Strategic Management

An Introduction to Strategy and Strategy Making

A summary of chapter 1 to 4

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Introduction

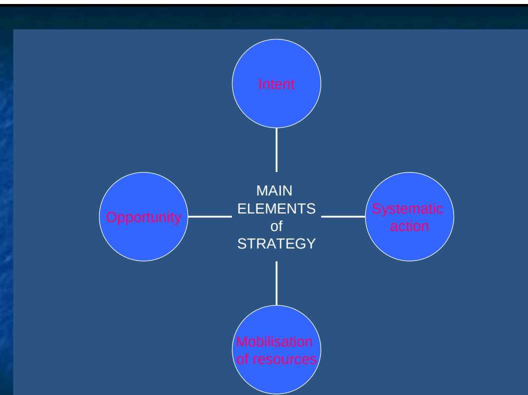
- What is strategy?
- Development of the concept
- Various meanings and schools
- Supporting academic disciplines
- Stakeholder groups
- Constraints

  cognitive, social and political

What is strategy?

- Provisional definition:

  "a coordinated series of actions which involve the deployment of resources to which one has access for the achievement of a given purpose."



Two Types of Strategic Thinking

	First approach	Second approach
Ways of thinking	Creativity - lateral thinking	Reason - vertical thinking
Nature of problem	Divergent	Convergent
Area of relevance	Creating the vision	Realising the vision

Strategic Perspectives

- Strategy is:
  - future-orientated
  - holistic and integrating
  - complex
  - path-dependent
  - interactive
- Aims for balance
- Asks new questions

Who are the strategists?

- According to the definition it might be
  - Everyone in their own ‘domain’
  - Or just the master strategist
- The size of the relevant domain of strategy making differs
- Not the same people as the stakeholders or strategic players, although there may be overlap between these different groups

The need for strategy

- Good performance requires good strategy
- Everyone has an implicit strategy
- It is better to make it explicit
- Good strategy is a necessary but not a sufficient condition for good performance

Development of the Concept

- Military origins
  - Strategy and tactics
- Historical origins: Alfred Chandler
  - Strategy and structure
  - The invisible and visible hand
- Two world wars, depression and communism
  - Planning
- Stages of development

Stages of development of the concept of strategy

- Stage 1: 1945 – mid- to late-1960s
  - Main features:
    - Clear priorities
    - Recovery
    - Technical catch up
    - Rapid economic growth
    - Backlog of pent-up demand
  - Design and planning schools emerge

Stage 2

- Late 1960s to the late 1970s
  - Rapid growth continues
  - Supply begins to catch up
  - But inflationary forces began to emerge
  - Need for prioritisation emerging
- Powerful oversimplifications from consultants: the experience curve and portfolio management

Stage 3

- Mid-1970s to the mid-1980s
  - Instability in the external environment: oil shocks and debt crisis
  - Stagflation
  - Supply outstrips demand
- Michael Porter and positioning indicates a focus on the external environment in strategy making
- The search for a decisive competitive advantage

Stage 4

- The late 1980s to the present
  - Uneven growth - fast growth and serious recessions
  - Communications revolution
  - Deregulation of markets by government
  - Environmental concerns
  - Complex objectives
- Resources Based View of strategy indicates a turn to the internal environment of an enterprise

Various meanings and schools

- Multiple meanings of the term strategy
- Different emphasis on content or processes
- Varying motivations and desired outcomes

Four General Approaches

Outcomes / Processes	Profit Maximisation	Pluralist
Deliberate	CLASSICAL	SYSTEMIC
Emergent	EVOLUTIONARY	PROCESSUAL

Classical

- Deliberate, rational and explicit
- Clear sequence: formulation, then implementation
- Clear motivation: profit maximization
- Handed down from above

= voluntarist view

Evolutionary

- Clear motivation: profit maximization imposed on the enterprise
- Successful strategy selected by forces of competition
- Little or no room for deliberate strategy making
- Strategy little more than adjustment to a changing environment

= determinist view

Processual

- ‘Bounded rationality’ – limited information and limited ability to process information
- Strategy is the result of political bargaining and negotiation
- ‘Satisficing’ rather than maximization
- The significant existence of organizational slack

