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STRATEGY

Strategic choice

Tony Grundy, p 2

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Strategic choice

A characteristic of successful companies is that they understand that they need to examine all of their strategic options. This article considers some of the ways in which companies can analyse choices. It uses a hypothetical example to illustrate some of the tools that can be used, and shows how the points of view of the various stakeholders can be mapped and taken into account.

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Introduction

My favourite book on strategic management is not by one of the strategy gurus such as Michael Porter, Henry Mintzberg or Gary Hamel and C K Prahalad. Surprisingly, it is *Winnie The Pooh*.

The book begins with a teddy bear being dragged unceremoniously downstairs. The story goes as follows :

> *'Here is Edward Bear going down stairs, bump, bump, bump on the back of his head. It is as far as he knows the only way of coming downstairs, but sometimes he feels that there really is another way, if only he could stop bumping for a moment and think of it … .'* (Milne, 1973, Chapter 1, p 1)

This indicates the importance of always obsessively looking for other available options, and therefore at strategic choice.

Organisations often seem hell-bent on pursuing strategies which are patently not working, and which are destroying shareholder value. Reasons for this myopic vision include the following :

- excessive commitment to the past investment in a specific strategy (see, for example, Ghemawat, (1991));
- difficulty in injecting learning into the organisation's decision making (Senge (1990) and Argyris (1991));
- the lack of a deliberate, as opposed to an emergent or even 'submergent', strategy (Mintzberg (1997) and Grundy (1995));
- a failure to manage stakeholders and their agendas (Grundy (1998), *Harnessing Strategic Behaviour*).

This article dissects strategic choice, and shows specifically how stakeholder influences can be managed more effectively than they often are at present. It considers the following issues :

- moving from tactics to strategic choice;
- strategic attractiveness;
- financial attractiveness;
- implementation difficulty;
- uncertainty and risk;
- stakeholder acceptability.

From tactics to strategic choice

Many organisations focus on reactive, tactical decision making rather than on making more balanced strategic choices. In addition to day-to-day financial pressures (especially that of delivering the current year's profit target), senior managers are afflicted by many personal and political agendas.

I call these the PASTA factors (personal *and* strategic agendas). They are very much like white and green pasta. When cooked, the pasta becomes tangled, sticky and *messy*. Something similar happens in organisations when personal agendas become hopelessly intermingled with strategic agendas. Managers even lose sight of the origins of these agendas (Grundy (1998), *Harnessing Strategic Behaviour*), and they may fail to challenge the logic of their decisions.

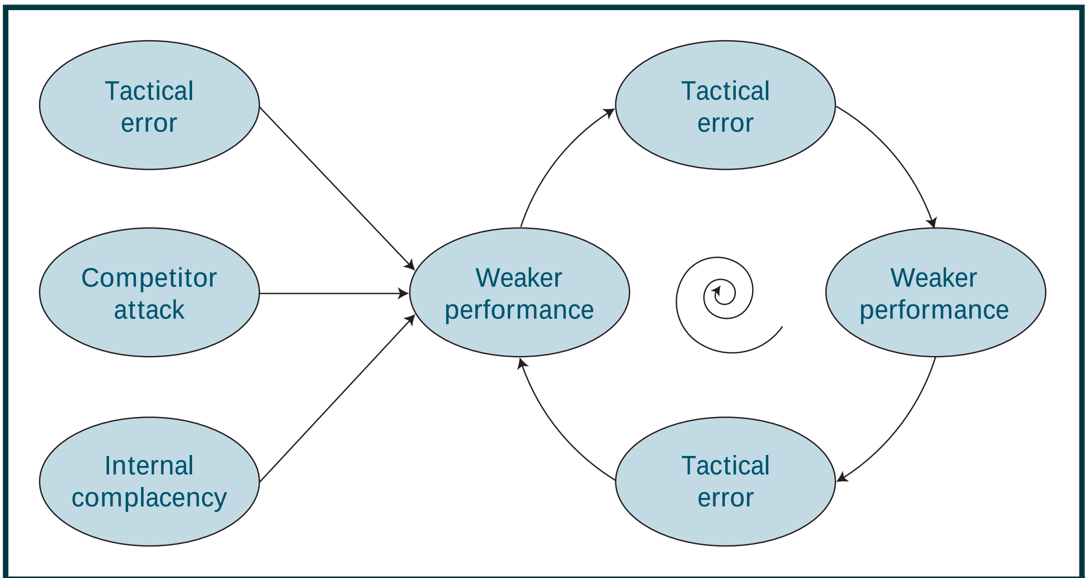

Figure 1 Tactical decline

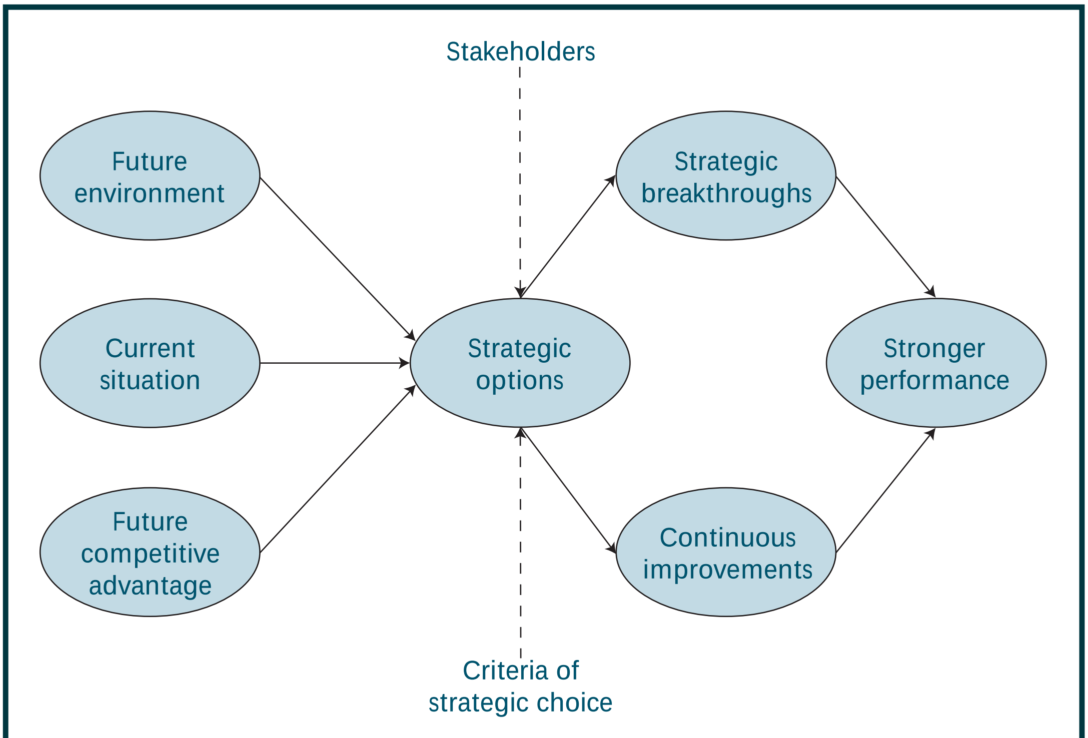

Figure 2 Strategic choice

Unable to agree on an overall framework for strategic choice, they then 'muddle through' their strategy on a highly tactical basis. The result is frequently strategic drift, as they become unable to cope with external competitive challenges, resulting in tactical fire fighting and financial decline.

The decline of Marks & Spencer and Sainsbury's in the late 1990s illustrates how a vicious cycle of tactical decision making can result in weaker performance and thus further use of desperate tactics. In fact, much decision making in business seems to be of a tactical rather than strategic nature. Contrast *Figure* 1, which illustrates a tactical style of decision making with *Figure* 2, which is based on strategic choice.

In *Figure* 1 we see a combination of tactical error, competitor attack and internal complacency producing a spiral of tactics, weaker performance, further tactics and even weaker performance.

Criteria	Option 1	Option 2	Option 3	Option 4
Strategic attractiveness				
Financial attractiveness				
Implementation difficulty				
Uncertainty and risk				
Acceptability (to stakeholders)				

Figure 3 Evaluation of strategic options

In *Figure* 2, notice that, instead, in addition to carrying out an objective examination of our current strategic position, we also need to think about the *future* competitive environment and also *future* competitive position. This will then generate some more challenging and exciting options for the business, and these will then need to be evaluated and prioritised. The evaluated options will become strategic breakthroughs (that is, external or internal programmes which make a major impact on competitive position and financial performance, and areas for continuous improvement). The number of these strategic breakthroughs will be relatively small. Typically there will be only one to three in a particular business area over a particular time period of somewhere between 18 months to three years. This follows the Japanese philosophy of breakthrough, or *hoshin* (Grundy (1995)).

