

Strategic Management.

Preface:

In 1992 Nokia's main business units were Nokia Consumer Electronics (31 per cent of total sales), Cables and Machinery (25%), Nokia Mobiles Phones (20%), Nokia Telecommunications (17%) and Other Operations (7%).

Nokia's turnover was 3043 million €, and net losses 121 million €. (€ = EURO, 1€ ~ 1USD)

“Nokia's strategy is to invest in telecommunications and closely associated business operations. It focuses on industry segments and geographic regions that have good opportunities for growth and profitability” Jorma Ollila, the new chief executive officer, 1992.

In 1999 Nokia had 100 per cent of its operations in the telecommunications and mobile phones, turnover was 19772 million € and net profit 2557 million €.

In this assignment I focus on strategic analysis at Hefley Finland business unit level.

Strategic Management

All firms are faced with the need to create strategies and engage in strategic management. According to Porter unclear strategy is a guarantee for failure.

Strategic management is the management of the process of strategic decision making.

It can be divided in three parts:

1. Strategic analysis
2. Strategic choice
3. Strategy implementation

In an organisation every person may (and should) has a strategy. But it is more common to classified organisational strategies in three levels:

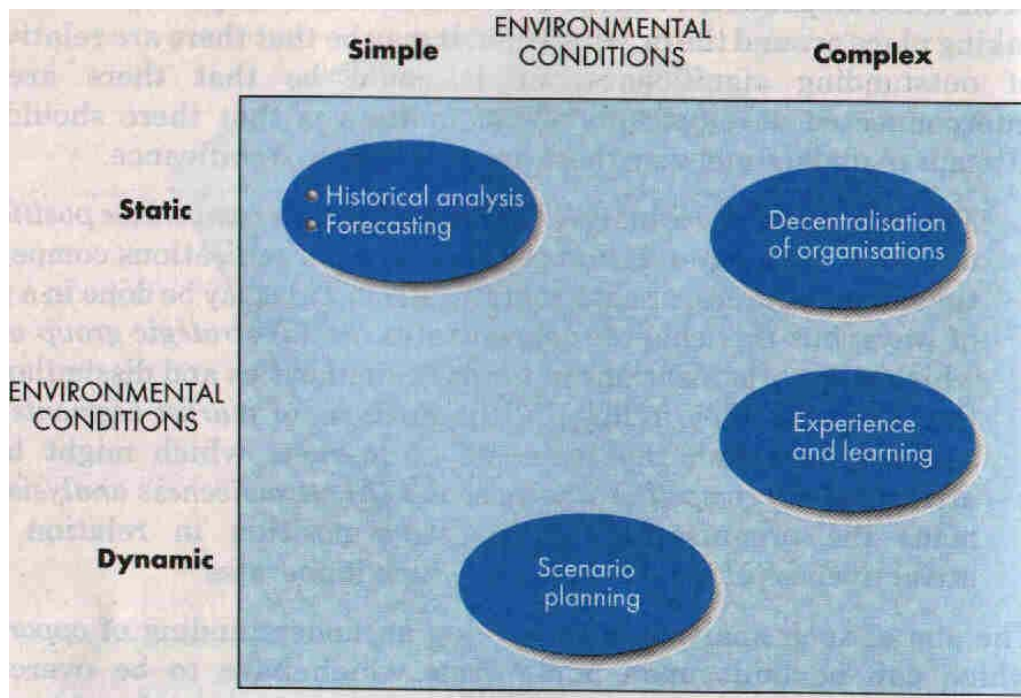
1. Corporate level strategic decisions, which deal with
 - Overall purpose and scope
 - Portfolio issues. Adding value to shareholder's investments
 - Corporate financial strategy
 - Structure and control of strategic business units
 - Resource allocation between strategic business units
2. Strategic Business Unit strategy, where the main issues are
 - Developing market opportunities
 - Developing new products and services
 - Resource allocation within the SBU
 - Structure and control of the SBU
 - Competitive strategy
3. Operational strategies, which are concern with
 - to implement strategy and
 - integration of resources, processes, skills and people

The Competitive Environment

According to Sidney Schoeffler “the laws of the marketplace” determine most of the observed variance in operating results across different businesses.

He claims that 80% of the reasons for success or failure are determined by the characteristics of the served market, of competitors and of the business itself. The skill or the luck of the management determines only 20%.