= realist view

Systemic

- Strategy reflects nature of different societies
  - Cognitive differences – even on what strategy is
  - Behavioural differences
  - Institutional differences
  - Value differences

= social relativist view

Different schools

- Prescriptive v. descriptive

Prescriptive

Strategy as

- design
- planning
- positioning

Descriptive (1)

- Strategy as:
  - Social process
  - Political process
  - Cognitive psychology
  - Rhetoric or a language game
  - Applied ethics
  - Rationality

Descriptive (2)

- Strategy as:
  - Entrepreneurship
  - Learning process
  - Episodic or transformative process
  - Adaptation to environmental change
  - Simple rules

Meta-theories

- A meta-theory is a theoretical framework for understanding the world around us. It is usually the basis for the implicit assumptions we make about:
  - behaviour and action (theories of action)
  - modes of perception
- The role of:
  - Economics
  - Sociology
  - Psychology
  - Political theory
  - Even biology

Strategists and stakeholders

- Definition of a stakeholder
  - "A person, or a group of people, who have a 'stake' in the enterprise, that is, can receive either benefit or damage, or both, from the operation of the enterprise, and therefore has a reason for influencing the formulation and/or implementation of strategy".

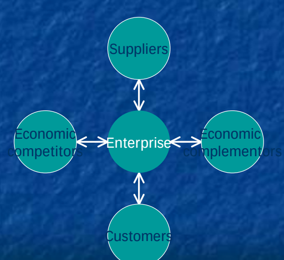
The stakeholders

- External
  - Financiers to the enterprise: shareholders, or major creditors
  - Product market stakeholders: customers, suppliers, trade unions, host communities, governments, strategic allies
- Internal
  - Employees: managers and workers

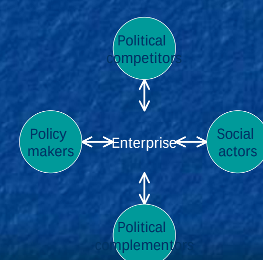
Motivation

- Shareholders – profit, dividends and capital gains
- Creditors – the ability to service debt
- Customers – the price and quality of product
- Suppliers – the price and quality of the inputs
- Unions and workers – pay, employment and the conditions of employment
- Host community – employment and environment
- Government – taxes and employment
- Managers – income, status, power

A Map of Economic Stakeholders



A Map of Political Stakeholders



Constraints on process and content

- Cognitive – that which limits the way we think about strategy and what it can do
- Ethical – keeping all stakeholders happy and promoting corporate social responsibility
- Social – the cultural web which envelops the enterprise, including the paradigm (the set of attitudes, values and behavioural patterns embraced by an organization)
- Political – negotiation and bargaining between strategist and stakeholders with different strategic power

Strategic stances

- Revolutionary
  - Remaking the environment with 'disruptive innovation'
  - Dealing with turnaround situations
  - Introducing paradigm shifts
- Adjusting marginally
  - Engaging in logical incrementalism – a little more of the same
- Strategically inert
  - Allowing strategic drift: 'success breeds failure'

The Paradigm, or Corporate Culture

- Routines and rituals
- Control systems
- Organizational systems
- Power structures
- Symbolic expressions of identity – logos, names
- Stories or legends concerning the history of the organization

Strategy and leadership

- Types of leadership
  - Charismatic
  - Traditional
  - Institutional
- The hero leader
- Leadership teams
- The strategic role of leaders - the power to influence strategy

Strategic Management 2

Thinking and Acting Strategically

Strategic activities

- Strategic thinking
  - universal
- Strategic management (programming)
  - common
- Strategic planning
  - unusual

Strategic Thinking (1)

- = creative, imaginative thinking, plus a sense of where the relevant idea might lead
- Often implicit
- Motivation as often 'intrinsic' as 'extrinsic' – the pride of doing something well or confronting a challenge
- All ideas have a context
- Need for a reality check – can the idea be realised?