For example, if we track Tesco's strategic breakthroughs over 1994–97 and 1997–2000 we can identify the following :

1994–97

- Clubcard;
- customer service (One-In-Front);
- brand and product repositioning;

1997–2000

- product extension (non-food and financial services);
- new formats and Internet home shopping;
- international development.

Tesco's continuous improvements during this period included its own brand, management development and process simplification.

It is imperative to ensure that strategic breakthroughs are championed by appropriate stakeholders in the business.

The criteria for strategic choice need to be predefined and explicit rather than loose and unstructured. The strategic option grid (see *Figure* 3) allows personal and strategic agendas to be thoroughly unscrambled. The row headings are generic criteria for appraising strategic options, and the column headings are strategic options (more than four columns can be used if necessary). Sometimes options are created by combining other options (and so, for example, option 3 could be a combination of option 1 and option 2). Each option generates a different pattern of stakeholder influence, and thus of stakeholder acceptability. Each of the boxes in the strategic option grid can be scored high, moderate or low to indicate the option's overall attractiveness. (Note that the areas of uncertainty and risk and implementation difficulty have to be scored in reverse, that is, something that is 'highly difficult' is given a 'low attractiveness' score.)

Figure 4 shows an example of the use of the

Criteria	Closure (option 1)	Cost cutting (option 2)	Price rises (option 3)	Options 2 &3 +more funding (option 4)
Strategic attractiveness	* * *	*	* *	* * *
Financial attractiveness	* *	* *	* * *	* * *
Implementation difficulty	*	* *	*	* *
Uncertainty and risk	*	* *	*	* *
Stakeholder acceptability	*	* *	*	* * *
Total score	8	9	8	13

Figure 4 Strategic option grid for railway telephone enquiry system
[* : high attractiveness, ** : moderate attractiveness, * : low attractiveness.]**

strategic option grid. It scores the telephone enquiry system of a railway that was to be privatised. Option 1 (closure) was strategically and financially attractive, but it was uncertain, difficult and less acceptable. Options 2 and 3 (cut costs and increase prices, respectively) looked marginally more attractive, but it was option 4 (obtain more centralised funding, raise prices and cut costs) which saved the organisation.

We now look at strategic choice criteria in more depth, and especially at the influence of stakeholders.

Strategic attractiveness

Strategic attractiveness can be defined in terms of a number of factors, which include the following :

- market growth (present);
- market volatility;
- competitive intensity;
- future market growth;
- fit with own capability;
- fit to own brand;
- likely edge over competitors;
- scale of opportunity;
- focus or possible dilution of own strategy.

These criteria can be represented visually. One useful way of picturing them is to tailor force field analysis (Grundy (1995), based on Lewin's much earlier technique). In this system, upward vertical lines are drawn in proportion to the perceived importance of positive strategic attractiveness factors, and downward vertical lines indicate the relative importance of the negative factors.

Figure 5 illustrates this technique for a hypothetical acquisition of Marks & Spencer by Tesco. The analysis would help key stakeholders to make a much more informed and objective strategic choice. It suggests that such an acquisition would be very much a mixed bag, and our verdict based on this analysis would be that acquiring Marks & Spencer would be of dubious strategic attractiveness for Tesco.

Financial attractiveness

Financial attractiveness is based on the key value and cost drivers which underpin a strategic option. A value driver is defined as 'anything which directly or indirectly

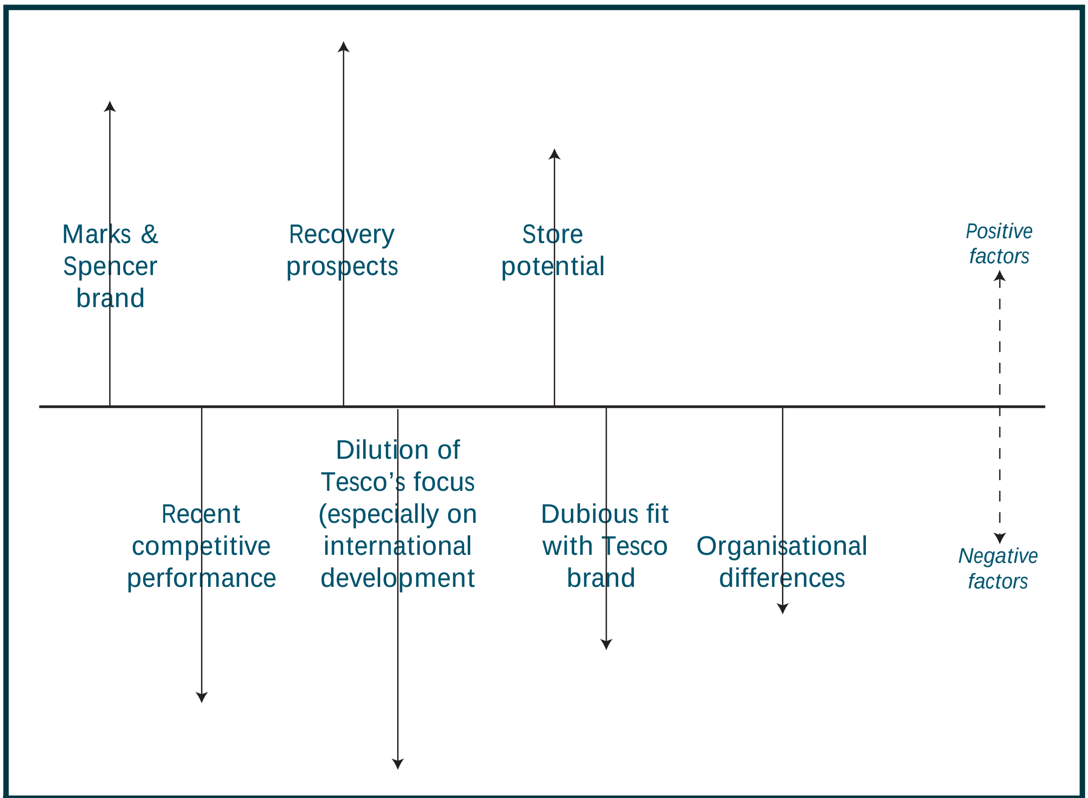

Figure 5 Acquisition of Marks & Spencer by Tesco : strategic attractiveness

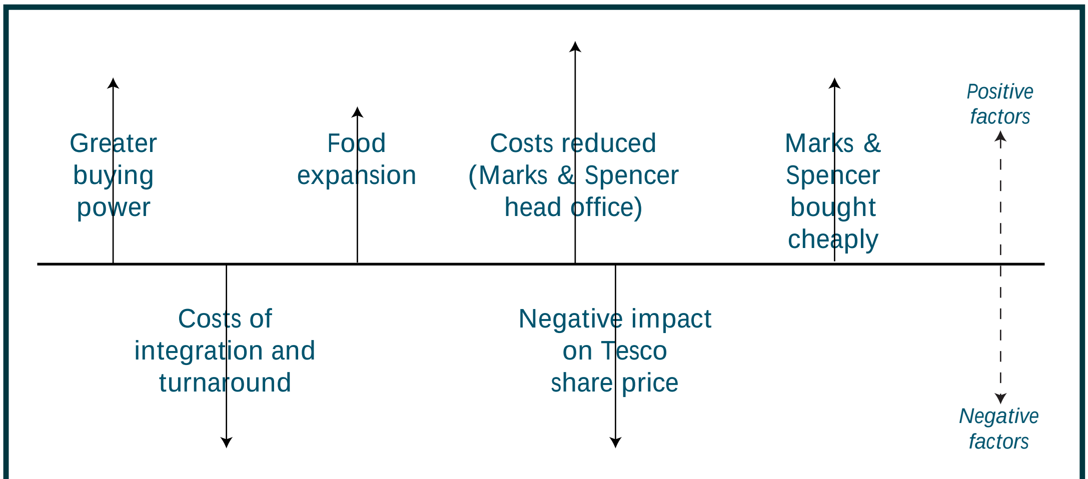

Figure 6 Acquisition of Marks & Spencer by Tesco : financial attractiveness

generates cash inflows, present and future, into the business' (Grundy (1998), *Exploring Strategic Financial Management*). A cost driver is defined as 'anything which directly or indirectly generates cash outflows, present and future, out of the business'.

These value and cost drivers can also be represented visually using force field analysis. *Figure* 6 shows the analysis for the hypothetical acquisition of Marks & Spencer by Tesco. Key criteria here could be

- incremental sales volumes generated;
- premium pricing achieved;
- discounts avoided;
- costs reduced;
- costs avoided (for example by having one head office rather than two);
- accelerated or retarded strategy development;
- share price impact.