First step in scanning the environment is to take a look how uncertain is the nature of the business’s environment. In what extent it is stable or dynamic, and in other extent how simple or complex it is to comprehend.



Source Exploring Corporate Strategy: Prentice Hall

Pic 1. Approaches to making sense of the environment

Pic.1 shows different approaches to making sense of the environment according its extents.

Mass production companies like Junipoly Hefley and raw material suppliers are good examples of organisations which live in simple or relatively low complexity / static environment. Production processes are fairly simple and markets are fixed over time.

In such conditions, when trying to analyse the environment and forecast the future, historical analysis seems to fit best. Most likely future’s changes are rooted at the present.

A multinational firm like Junipoly Hefley as a whole may be in complex condition because its diversity. It is difficult to handle complexity by analysis. In such position best is to give each SBU authority and responsibility for their own part of the environment i.e. decentralisation of organisation.

PEST Analysis and Scenario Building

Second step in environment analysis is the auditing of environmental influences. Organisation tries to identify which of the many macro environmental influences are likely to affect the organisation’s future.

This can be done by PEST analysis, by Porter's diamond (especially in the context of global competition) or by scenario planning.

The PEST analysis is concerned with two questions

1. What political, economic, sociocultural and technological factors are affecting the organisation?
2. Which of those are important at the present or in the future?

Political questions include policy, export/import regulations, government stability, environmental laws, employment law etc.

Economic factors deal with business cycles, money supply, inflation, interest rates, disposable income, energy etc.

Sociocultural factors: demographics, income distribution, lifestyle trends, levels of education, consumerism etc.

Technological factors like speed of technology transfer, new inventions/discoveries, industry and government focus of technological effort etc.

But it makes no sense of making just a list of influences. The key influences and drivers of change must be recognised and developed further. It is also important to understand what may be the differential impacts of key environmental influences.

These impacts can be examined by using scenario building method. In scenario method several plausible futures are built based on key environmental influences.

Good examples are:

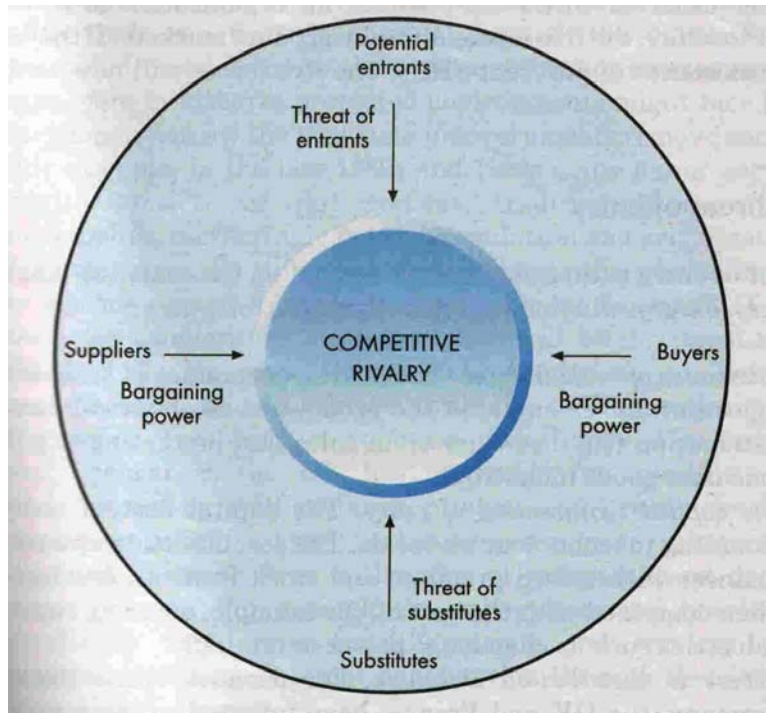
- What should we do if environmental protection laws became extreme tight? No pollution would be accepted? What would be the effects? (I strongly believe this is going to happen in near future. How Finnish paper and pulp industry is going to react?)
- What should we do if USA is going to place 200% extra import taxes for Finnish products due to EU restrictions to gene manipulated meat, wheat, soybean and -oil produced in USA? What would be the effects? (This is "a hot potato" at the moment. How Finnish companies exporting to USA are going to react?)
- What should we do if interest rates are going to raise due the governments attempts to "cool down" economic situation in western worlds? What would be the effects?
- What should we do if trade barriers are going to exit between different economic areas and economic unions (EU, NAFTA, and AFTA)? What would be the effects?

