility of hosting a production base.

The main influences on international location beyond politics and labour force factors are:

- **Maximising economies of scale**

If businesses are able to have a single plant supplying all their requirements for a type of product or range of components, then their average costs of production can fall. That is why huge factories are built to produce products that are sold in many different countries.

- **Access to international markets**

Access to a trading block such as the EU or NAFTA (North American Free Trade Association) may depend on setting up a production facility within that trading block. Europe has received a massive inflow of investment from US and Far Eastern companies wanting free access to European markets.

- **Tax advantages**

Companies sometimes establish operations where taxation levels are lower than their home base. This can allow transfer costing to take place. Transfer costing is a process by which businesses are able to inflate their profits in countries where taxation levels are relatively low and to decrease their profits where taxation levels are relatively high.

- **Freedom from restrictions**

Businesses can reduce their costs if they locate operations in countries where red tape is less present or employment law is less complete. For example, many merchant ships now use flags of convenience. This means that the ships are registered in counties that impose fewer restrictions on wages, manning levels etc. This switch leads to loss of employment in the country where the ship was originally flagged. When locating in these less regulated countries, businesses may also attempt to reduce costs by ‘cutting corners’. Practices or systems that would have been unacceptable in economically developed countries may be the norm in less developed nations.

- **Footloose businesses**

A footloose business is one that is not tied to any particular location or country and can relocate across national borders in response to changing economic conditions. Many manufacturing industries seem to have this characteristic. Footloose businesses follow cheap capital, low cost labour and tax advantages. Multinationals aware of changing production conditions and costs that occur between different countries often structure production so that flexibility of location is built-in, for example leasing factories for just a few years, negotiating short term tax breaks and getting host countries to pay for necessary improvements in infrastructure etc.

Outsourcing production

Outsourcing occurs when outside suppliers are involved in activities that could be undertaken internally by a business. These suppliers are not directly employed by the business. For example, the outside suppliers or sub-contractors may deal with phone enquiries, computer processing and production of components or even produce finished products.

Outsourcing moves jobs outside the business and may even replace them with employment overseas (sometimes called 'offshoring').

Outsourcing can lead to increased efficiency and lowered costs. The outside businesses who take on the job will often carry out the same work for a lower cost.

Offshoring manufacturing jobs has been going on for decades but it was with the full entry of China into the world trading economy that the opportunities for relocating manufacturing jobs boomed. Over the last 15 years more and more businesses have taken advantage of production in this low cost but efficient market – a picture partly repeated with an increase in investment manufacturing in the newest member states of the EU such as Poland and Romania. Over the last 10 or 15 years there has also been a massive growth in offshoring service jobs. Call centres for the USA, Australia and UK markets are found in India and the Philippines. Low cost communication systems allow jobs involving customer service to be located potentially anywhere on the planet.

Advantages of outsourcing

- Significantly reduced staffing costs
- Well-trained staff provided by the outsourcing company will reduce HRM costs such as recruitment and training
- Existing workload and stress levels reduced, this is very important if a business is operating near or at full capacity
- Less investment risk. Instead of investing in new production facilities, let the outside supplier take the risk of investing
- Capital needs reduced – because there is less investment, there is less need to raise finance
- Lower costs increase profits giving more capital for research and development, so speeding the development of new products.

Disadvantages of outsourcing

- Potential of poor customer service (call centre related), with communication made difficult because of cultural differences
- Existing employees may feel demotivated if they believe their jobs are at risk, especially if previous redundancies resulted from outsourcing. This demotivation can increase staff turnover and reduce productivity
- Quality of production/ product cannot be guaranteed. Quality control systems are now in the hands of producers who may be thousands of miles away. Even if quality is maintained, it may be more difficult to keep up with improvements in quality from competitor companies
- More difficult to implement JIT systems
- Breakdown in communication in the production chain. It is often difficult for functional departments to talk to each other when they are in the same building. Speedy and effective communication becomes much more difficult when the person you need to talk to is on another continent and speaks a different language

- Loss of security of data. There have been cases where customer data has been made available to external organisations from subcontracting businesses. In the worst cases the information has been passed to competitors or even criminal gangs
- Lost tax revenues to the home government when offshoring is used.

Discussion themes
Using the Ansoff matrix explain the four different strategies for growth.
Ansoff matrix: https://www.youtube.com/watch?v=4dKliWrCywM
Use the internet to find a business that has a wide product portfolio. Explain how the Ansoff matrix could be useful to the company.
External growth is always the best strategy to grow. Discuss this statement.
Summarise the different forms of external growth through integration.
Why would the Competition and Markets Authority get involved with mergers and takeovers?
How Uber conquered London: https://www.theguardian.com/technology/2016/apr/27/how-uber-conquered-london
Search the internet news sites to find a recent takeover or merger, summarising the main points and explaining the benefits to the new larger business.
Explain how franchising is used to help a business grow.
Explain what is meant by rationalisation.
The most important factor for location decisions is access to markets. Discuss.
What are the advantages and disadvantages of outsourcing production?
Business growth: http://www.slideshare.net/tutor2u/business-growth-takeovers-and-mergers