Note that while the impact on share price criterion is not strictly a cash inflow or outflow to the business, it does impact shareholder value directly. As it happens,

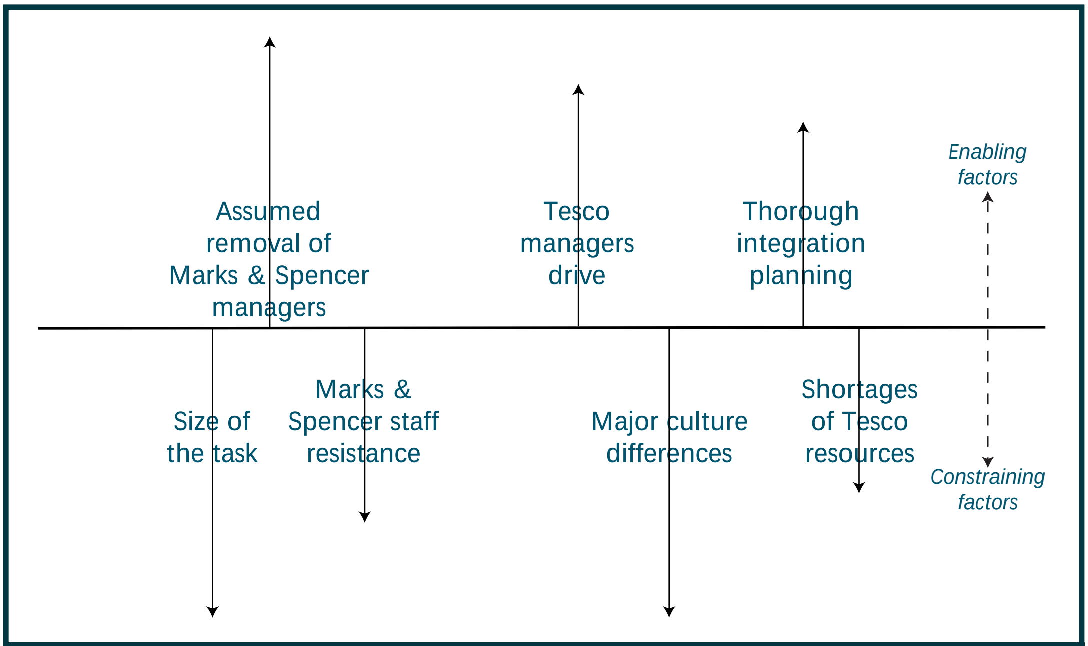

Figure 7 Acquisition of Marks & Spencer by Tesco : implementation difficulty

this force has a very negative impact in this analysis.

Our verdict based on this analysis would be that the acquisition would be moderately financially attractive.

Implementation difficulty

Implementation difficulty needs to be anticipated over the *total time of implementation*, and not just during its early phase. *Figure* 7 illustrates the inherent difficulty of the hypothetical acquisition of Marks & Spencer. Typical criteria of difficulty include the following :

- inherent complexity;
- clarity of implementation strategy;
- determination and commitment;
- resistances;
- availability of resources and skills.

More specifically, *Figure* 7 draws out the enabling and constraining factors relating to the acquisition.

Our verdict based on this analysis would be that the acquisition would be very difficult, and thus of low attractiveness in terms of the implementation difficulty criterion.

Uncertainty and risk

Detailed factors for uncertainty and risk are diverse, and are specific to the context of a particular option. Some generic factors are

- environmental uncertainty (will external conditions change ?);
- management uncertainty (can we make it work ?);
- cultural uncertainty (will people adapt ?).

Figure 8 shows an analysis for the Marks & Spencer acquisition, which looks highly uncertain and is of low attractiveness.

Stakeholder acceptability

Having worked through the previous four criteria (it typically takes managers a relatively short period of time to do this, at least in outline), we are in a better position to examine the stakeholder agendas. Here we can take one of two approaches to the analysis. Either we can do another force field analysis (see *Figure* 9), which will average out the stakeholder agendas, or we can analyse the agendas stakeholder by stakeholder.

Figure 9 gives a useful overview of where Tesco's internal stakeholders would be likely to be coming from in the Marks & Spencer acquisition, and it shows some overall hypothetical inferred agendas. It demonstrates that while the strategy would have some 'turn-ons', there would also be some substantial 'turn-offs'. This kind of analysis can be used to reflect on 'do we really want to do this, and do we want to do it for the most appropriate reasons ?'.

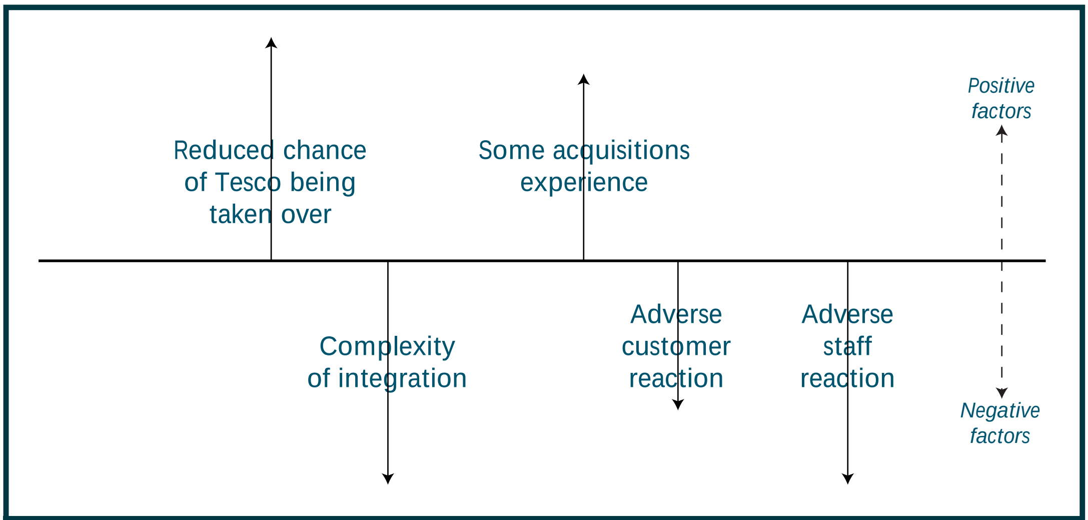

Figure 8 Acquisition of Marks & Spencer by Tesco : uncertainty and risk

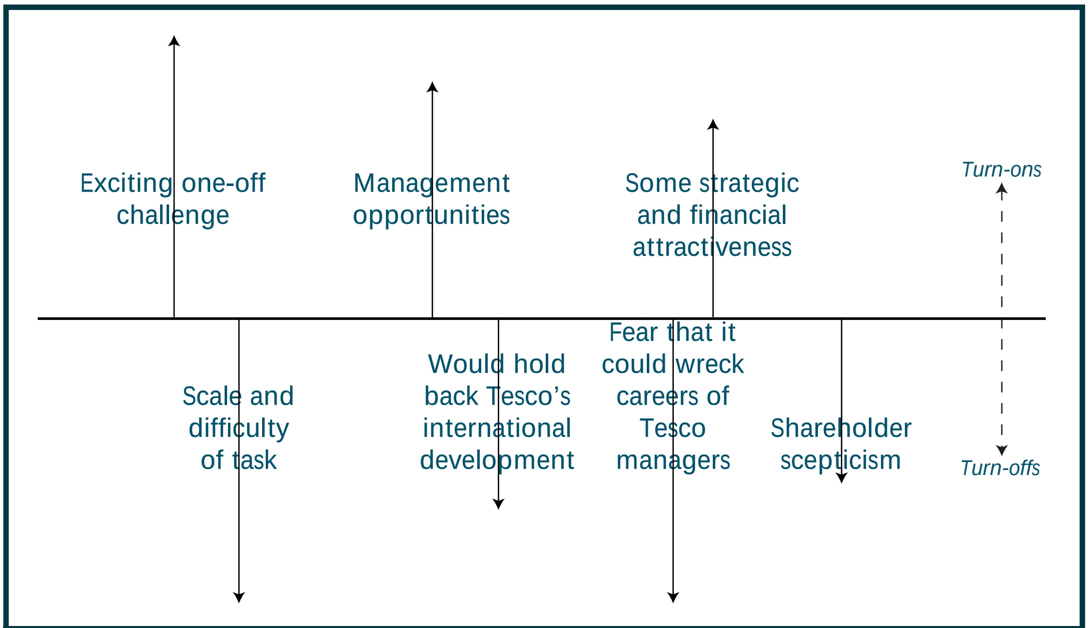

Figure 9 Acquisition of Marks & Spencer by Tesco : stakeholder agendas

The type of analysis shown in *Figure* 10 can help us to disaggregate the agendas of the individual stakeholders. If we widen our thinking about stakeholders not only to those who have an influence over the decision, but also to those who are involved in implementation and are the victims of implementation, this is a more informative practice (see Piercey (1989)). To determine the attitudes of the stakeholders, we need to imagine (as fully as we can, in a kind of out of body experience) that we are actually them. Otherwise, we may misread the stakeholder agendas.