It is not useful to build up scenarios based on every influence, but to build up the most pessimistic, the most optimistic, "middle of the road" and the most likely scenarios of the future. Strategies can be built based on these opportunities and threats.

These methods, PEST analysis, Porter's diamond and scenario building are tools for senior level managers. These give to organisation an overall impression of the environment.

Five Forces Analysis

At SBU level PEST analysis and scenario building can be used for analysing environment at broad aspect. But to examine the competitive environment at SBU level, Porter's Five Forces analysis is more suited for the purpose. It provides an understanding of what competitive force influence SBU. Based on these forces SBU can build competitive advantage over competitors



Source: Exploring Corporate Strategy. Prentice Hall

Pic2. Five Forces Analysis

Pic2. At the level of the SBU Porter's five forces analysis is a useful tool to understand competitive environment.

Threat of Entry

Threat of new competitors' entries to markets depends on the levels to which there are barriers to entry. Typical barriers are:

- Economies of scale. Where MES (minimum efficient scale) is high. A new entrant with small sales finds itself at a substantial cost disadvantages relative to established rivals
- Economics of scope. Where multi-product firm produce several different products with lower unit costs than if they had been produced in independent firms. It could be from shared head-office functions, common distribution and marketing function. A large firm can raise capital more cheaply than several small firms etc
- The capital requirement of entry. Set-up costs to entry can be high, for example heavy advertising, expensive machinery needed (to enter paper manufacturing business at least one paper machine is necessity) etc. With one dollar you can buy a bucket and a sponge to enter to window cleaning business.
- Access to distribution channels. Producers have acquired most of hydraulic hose outlets.
- Learning curve. Where early entry to new markets give cost advantages. Gillette has calculated that first produced razor blade cost ~10USD but after 2 000 000 produced the next one costs only 0,02 USD. Also it is difficult to break into markets where are well-established operators who know markets well and have good connections with buyers.
- Expected retaliation. A firm will not enter a market if it expects continued losses after entry. Predatory pricing when entry occurs is not only a way to drive new entrance to bankrupt, but it is a clear message to potential future entrances.
- Differentiation. New rival offer products or services with higher perceived added value. New entrance overtakes one small segment and may use it as beachhead for future overtakes.

MES in hydraulic hose production is 12-15%. At ½ MES production costs are 15-17% higher (estimated values given by Junipoly Hefley).

Also Economics of Scope is effective barrier to entry. Same companies own each step from raw materials to outlets. Lower marketing costs through the supply-chain, shared head-office costs etc. The capital cost of entry is high. To invest hose manufacturing plants, to create own outlets network, buy own raw material sources etc.

New entrances must find market segments where customer's needs are not fully met.

In maintenance segment customers are outsourcing maintenance services. They aspire to have only few suppliers, which are expected to create on supplier network.

The power of buyers

The buyers' powers are likely to be high when:

- In the markets there are few buyers, especially when purchasing volumes are high.
- Supplying industry is highly fragmented. There are many alternative sources.
- Products or services are undifferentiated.
- Material costs are high percentage of end products.
- Switching costs are low
- There is a threat of backward integration.

The hydraulic hose markets can be divided roughly in three parts: OEM, maintenance and OTC (over-the-counter) segments.

OEM segment is the most "demanding" segment. Few customers with high purchasing volumes. They know all possible sources. They can choose between many suppliers, do not need local or "special" services. They use hose assemblies made according to SAE norms. Products are undifferentiated. The material costs are high percentage of total cost. And to switch from one supplier to another is easy. OEM customers want low prices and accurate deliveries, which all five major suppliers in Finland can guarantee.

In maintenance segment instant deliveries are major issue. When a paper machine is not running due to broken hydraulic hose, price of new hose is secondary matter. Customers are less price sensitive. Products are more differentiated (Loctite is the glue. Furth's glues must be sold very cheap, in spite they are made by Loctite!). Brands are important in maintenance markets.

It is very common that suppliers are familiar with customer's processes and equipment. It can make the risk (and therefore the cost) of switching supplier very high. Maintenance customers have been very fragmented. Co-operation between different production plants within same company has been very low. Today national-wide (and multinational) companies seek to increase buyer's power by forming buying groups. The aim is to decrease numbers of suppliers. The remaining suppliers gain in volume but with strict criteria of price level, quality and delivery.