Strategic Thinking (2)

- Reinterpret the world around us to see how it can yield a new way of meeting a basic human need
- Identify the relevant problem or question(s)
- Does it create an exploitable opportunity?
- Generate a new idea or ideas
- Apply rational thought to the development of the idea(s).
- Discover a solution

Single and multiple ideas

- The source of an innovation can be:
  - a single new idea: Ogawa Kikimatsu and the English primer
  - a combination of new ideas: Elizabeth David and the new cuisine, the date rape solution or Sony's disruptive innovations
  - the combination of a new idea with old ideas : Brian Epstein and the Beatles
  - the recombination of old ideas: the IKEA way

The Elements of Strategic Thinking

Explicit and implicit strategic thinking

- Strategic thinking is everywhere:
  - Personal careers
  - Scientific discovery
  - Artistic creation
  - Military preparation
  - Business activity

A complex world

- Strategic problems are of their nature 'wicked problems' which are:
  - essentially unique
  - highly complex
  - linked to other problems
  - can be defined and interpreted in many ways
  - have no one correct answer, nor even a limited set of solutions

A dynamic world

- Strategists change the world, or remake the environments of other strategists.
- Strategy breaks from routine; it involves innovation
- Strategy is about change and change management
- Changing context in which strategy is made:
  - progressive replacement of labour with capital
  - automation of most manufacturing processes
  - the increasing importance of human capital and knowledge
  - an increased emphasis on services

Aims and objectives

- "Strategy anticipates wants before they are perceived and problems before they manifest themselves."
- The main aim:

to generate above normal profit at a risk level which is acceptable

- Two main parts:
  - to create and maintain comparative advantage over competitors
  - to control risk

Vision(1)

- The vision:
  - defines what an enterprise is
  - represents the reason why the enterprise exists
  - is at the core of the enterprise's identity
  - is closely linked with what the enterprise can do
  - expresses the dynamic of the enterprise, where it has come from and where it is going to

Vision (2)

- The vision
  - precedes but overlaps strategy
  - is an expression of the creative or imaginative part of strategy
  - is the raison d'etre of a new enterprise
- In an existing enterprise it is important to distinguish between what is unchanging and what is only temporary

Vision (3)

- A vision contains:
  - the paradigm
  - the core purpose or strategic intent
  - an 'envisioned' future
    - long-term goals
    - what it would be like to achieve those goals
- A vision can be expressed in writing or verbally.

Vision (4)

- The core purpose might be to:
  - be the best in a specific area
  - be the market leader
  - be the most innovative player
  - provide the best service

Mission

- The mission is:
  - written or unwritten?
  - real or token?
  - articulates the enterprise vision
  - is for internal or external attention?
- Where is it stated?
- For whom is it stated?

Strategic Management (1)

- Strategic management is any strategic action to realise a strategy.
- There are three parts:
  - codification: identification of the strategic intent as operational objectives
  - elaboration: formulation of proposed action to facilitate the achievement of these intentions
  - conversion: the efficient and timely execution of these actions

Strategic Management (2)

- Strategic management:
  - emphasises the actions of teams or units rather than individuals
  - is more common in certain areas than others, e.g. finance or marketing
  - is most frequently articulated in a short-term business or corporate plan
  - requires coherence and consistency.

Role of business plan and financial controls

- How is it possible to quantify a strategy?
- The use of present value or adjusted present value in:
  - discounting the future
  - allowing for a risk premium
- The need for financial controls
- A stress on financial targets distorts strategy
- The budget should follow strategy, not precede it.

Above normal profit

- Normal profit can be regarded as:
  - the opportunity cost of the capital employed in a project
  - the equilibrium return in a perfectly competitive market with no risk
  - a profit which contains no monopoly element
- An above normal profit is a monopoly profit, or a profit which reflects some element of monopoly.

Strategic planning

- A strategic plan is in theory “a detailed and comprehensive set of blueprints for the future development of the enterprise, including an aggregative plan as well as compatible functional plans”
- There are dangers in having only a token plan

Choosing the appropriate strategic activity

- When should an enterprise employ strategic thinking, strategic management and strategic planning?
- The key issue is the degree of predictability in the relevant markets.
- The more the situation is predictable, the more it is likely that an enterprise moves from thinking, to management, to planning

How to classify an industry or market

- The principal sources of difference relate to:
  - the speed of change
  - the level of risk
- Three ways of classifying enterprises:
  - the degree of competition
  - the age of the industry
  - the speed of turnover in the cycle of competitive advantage

No. of sellers / Age and speed of cycle	One seller	Few sellers	Many sellers
Young, fast	A	B	C
Mature, standard	D	E	F
Old, slow	G	H	I

Appropriateness of strategic planning

- Monopoly is unusual – A,D and G are rare.
- Most industries in their maturity end up as oligopolies – therefore I is also rare.
- Strategic planning is most likely with no competition and in an old industry with a slow cycle, but G is rare. Investments that are large and for the long term are also positive elements.
- Other appropriate situations are D, E and H, but D is rare. Strategic planning is more likely in industries of the H type than those of the E type.
- Electricity generation might be a good candidate.