Figure 10 separates out the influence and attitudes of the stakeholders in the hypothetical Marks & Spencer acquisition.

Assumptions underpinning it include the following :

- Tesco shareholders would be likely to be nervous about the possible distractions of the acquisition.
- Marks & Spencer middle managers might not be against Tesco as it might offer them a fresh regime.

A force-field analysis for each group of stakeholders could then be conducted (for any of the ellipses in *Figure* 10) to determine their turn-ons and turn-offs. Sometimes the outcome of critical strategic decisions is based on the micro-agendas of a very small number of stakeholders. This again high-

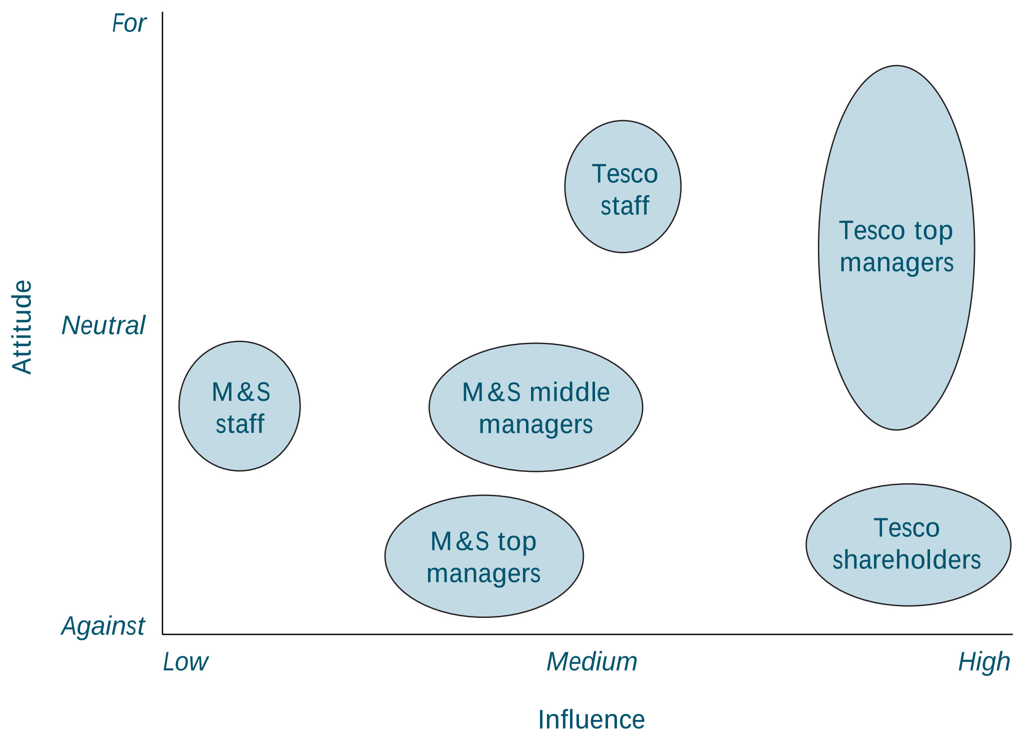

Figure 10 Acquisition of Marks & Spencer by Tesco : stakeholder positioning (hypothetical)

lights the imperative to separate personal and strategic agendas.

Our verdict based on these analyses would be that the stakeholder acceptability of the acquisition would be medium to low.

Summary and conclusions

Through formalisation and visualisation of the criteria for strategic choice, and in particular a formal stakeholder analysis, more informed choices can be made.

In our hypothetical Marks & Spencer example, our analysis clearly suggested that a potentially exciting and bold move by Tesco would have some significant downsides. The option grid suggested that a straightforward acquisition of Marks & Spencer by Tesco was probably not a very good strategic idea. However, it is possible that thinking about alternative implementation strategies might have made the strategy look more attractive.

For example, Tesco might just have acquired the Marks & Spencer food retailing activities (and kept the Marks & Spencer brand), and then floated off the non-food activities as a separate public company, perhaps retaining some ownership in it. It might have invited a consortium of experienced retailers to run the non-food sites. It might conceivably have taken over Marks & Spencer's core (and profitable) non-food activities in women's lingerie and basic womenswear/menswear, and turned these around, while bringing franchises into the stores. Each of these sub-options could be worked through using the strategic options grid, especially for the detailed stakeholder positions.

Managers (and their accountants) are likely to be able to optimise shareholder value *and* their longer term career prospects by following a more explicit model of strategic choice and by formally incorporating stakeholder positions.

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Dealing with conflict

Conflict management is an essential business skill. This article reviews how and why conflict arises in the workplace, the problems it can cause, and how to deal with it. The importance of the individual's personality in determining how to resolve the conflict is considered, and four styles of conflict management are explained : avoidance, accommodation, collaboration and compromise. Methods of conflict resolution are discussed.

Introduction

A consultant to finance directors recently estimated that her clients spend at least 85% of their time dealing with people dilemmas (most of which involve conflict of some kind), and not in dealing with finance strategy or financial issues. She also noted, however, that most people make attempts to avoid dealing with conflict and/or they are not skilled at managing situations that involve conflict, and so many people situations or dilemmas remain partially or wholly unresolved.

Benne (1982) speculated that an audience asked for its reactions to the word 'conflict' would come up with a variety of responses, ranging from those with highly negative connotations (for example aggressiveness, violence or destruction) to more positive ones (for example adventure, drama and excitement). He felt that the idea of conflict engenders a basic ambivalence in us, because in reality conflicts can be both negative and positive. Attitudes towards conflict can range from it being described as 'healthy' or a 'normal part of life' to 'to be avoided at all costs' or 'rude, and for the lower classes'.

Whether we are dealing with workplace conflict or personal conflict, our attitudes towards conflict, ways of dealing with conflict and comfort level with the emotions associated with conflict vary according to our

- upbringing;
- personality style;
- cultural background;
- gender (possibly).

A representative from a well respected business school in the UK once said that he felt that there was a need to run a course on how to handle conflict in the workplace, but that the course would have to be renamed so that the title did not include the word 'conflict'. He believed that UK managers would either not admit that they had conflict in the workplace, or would be made very uneasy by the prospect of attending a course that dealt with it. The course was subsequently offered with the word 'conflict' in its name, and it did not attract enough participants to run.

Conflict can have both benefits and costs. These are usually associated with whether or not the conflict is recognised and dealt with in a way that produces positive consequences and outcomes. Hoffman, in literature from his organisation Concorde, stated that the beneficial outcomes of dealing well with conflict can include

- focusing attention on the real problems (for example in an organisation);
- preventing social stagnation;
- encouraging growth and change;
- increasing internal cohesion.

On the other hand, not dealing well with conflict, or dealing with it by using dominance and imposition, withdrawal or avoidance can lead to cycles of violence or vengeance. In a workplace situation, this may involve

- refusal to work with certain people;
- not cooperating in supplying resources to another's project;
- out-and-out sabotage of projects.

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In an article on psychology in management (Lee (1999)), I stated that it is common for there to be situations involving conflict in organisations, for example

- dealing with difficult employees;
- labour management issues;
- office politics;
- distribution of workload;
- responsibility and accountability issues.

Difficult situations that are well handled and quickly dealt with can strengthen the trust that employees have in their management and, indeed, in the organisation as a whole, and thus create a psychologically healthy working environment. However, if they are not dealt with, such situations, especially when they are allowed to become chronic, can result in

- low morale;
- high staff turnover;
- illness;
- depression;
- chronic absenteeism;
- lateness.

The article gave an example of a man in his early fifties who had been with his organisation for eight years in a senior management position. For the last four years, the personnel department had been aware of his inappropriate methods of managing the staff who reported to him directly. He shouted at them, leaving them shaking and in tears, made unreasonable demands on their time, grilled them, and went over every piece of their work in excruciating detail.

An internal report described his management style as ‘aggressive, bullying and confrontational’. His peers had periodically given him feedback regarding his behaviour, which resulted in him making minor, temporary changes and then reverting to old patterns. Despite all this, action was only taken when a complaint was made to the personnel department from outside the organisation by a relative of another employee. Those who held authority and responsibility not only did not have the skills to deal with him, but also lacked the will to do so. Thus a large number of employees were left at the mercy of this difficult manager and his inappropriate style.