Customers in the OTC segment are more price sensitive. They are mainly owners of few trucks or earthmovers, owners of small enterprises etc. Lot of customers with relatively low annual purchasing volume per customer. Products are more undifferentiated, brands are not so important.

The power of suppliers

Suppliers' power is likely to be high when:

- There are only few suppliers in the market.
- When the switching costs from one supplier to another is high
- Customers bargaining power is low
- There is a threat of forward integration in supply chain.

The hydraulic hose markets are very concentrated. Manufactures own distribution companies. Companies that are selling supportive products to these companies are in weak position.

The threat of substitutes

The threat of substitutes can increase / decrease products or services price level and market's overall attractiveness.

When considering substitute effects on company's strategy, key questions are:

1. Are substitutes real threats to company's products or services? Can they make present products or services obsolete. Can they push company out-of business?
2. Do customers perceive higher value from substitutes?
3. Is it easy to switch to substitutes?

The substitution could be:

- Product-to-product substitution. For example email for the fax, car for the motorbike etc
- Substitution of need. New product or service could render an existing one superfluous. Good example is developed oil-filtering methods which have reduced the worn of hydraulic components (and therefore decreased replacement).
- Generic substitution. When products or services compete for need. In Finland rapidly increased use of cellular phones has reduced money available to other consumption.
- Doing without.

At the moment there are no substitutes for hydraulics. Some early developments have been done to replace hydraulic motors with electric motors, but with little success. In long run some hydraulic applications may be changed to electronic.

New hydraulic components, motors and valves, are more sophisticated. Pressure level and pressure peaks are in better control. These have reduced uncontrolled bursts of hoses. Also better knowledge of hydraulics and better measure devices (to control pressure peaks) is going to have some impact to consumption of hydraulic hose assemblies.

Competitive rivalry

The market is expected to be in the most competitive conditions when the threat of entry is likely, the power of suppliers or buyers is high and there is threaten of substitutes.

Extra contribution to competitive environment is given when

- Size of competitors is equal. It is likely that one of the companies try to be market leader. This led to intensive competition. Markets with clear market leader are more stable
- Markets are between growth and mature stages. In growth stage companies strive for market leadership. And in mature stage business can increase only by taking market share from competitors
- Extra capacity is in large increments. This easily creates oversupply.
- In markets there are high exit costs.
- There are global customers in market.

In hydraulic hose markets the barriers to entry are high. No new "players" are expected to come up. The power of buyers is going to increase, especially in maintenance markets.

Hefley Finland is a clear market leader with 45% market share, but competitive environment varies between different business units (depots). Some depots have 75% market share and no local competitors, on the other hand, some have only 20% share and strong, well established competitors. In OEM markets Hefley is in strongest position.

In maintenance markets our market share is lower than one of our competitor. They have focused on maintenance markets, and developed business on that direction. Regions where both can be found, market shares are divided equally. Competitor's geographic coverage is better in maintenance business.

Conclusion:

Junipoly Hefley is a part of larger, multinational corporate, which operates in all continents. Environmental conditions are rather stable. Manufacturing processes are quite simple and markets are fixed over time. Typical oligopolistic markets. Future changes in markets are predictable. Likely future can be forecasted on an historical basis.

Due the geographic diversity of Junipoly S.A., responsibility and authority should be decentralise.

OEM segment

Main strategies should concern cost efficiency (scale economies) and quick deliveries.

Hefley should build barriers, which make customers more difficult to switch supplier

Maintenance segment

New possible entrances must find small segments, where customers need are not fully met

One fast changing segment is maintenance customers. This segment is undergoing a change, where maintenance services are going to be done by external companies.

Hefley should reduce the buyer power of “middle-men” (maintenance service companies).

In maintenance segment brands and “differentiated products” are important. Junipoly Hefley should build strong, well-established brands in hydraulic hose markets. Marketing efforts should be directed to maintenance personnel (workers, foremen, and maintenance managers) in industrial plants.

One competitor has focused on this segment and they have gained better market share. It is obvious that every action to displace this competitor led to intensive competition.

Over-The-Counter segment

The buying power of OTC customers is low, but they are very price sensitive.

Hefley should create strong brands and try to get OTC customers more “brand loyal”.

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