Entrepreneur and manager

- An entrepreneur innovates and has a greater risk appetite.
- An entrepreneur is primarily a strategic thinker.
- A manager imitates and has a lower risk appetite.
- A manager is primarily a strategic manager rather than a strategic thinker.

Intrapreneurship

- This is entrepreneurial activity conducted on a continuing basis within the enterprise.
- It is part of the process of creating new monopoly elements, which can be positive or negative
- The dangers of 'creative destruction' : the interaction of the old and the new economy is relevant
- The need to encourage innovation
- "Success creates failure"

The Mix

- It is possible to specialise in either entrepreneurship or management but all need to some degree to be good at both.
- The mix within an organization is a critical issue
- There are two common dangers:
  - over-emphasizing one of the roles
  - failing to adjust the mix according to a changing context

The 'IKEA Way' (1)

- An example of combining old ideas in a new combination - in particular a combination of cost leadership with product differentiation
- Applied to an old industry
- Applied mass methods to both production and distribution
- Production outsourced
- Concentration on the value-adding activities of design, promotion and distribution

The IKEA Way (2)

- Cost leadership:
  - Bargaining power and suppliers
  - Standardisation in the world market
  - Strong logistics and the distribution centres
  - The customer does as much as possible: chooses as in a supermarket, also assembles and transports
  - Suburban location of retail outlets
  - Price as starting point for new or redesigned products
  - The importance of the catalogue

The IKEA Way (3)

- Product differentiation
  - Highly individual and modern styling with strong Swedish influence
  - Continuous restyling
  - Natural setting of retail outlets
  - An infinite variety of mixes of furniture and furnishings
  - As much choice as possible

Strategic Management 3

Adopting a global perspective

Key questions

- Why should an enterprise engage in international transactions?
- Does this engagement mean the nature of strategy must change?

A global world

- A world government
- An effective world law and order framework
- Multilateral institutions for overseeing the implementation of business rules
- A common language
- A common culture
- Fully integrated markets
- No barriers to trade or investment
- No transport or communications costs

Definition

- "Globalization is the movement towards a 'global world'"
- The concept encapsulates for many the defining features of the modern era
- It is perceived by different people as both good and bad

Benefits of globalization

- Accelerated technical change
- Increased competition = lower costs
- Reduction in home country bias
- Faster growth = more jobs
- Higher standard of living
- Reduction in poverty
- Broader access to consumer goods
- Widespread dissemination of information
- Undermining of traditional hierarchies
- "Democratisation"

Losses from globalization

- Loss of national sovereignty
- More uneven income distribution
- Damage to the environment
- Erosion of health and safety standards
- Erosion of local cultures
- More cultural imperialism
- Loss of independent decision-making
- Increased power of large companies
- Increased power of international organizations

Four different views of globalization

- A change of mental perspective
- A change in behaviour
- Increasingly institutionalized patterns of global interaction
- The imposition of a new discipline on existing behaviour – the notion of 'hyper-competition"

Five main elements of globalization

- The integration of world markets and the world economy
- Accelerated diffusion of new technology
- The loss of national sovereignty
- The homogenisation of a global culture
- The democratisation of key activities

Is globalisation new?

- Long history of an increase in international interactions – trade and investment
  - 5,000 B.C to the 1600s *incipient* globalization
  - 1600s to 1970s *bridging* globalization
  - 1970s to present: *accelerated* globalization
- Reversals followed by recoveries – for example 1914 – 1945 reversal, 1945 – 1970s recovery.