Managers need to be able to distinguish between ‘true’ conflicts in the workplace and their attempts to resolve their own internal anxieties. They should ask themselves how much real need there is to eliminate difference of opinion, differences in ways of doing things, methods, and so on, and how much they are trying to accommodate their own inability to tolerate difference. People have their own ideas and ways of dealing with the world. If they are to be individuals in the workplace and not clones, they must necessarily bring these ideas and methods to the workplace, and their personal effectiveness will depend on their ability to negotiate with their fellow workers about them.

Accommodating or tolerating difference, for example when someone holds different views from our own or looks different from us, involves dealing with levels of personal anxiety. When there are differences, it may feel to us as though our own values and ways of being are being challenged by others. In other words, our own ways of being are not confirmed or verified by those who are different. We must then ask ourselves how much we need to have others agree with us simply so that we can feel comfortable.

Those in a position to deal with conflict have to do the following :

1. have the ability to understand such situations, in terms of both the content of the conflict and the emotions involved;
2. have the skills to deal with the situations;
3. have personality attributes such as maturity and courage (that is, have the ability to stand alone) that will enable them to take action when necessary rather than avoid it.

What is conflict ?

Thomas (1976) defined conflict as a process that begins when one of the parties to an interaction perceives that another has frustrated or is about to frustrate one of his or her needs or concerns. Ross’s comment (1982) was that, if this is so, it is no wonder that conflict is so pervasive. He also stated that dealing with conflict is one of the most important social skills that one can acquire. It is certainly a key managerial and leadership skill.

Conflict can also be defined as any situation in which there is difference that is unresolved. Mutually exclusive goals and or values either exist or are perceived to exist by the parties involved. Conflict may involve situations in which two or more parties seek to impose their will on one another. These parties may be in conflict over a single resource, value, vision or strategy, for example, or one group or individual can be in conflict over several alternatives. Sometimes there is only one way in which something can be done, and this must be chosen from the known alternatives, or sometimes a completely new solution must be invented.

At an even more basic level, Freud described conflict as essentially an internal, psychological struggle between the demands of our id (what our instincts would urge us to do), our superego (what we 'should' do in order to be perfect) and our conscious self, or ego, which tries to mediate between the two by considering thoughtfully what, in its best judgement, the situation calls for (Fischer (1970)). He stated that conflict between these parts of us over what action we should take causes anxiety in us, and this anxiety 'demands' resolution of the conflict by some means or other. Freud further believed that people's ability to deal with external conflict is directly related to their ability to resolve their own internal conflicts. If this is so, a manager's awareness of his or her own internal anxiety levels, and what he or she does to cope with it (that is, avoid, confront, and so on) could be invaluable in understanding reactions to workplace conflict and the ability to deal with it.

In any conflict, as far as is possible, it is important to separate out

- the facts about the conflict;
- emotional reactions to the conflict (for example anxiety);
- ways or styles of coping with the conflict.

While these three groups of factors are interrelated, it is essential to distinguish between them and deal with each effectively.

Personal style in dealing with conflict

There is some evidence (Thomas and Kilmann (1974)) that people develop certain preferred styles in coping with conflict, and with the anxiety engendered by conflictual situations. These styles are dependent on, for example,

- personality factors;
- experiences;
- cultural background;
- family preferences;
- school training.

Often these ways of coping are used out of our conscious awareness.

A manager's preferred way of coping with conflict may or may not be the most appropriate method in a particular situation. The best way to maximise one's success rate in using an appropriate coping style is

- to be aware of as many styles as possible;
- to be flexible in terms of being able to use the style that best fits the situation (which means having skills or knowledge combined with appropriate personality attributes).

For some people this flexibility is a natural part of their personality makeup. For others who use one style or method of coping almost exclusively, it can be difficult to achieve a more open or flexible style when dealing with conflict.

Thomas and Kilmann developed a questionnaire to help people to identify their preferred style of coping with conflict. The styles or methods are based on two dimensions of behaviour :

- how assertive or unassertive a person's behavioural response to conflict is;
- how cooperative or uncooperative the person's response is.

You can see in the 2×2 matrix diagram of the Thomas–Kilmann model shown in *Figure* 1 how the various styles relate to each other.

Competition

Competition is a style that is based on being high in assertiveness and low on cooperation. It is based on the desire to meet one's own needs and concerns at the expense of others' interests. As it is a power-oriented style, those who use it gain cooperation by force, and they engender defensive reactions in others.

It is used in the workplace by overbearing people who insist on always getting their own way, as in the above example of the manager in his fifties. Those who use it repeatedly are bullies.

However, there are times when it is the most appropriate method to use when used judiciously. For example, it is a suitable style if someone has to protect him or herself or others from those (for example bullies) who take advantage of non-competitive behaviour.

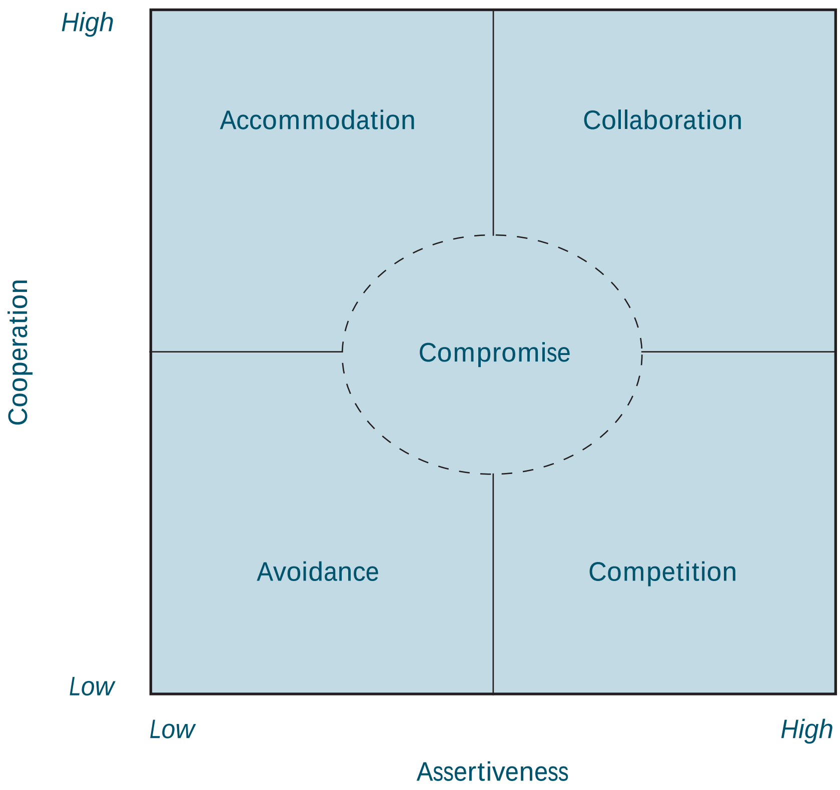

Figure 1 Thomas–Kilmann model matrix

Avoidance

Avoidance is characterised by uncooperative and unassertive behaviour. The conflict is not addressed, and both parties could be seen to be, or actually are, indifferent to the other's needs and concerns.

While this can be a useful technique to use temporarily while tempers are heated or when there is insufficient information to proceed, it is rarely a good permanent solution, and it can result in situations such as the bullying manager example. As a permanent situation, it is useful only when the possibility of reaching a resolution is very low, or when it is better that someone else resolve the conflict (perhaps the manager in the case of a conflict between two employees).

Accommodation

Accommodation is characterised by co-operative and unassertive behaviour. The other party's needs and concerns are placed above the person's own, even if he or she has very strong needs and concerns in relation to the conflict.

This is an appropriate coping style if one party is not as concerned about the issue as the other, or when one person has a great deal more power than the other. It is a commonly used method of coping with young children, because their needs often have to be met by parents who have to set their own needs aside.

Collaboration

Collaboration involves the maximum use of cooperation and assertiveness. This style aims to satisfy the needs and concerns of both parties. Ross (1982) points out that this style

1. acknowledges that there is a conflict;
2. identifies and acknowledges each party's needs, concerns and goals;
3. identifies alternative resolutions and their consequences for each party;
4. selects the alternative that meets the needs and concerns and accomplishes the goals of both parties;
5. implements the alternative selected, and evaluates the results.

This style requires more commitment, time and energy than the other styles. It is therefore often not used when people think that they have to ‘get on with it’ on projects and other team tasks. However, it is actually all the more appropriate in many workplace situations in which the resolution (for example the way forward on projects) will need the ongoing support of all parties.

Compromise

Compromise is midway between all of the other styles. It thus achieves only a partial fulfilment of the needs, concerns and goals of each of the persons or parties involved. It only partly achieves the benefits of collaboration, for example, but it helps to avoid some of the pitfalls of the other styles, such as avoidance or competition.

This is a suitable style when

- a temporary solution is sought;
- the parties have only a moderate investment in their interests;
- there is strong commitment to mutually exclusive goals and it is unlikely that either party will be able to dominate the other.

To sum up, a knowledge of conflict style is essential so that one can

- assess the type of conflict with which one is faced, and the type of solution it requires;
- be aware of one’s tendency to use a particular style, and be able to either use it or set it aside according to the needs of the situation.

Skills in dealing with conflict

The skills needed to deal with conflict can be summarised as follows :

- excellent communication skills;
- the ability to recognise and deal effectively with emotions (both one’s own and those of all the other parties to the conflict);
- the ability to work toward the common good in a situation.

Kindler (1988), in his work on managing disagreement constructively, outlines some basic guiding principles to keep in mind :

- Preserve the dignity and self-respect of all concerned.
- Listen with empathy.
- Expect to change only the particular behaviour of others that affects the conflict in question, not their basic behavioural style.
- Express your independent perspective even if it cannot be satisfied

This attitudinal framework helps to provide the context for a straightforward method of dealing with conflict :

1. Prepare yourself for the negotiation. Consider and write down what you will say. Make an appointment to deal with the conflict.
2. ‘Send’ your message. Usually this should be done in person.
3. After you have delivered your message, be silent. Allow the other party or parties to respond, react or just take in the message.
4. Listen reflectively to their response. Be prepared for other parties to deny, defend themselves, or offer rational explanations for behaviours. Also, be prepared for the possibility that you may have incorrect or incomplete information.
5. Recycle the process if necessary.
6. Focus on finding a solution (rather than on trying to determine who is to blame for the conflict).

If you are the mediating party in a conflict, you can structure and facilitate the process in a similar way.

Summary

Dealing with conflict, dealing with difference, or dealing with the frustration of not getting all that we want in a situation is a normal part of workplace existence. We can do it well or poorly; it is our choice. However, dealing with conflict is an essential managerial skill. We learn to do it in the same way that we learn to do many things : informally, for example through experience, family rules and cultural norms. It may or may not be appropriate to use those methods when faced with workplace conflict.

With the increasing emphasis on effective teamwork in the workplace, and also effective project management, dealing with conflict in a skilled, caring and business-like manner is essential. For management personnel as a whole, dealing with conflict efficiently is a time saver and morale booster for all in the workplace environment.

In order to be effective in dealing with conflict situations, we have to be willing to examine our own attitudes about conflict, and question whether we have the flexibility and the skills required to deal with it appropriately. If the answer is no, we should view it in the same way as any other managerial skill; it must be learned and practised if we want to be able to use it effectively. It is not necessarily a natural skill for many of us, but it certainly can be learned.

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- ***Controlling the Costs of Conflict***
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- ***Developing Management Skills***
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  A general book on the necessary skills for good people management that includes a good chapter on managing conflict.

The marketing toolkit

Marketing decisions can be informed by the use of a number of analytical tools designed to highlight possible strategies, or the attractiveness of a company's or competitor's position. Various such tools are described, and their key features and limitations are highlighted to show how they can best be used.

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It is a natural human trait to seek certainty and reduce risk. Indeed, the art of management is to balance risk against reward as a route to generating profitability. Tools that help us to improve understanding and the quality of our information help us to make better decisions and thereby reduce risk. Managers also commonly hold the view that the quantification of risk through the medium of numbers is somehow more objective and scientific, and hence provides more reliable and believable information.

Numbers are precise by their very nature, but we should not confuse this with accuracy. If the underlying analysis is incorrect or faulty in some way, then, however precise the numbers are, the information is still inaccurate. Marketers, like everybody else, live in an uncertain world where, working from the certainty of the knowledge of the past, they deal with forecasts, estimates and predictions of the future, be that in terms of customer behaviour, market trends, or factors within the wider business environment. Each of these has to be understood so that marketers can make sensible decisions about the potentially infinite ways in which resources, and in particular money, can be deployed.

The marketing tools that we use are potentially extremely useful, provided that they are used properly and correctly interpreted. They have a number of uses :

- They reduce the multitude of complex issues into things we can actually understand, and in this way turn data into information.
- By careful selection and application of the appropriate analytical tool, we can ensure that we systematically and comprehensively analyse the internal, external and competitive business environments.
- Consistent application of the tools allows us to produce comparative information, either at a point in time (for example across a range of products), or over time, to help us understand trends.

What do these tools look like that are so wonderful and can do so much for us ? You certainly do not see too many marketers walking around with a hammer and screwdriver, so what is it that helps us to get to grips with our marketplace ? An extensive list of just some of the tools that can potentially be used is given in *Figure* 1. Previous marketing and strategy articles in MQ have dealt with many of these tools.

One of the mistakes that inexperienced marketers make is to use all of the tools all of the time. If this happens, the marketing job can be seen as one that consists almost exclusively of working with data, leading to the unfortunate state of 'analysis paralysis'. Let us take a selective look at some of the major tools, and in particular those that are used for the analysis of the product range.

Product lifecycle

The product lifecycle is a framework through which we understand how products enter, grow, mature and finally exit from the market (see *Figure* 2). Sales are plotted against time, but the tool has much greater value when product sales are also compared with market size, so that we can track market share.

Industry	Industry analysis Industry lifecycle Generic strategies Directional policy matrix
Product	Product lifecycles Ansoff matrix Boston matrix Product portfolio Volume/value/share Pareto analysis
Customer	Demographics Cycle of innovation Segmentation Qualitative/quantitative research
Market	Competitor analysis Channel management Demographics Integration/fragmentation issues

Figure 1 Planning tools

An understanding of the phases of the product lifecycle can indicate appropriate marketing activity. For example, in the growth phase, gaining market share and hence volume is very important, as experience shows that market share becomes very 'sticky' in the mature phase. Thus, by growing market share, we can positively influence long-term profitability. Hence in this phase there is likely to be considerable promotional activity and the development of new routes to market as the market expands. Some companies have a policy of innovation (for instance 3M, Hewlett Packard, Black & Decker, and Toshiba in the laptop computer market). They continually develop and introduce new products as a way of growing their businesses and forcing their competitors to follow.

Matrixes

Some of you who have sat through presentations by marketers may have been struck by their use of a simple but effective analytical device, the matrix. Very simply, two intersecting lines create four boxes on the matrix, and each axis is then labelled (see *Figure* 3 for an example).

This simple device can generate surprising insights, although it is sometimes unkindly said that the overuse of the matrix tool demonstrates the two-dimensional thinking of marketing people !

The use of the product lifecycle, for example, begs the questions of when a new product should be introduced, and when an old one