Integration of markets

- Supra-nationalisation v. Internationalisation
- The capital market leads the way
- Reduction in barriers to trade and investment
- Reduction in transport and communication costs

Accelerated diffusion of new technology

- The communications revolution
- Vastly improved access to information
- Price convergence in various markets
- More rapid spread of technical knowledge

Loss of national sovereignty

- The 'golden straitjacket'
- Who sets the rules of the game?
- Multilateral and multinational institutions
- Country risk
- Increase in number of nation states
- Cultural conflict (Huntington thesis)

Homogenisation of culture

- The role of language
- Cultural imperialism, from fast food to pop music
- Few global brands
- Local resistance

Democratisation

- Control of fertility
- Decentralisation of energy and transport – electricity and the motor car
- Access to travel
- Access to finance
- Access to information

Cultural clusters (1)

- The Anglo
- Latin America
- Western Europe
- Eastern Europe
- The Arab
- Sub-Saharan Africa
- Sinitic or Confucian
- South Asian

Cultural clusters (2)

- Areas of fragmentation
  - South-east Asia
  - Oceania
- Border areas
  - the Balkans
- Outliers
  - Brazil
  - Israel

Home country bias

- In key economic decisions:
  - Purchase of consumer goods
  - Use of savings
  - Location of investment
  - Employment
- In nature of multinational enterprises

Removal of the bias

- Reduction in transport and communication costs
- More information, less ignorance and uncertainty
- Removal of fluctuations in the level of country risk
  - Floating exchange rates
  - Government action

A convergent world

- What does convergence mean? By choice or by compulsion
- The 'end of history'
  - Economic – the market system
  - Political – representative democracy
  - Social – global tastes and global brands
- Price convergence - commodities
  - Interest rates converge
  - Systematic economic fluctuations occur
  - Economic structures become similar

Global players

- Multilateral organizations – from the WTO to Greenpeace
- Regional organizations – from the EU to APEC
- The main national players
  - The Triad: North America, the EU and Japan
- Multinational enterprises and organizations from Wal-Mart to the state of California

Multilateral organizations

- The United Nations and its agencies
- The World Bank and its agencies
- World Trade Organization
- International Monetary Fund
- Bank of International Settlements
- Greenpeace
- Red Cross
- Amnesty
- Oxfam

Regional organizations

- Regional development banks, e.g. Asian Development Bank
- European Union and its agencies, e.g. European Central Bank
- Free Trade Areas, such as NAFTA, ASEAN or Mercosur
- Others: APEC or OPEC

National Players

- The Triad – North America, the European Union and Japan
- North America is a little bigger than the European Union
- Both are something like three times the size of Japan
- Together with China, South Korea and Singapore the Confucian countries are a little bit smaller again

United States	9,781
China	5,027
Japan	3,246
India	2,913
Germany	2,078
United Kingdom	1,431
France	1,425
Italy	1,422
Brazil	1,219
Russia	995

Purchasing power parity GNI (2001) – in billions of American dollars

Multinationals

- By definition those companies engaged in FDI
- Growing in number
- Still concentrated on the Triad but becoming more diverse
- Different ways of defining size – by use of factors of production such as assets or employment, by capitalization or by revenues

Wal-Mart	220
Exxon Mobil	192
General Motors	177
British Petroleum	174
Ford	162
Enron	139
Daimler Chrysler	137
Royal Dutch /Shell	132
General Electric	126
Toyota	121

Revenues of 10 largest corporations $bill. (2001)

The impact of globalization on strategy

- Think globally and act locally
- Differing operating contexts
- Greater complexity
  - of value creating chain
  - of markets
  - of management team and labour force
  - of legal and political contexts

Globalization drivers

- Lure of markets
- Prospect of reduced costs
- Persistence of government policies which favour some kinds of globalisation
- Forces of competition

Global opportunities and risks

- Nature of the opportunities
- How to exploit the opportunities
- Need for leadership
- Complexity of risk

The Airlines

- Of its nature a global industry
- A strong case of home country bias - protection of the flag carriers
- Deregulation talked about and to some degree pursued
- Fast growth but low profit industry
- Highly vulnerable to shocks
- Consolidation and strategic alliances
- 'No-frills' airlines

Swissair

- Limited domestic base
- Ambitious strategy
  - Large route network
  - Minority interests
  - Non-airline business
- New Strategic Course Jan 1 2001
- Debt and bankruptcy late 2001
- Reconstruction as Swiss International Airlines
- Further problems in 2003
- Future? Take-over by Lufthanza

Qantas

- Strong domestic base
- Bankruptcy of Ansett
- Rides the shock well
- Problems
  - Further shocks – Bali and SARS
  - Competition from no frills airlines, Virgin Blue
  - Ageing fleet
  - High costs

Strategic Management 4

Reading an uncertain future

Ignorance, uncertainty and the future

- All strategy involves reading the future
- The difficulty of such a reading varies from industry to industry
- A successful reading depends on the information available
- Good strategy depends on the strategist having access to that information

Bounded rationality

- The existence of imperfect information is universal
- There is also a limited ability to process the information which exists
  - this is true at both the level of the individual and of the organization.
- There are limits to the application of reason
  - imagination, intuition and gut feeling are all relevant
- There are limits to the use of the process of optimisation: finding one best solution

A reasonable starting point

- Reason alone is not enough
- Information is always imperfect
- There is an abundance of information but it is costly to process
- There is considerable uncertainty
- The individual or organization can change that level of uncertainty, but at the cost of the commitment of considerable resources

Levels of uncertainty

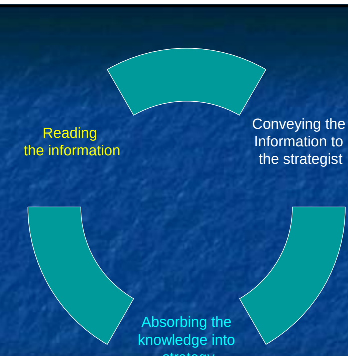
- Four possibilities:
  - A nearly complete ambiguity – little information and little knowledge
  - A broad range of possible futures with clear boundaries
  - A number of discrete alternative futures
  - An almost definite future

The costs of information

- The costs of transferring, processing and storing information have become much lower
- In its raw form information is almost costless.
- Search or selection costs are significant
- Information becomes knowledge when its relevance to strategy is shown

Reading

- Who is a reader? A reader might be:
  - anyone
  - selected individuals
  - the strategists
  - a strategy division
- Difficulties of reading:
  - ignorance or lack of expertise
  - dishonesty or corruption
  - a culture of inertia
  - lack of status of the reader(s)
  - a tendency to read what is expected



The Information Circuit

An information strategy

- The aim is to turn information into knowledge
- Target level of uncertainty?
- Resources to be committed?
- Selecting the readers and what is to be read
- How to link reading with strategy making

Reading the environment

- Scanning
- Monitoring
- Forecasting
- Assessing

Scanning

- Rapid and cursory viewing of information sources
- The 'Iceberg' – only part of what is desired is visible
  - events as indicators of trends
  - trends as indicators of changing structures
- Looking off-centre

Monitoring

- Targeting of what is relevant to a particular area
- Identifying the nature of relevant opportunities or threats
- Application of theory to the area – chains of cause and effect
- Tracing through particular developments

Forecasting and assessing

- How far can you extrapolate the past?
- Identifying elements of instability
- How will the forecast changes affect competitive advantage or the risk environment?
- What is the relationship between the macro environment (general environment) and the micro environment (immediate environment)?

Ways of thinking about the future

- Reject the possibility of and need for forecasting
  - it is impossible to forecast
  - the future is not given but needs to be created = foresight (strategy as revolution)
- Scenario building or planning
- Exact prediction: probabilities – the law of large numbers - routine

Different time horizons

- Short term – 2-3 years: period during which successful forecasting and a significant level of planning can occur.
- Medium term – 3 – 10 years: forecasting difficult and scenario building necessary.
- Long term – more than 10 years: only strategic thinking of the most general kind possible.
- The time periods are the norm but vary from sector to sector.
- The key issue is the exact timing of events or of a change of trend

	Degree of stability	Stage of uncertainty	Appropriate strategic activity
Short term	Predetermined elements predominate	Almost complete certainty	Strategic Planning
Medium term	Mixed strength	Discrete options, continuous but discrete range	Strategic management
Long term	Critical uncertainties predominate	Total ambiguity	Strategic thinking

The inevitability of prediction

- It is much more common than we think: it is often done intuitively or without thinking
- Exploring causation: endogenous change v. exogenous change
- Business success depends on being able to anticipate an opportunity or a threat
- It is much easier to see a threat missed than an opportunity lost.