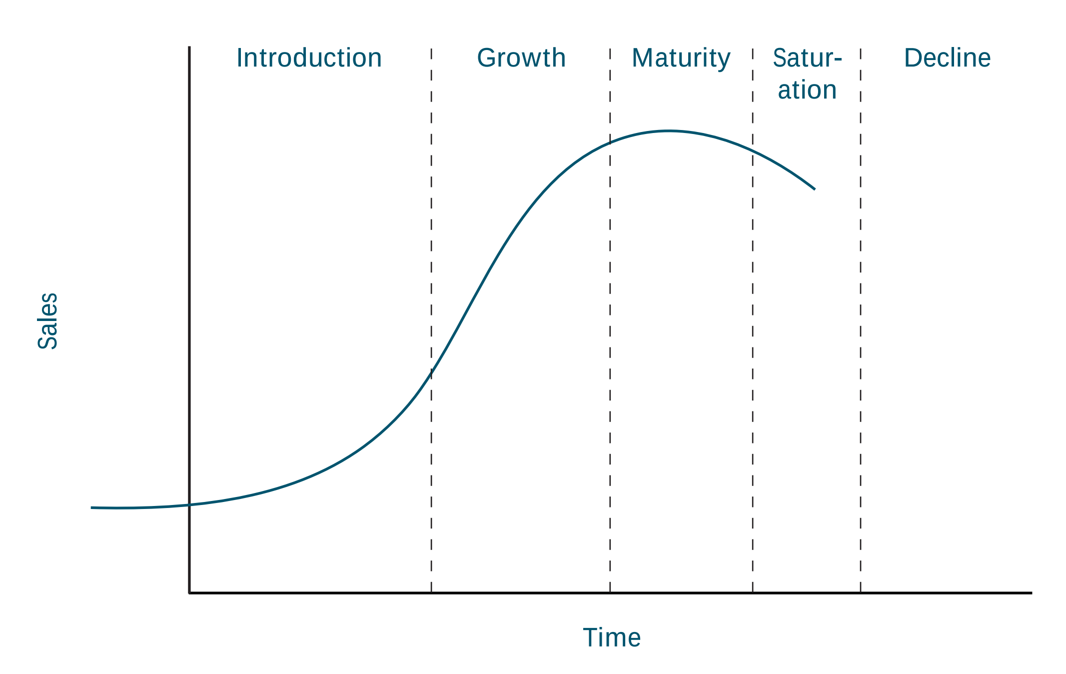

Figure 2 Product lifecycle

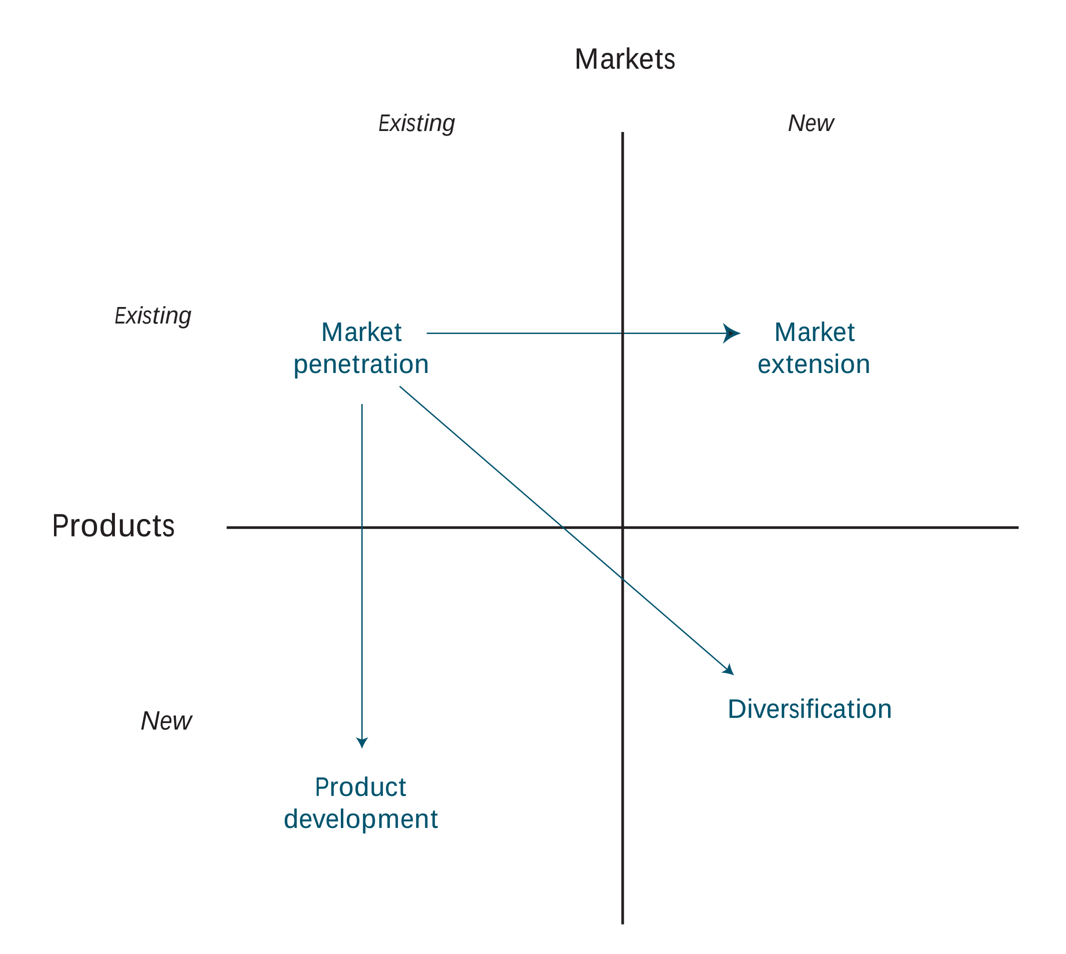

Figure 3 Ansoff matrix

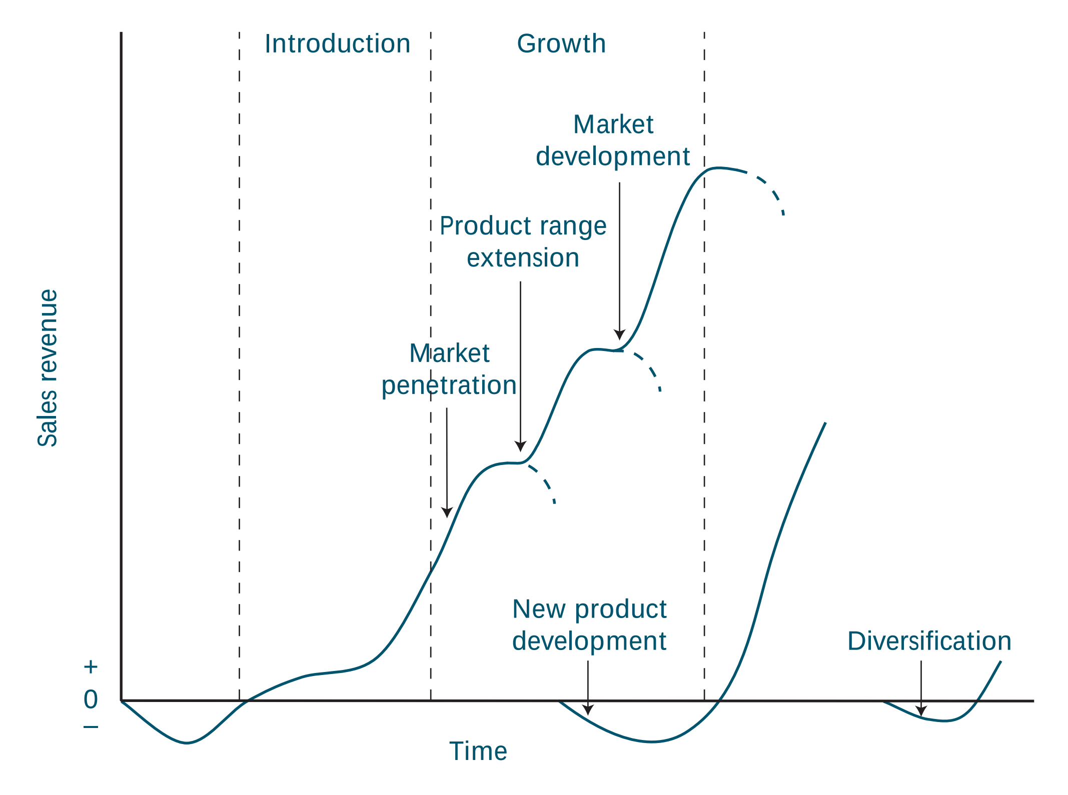

Figure 4 Ansoff matrix and the product lifecycle

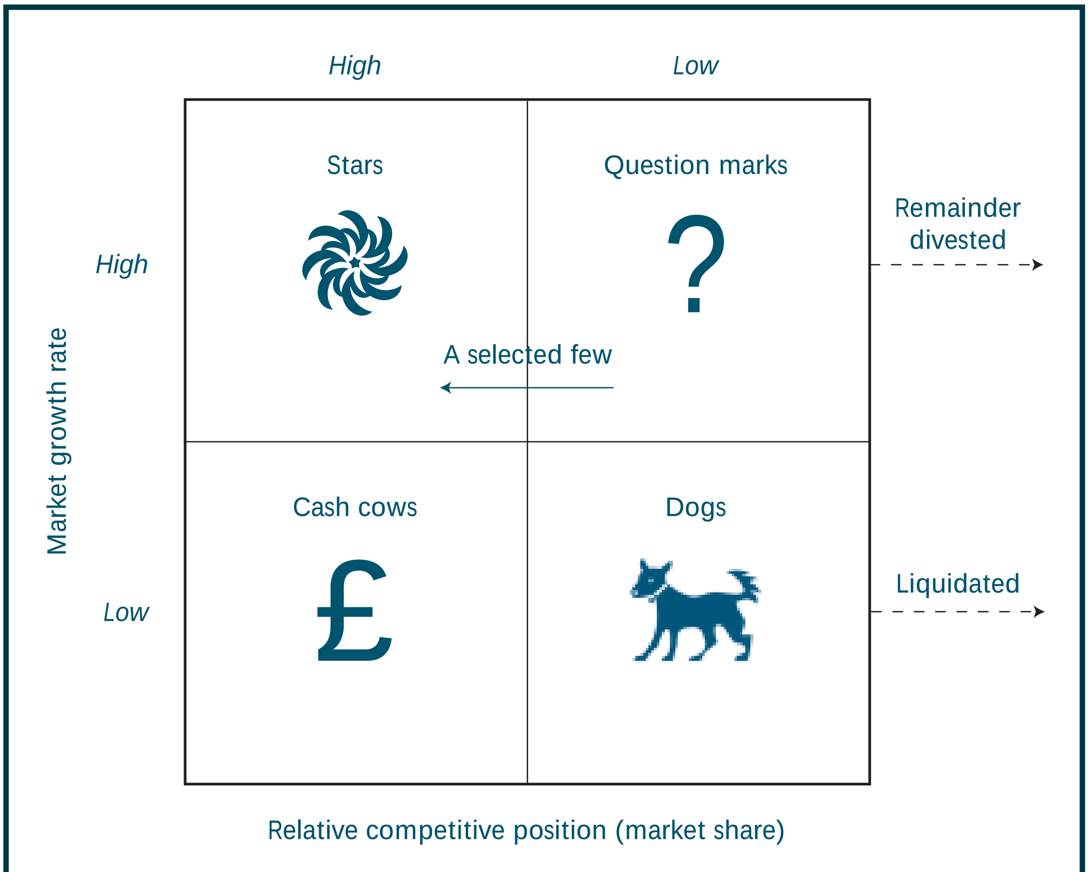

Figure 5 Boston or growth/share matrix

should be deleted. Also, how do we decide which type of product to introduce : a 'range extension' offering variants on a current product, or a further development of the product range with perhaps complementary products ? This might, for instance, be a new range of fabric softeners to support our current offering of washing powders. Several matrix tools can help us to address these issues.