Reading as a flawed process (1)

- Prediction fails because of:
  - A failure of recognition: not identifying the threat in the first place
  - A failure of prioritisation: nor according the threat the significance it deserves
  - A failure of mobilization: not committing the resources needed to deal with it

Reading as a flawed process (2)

- Reasons for failure:
  - Psychological: cognitive biases of various kinds - mainly we see the world as we want it to be.
  - Organizational: fragmentation of both information gathering and of responsibility for decision making - nobody sees the whole picture.
  - Political: interests groups push their own barrow – what does not fit is suppressed.

Reading as a flawed process (3)

- Outsiders should be used to counter the bias of insiders
- Cross-functional or cross-departmental teams should be set up to prevent fragmentation
- Forcing mechanisms and sufficient resources should be put into place to ensure reading is properly carried out

Methods of dealing with uncertainty about the future

- Contingency testing
- Sensitivity analysis

  Both these assume the existence of a strategy and can help in testing its robustness, that is, its ability to ride unpredictable shocks
- Scenario building and planning

Different kinds of risk

- Global
- Industrial
- Country
- Enterprise
- Individual person or individual project

Global risk

- Epidemic disease, e.g. AIDS or SARS; foot and mouth or mad cow disease; or rusts and smuts for grains
- Economic depression – the 1930s depression or the Asian Economic Crisis of 1997.
- War – particularly world wars
- A virulent computer virus
- Acts of international terrorism
- The effects of global warming or other environmental damage

The Risk Matrix for an Enterprise

Industry risk Country risk	High	Low
High		
Low		

Industry risk

- Unforeseen technical change – only the timing may be unforeseen
- Rapidly changing consumer tastes and fashions
- A change in competitive conditions – the forces of competition
- A change in the rules of the game – either government regulation or WTO rules
- Problems arising from the nature of the product or production process
- Problems arising from an increase in the price of inputs – labour, capital or components

Enterprise risk

- Price – differing maturities of assets and liabilities
- Off-the-balance sheet liabilities
- Operational risk
- Technical risk
- Liquidity risk
- Insolvency risk
- Political risk
- Transfer risk

Scenario building

- Aims – either to help in making a particular decision or as a perception device
- Either micro or macro orientated
- Usually three scenarios selected: but do not average them – the result is meaningless
- Three key elements: predetermined elements, driving forces and critical uncertainties

The stages (1)

- 1. Define the scope of the exercise
- 2. Identify the key stakeholders and players and the motivational issues local to the problem
- 3. Identify predetermined elements and critical uncertainties.
- 4. Focus on the critical uncertainties

The Stages (2)

- 5. First drafting of the scenarios
- 6. Check scenarios for consistency and for plausibility and name them.
- 7. Flesh out the scenarios
- 8. Draw out the implications of the scenarios
- 9. Monitor the evolution of the scenarios and select the relevant signposts

Why build scenarios?

- To deal with a high level of uncertainty
- To counter too many surprises in the past
- To assist an enterprise in a new industry or one subject to significant change
- To imitate competitors already using the technique effectively
- To combat excessive conservatism
- To stimulate strategic thinking
- To highlight and resolve differences of view

Airbus v. Boeing

- Airbus the first genuinely European company
- Boeing the pioneer of mass jet travel
- The industry currently a duopoly
- The role of government subsidy for both companies
- Size of commitment needed to initiate a new generation of planes
- The relevant time horizon is very long
- How far is the company diversified into other areas?

The A380 project

- The next generation of airliners: incorporating new technology
- Airbus already out-competing Boeing: role of new project for the companies
- Different view of the future market – Boeing does not see a market for the new plane, Airbus does: see the websites for their models for predicting demand

First mover advantage

- Economies of scale – how many planes sold makes a big difference
  - A family of airplanes
- Learning reduces costs
- The new generation of planes as the embodiment of new technical advances
- Adapting to airline needs

Strategic risk

- Strategic risk = country risk + competitive risk
- Strategic risk at its greatest for a duopoly – cooperation v. opportunism and deception
- Anticipating the size of market
- What attributes does the market want?
- The cost position for the leader
- The role of bluff: stopping the competitor from going ahead with a new project.

The Risk Pyramid