Ansoff matrix

The first tool is the Ansoff matrix, which was named after Igor Ansoff, the corporate strategist for General Electric in the 1960s. As *Figure* 3 shows, this matrix has two axes labelled 'products' and 'markets', and there are 'existing' and 'new' subdivisions.

We can use this matrix to start to understand where our product range is concentrated, and to weigh up the various opportunities for product range development. What we try to achieve is a sensible balance between our core business, existing products/existing markets, and the extreme of diversification. Each of these represent very different levels of risk, and of course profit is the reward for risk. We need to exercise careful judgement in order to balance our planned growth against the potential downsides.

The Ansoff matrix is particularly useful in a process known as gap analysis. How can we bridge the gap between a somewhat pessimistic, or at least unacceptable, forecast and the desired position that would deliver the required profitability ? By considering each box of the Ansoff matrix, we can look for incremental improvement in performance, taking care to balance risk against reward.

Perhaps in our core activity there are opportunities to increase penetration, or maybe to take out some costs. With existing products, there may well be opportunities in as yet untapped markets, or maybe with a little more development we can meet more needs of our current customers. Generally speaking, we would consider diversification as a last resort. This is a risky operation in which we diversify from our core business into an area that is unknown to us, but which is of course our competitors' core activity, in which they are likely to have more advantages than we do.

This is an iterative approach that requires experience and insight, as the process is by no means as simple as it appears. *Figure* 4 shows how we can manage each area of the Ansoff matrix in order to contribute towards our overall target achievement.

Boston matrix

A matrix-based tool known as the Boston matrix or growth/share matrix can help us to understand the principle better. An additional benefit is that we can use it to manage not just one product, but a range of products. Hence it is sometimes generically known as a portfolio analysis tool.

The Boston matrix originated from the Boston Consulting Group, and it appeared in the early 1970s.

The matrix has two axes labelled 'market growth rate' and 'relative competitive position (market share)' (see *Figure* 5). This indicates the value attached to market share as a factor in the ability to compete. The matrix can be a little tricky to construct, and we will discuss the main principles rather than the details here.

The market share scale can be determined in relation to the conditions prevailing to give a meaningful spread so that a sufficiently comprehensive view can be provided.

It is also important to define the unit of analysis, which could be one product, a class of products, or even business units. Once this has been decided, the units of analysis (commonly products) can then be plotted on the matrix.

The Boston matrix was initially designed as a financial management tool. The quadrants of the matrix originally had labels such as 'annuity' and 'loan', but they now have the graphic descriptions 'problem child' or 'question mark', 'rising star', 'cash cow' and 'dog'.

- The cash cow, from its high market share, low market growth box, generates cash that can be reinvested in products new to the market or grow their market share.
- The problem children are generally cash hungry.
- Rising stars are cash neutral.
- Dogs are also regarded as cash neutral, and they represent the final stage of the progression of the product around the matrix (see *Figure* 6).

The relationship to the product lifecycle is quite clear.

These graphic descriptions of products also suggest the appropriate strategy for each type of product, as well as the criteria by which success should be measured.

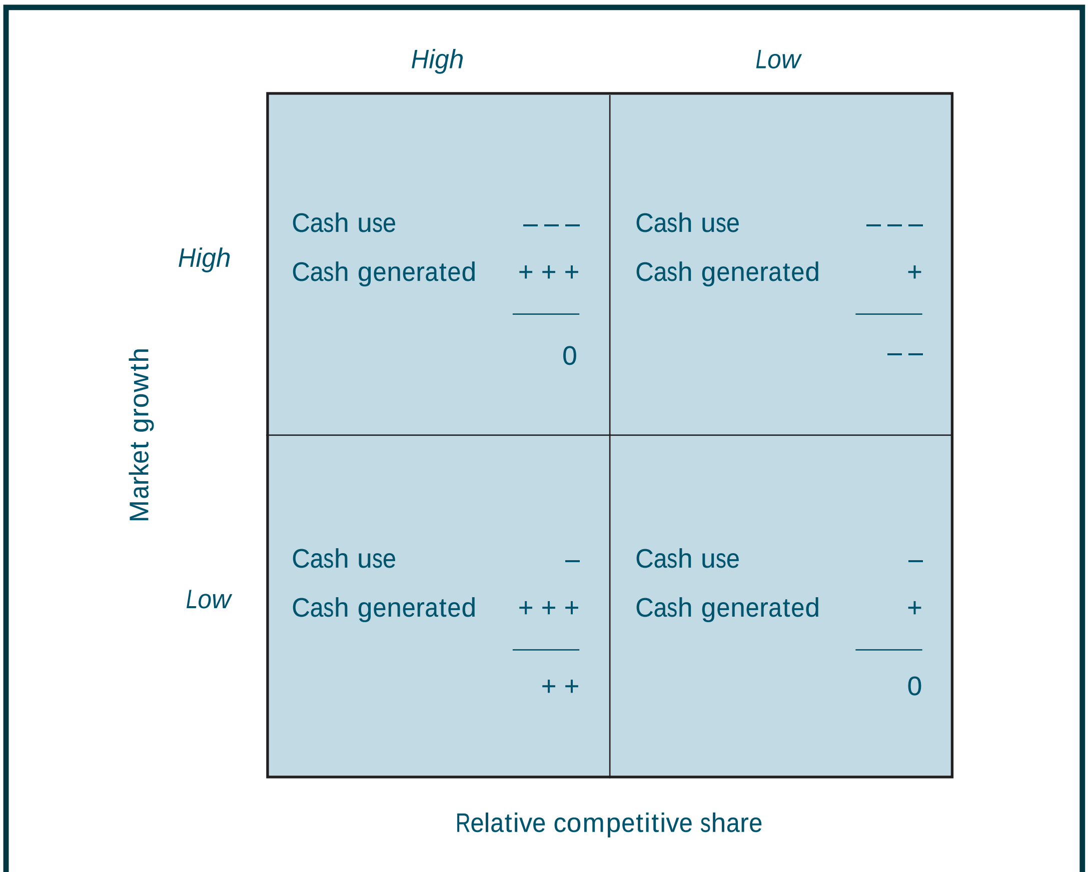

Figure 6 Boston matrix and the product portfolio

- New products coming into the matrix as problem children require investments in both product and market development, and so the future potential income stream will be an important factor in these somewhat risky investment decisions.
- Market share is generally easier to obtain as markets develop, and hence we should aim to grow volume for rising stars as quickly as possible in order to create a profitable cash cow for the future.
- With cash cows, there needs to be careful consideration of the balance between cash generation and maintenance of position in the market. There is no immutable law that says that cash cows will eventually die. However, many a good cash cow has been overmilked and the market share 'sold' to generate profits in the present rather than the future.
- Dogs are products that are reaching the end of their profitable life. Their retention within the product range should be carefully considered, and return on capital employed is often an appropriate criteria.

Directional policy matrix

Such was the success of the Boston matrix that one of the Boston Consulting Group's competitors, McKinsey & Company, developed and introduced a similar matrix-based portfolio tool. This is known by a variety of names : the GE (General Electric) matrix or Shell matrix (named after the companies that assisted in its development), or the directional policy matrix.

The directional policy matrix (see *Figure* 7) was originally developed as a 3×3 matrix, no doubt in an attempt to be bigger and better, but it is also commonly seen in the four box format. The main difference between it and the Boston matrix is the way in which the axes are constructed. They are usually labelled 'market attractiveness' and 'business strengths'.

The advantage that this tool has over the Boston matrix is that each of these main headings can incorporate a number of variables. For example, market attractiveness could be composed of a number of factors, such as growth, size, and margin availability.

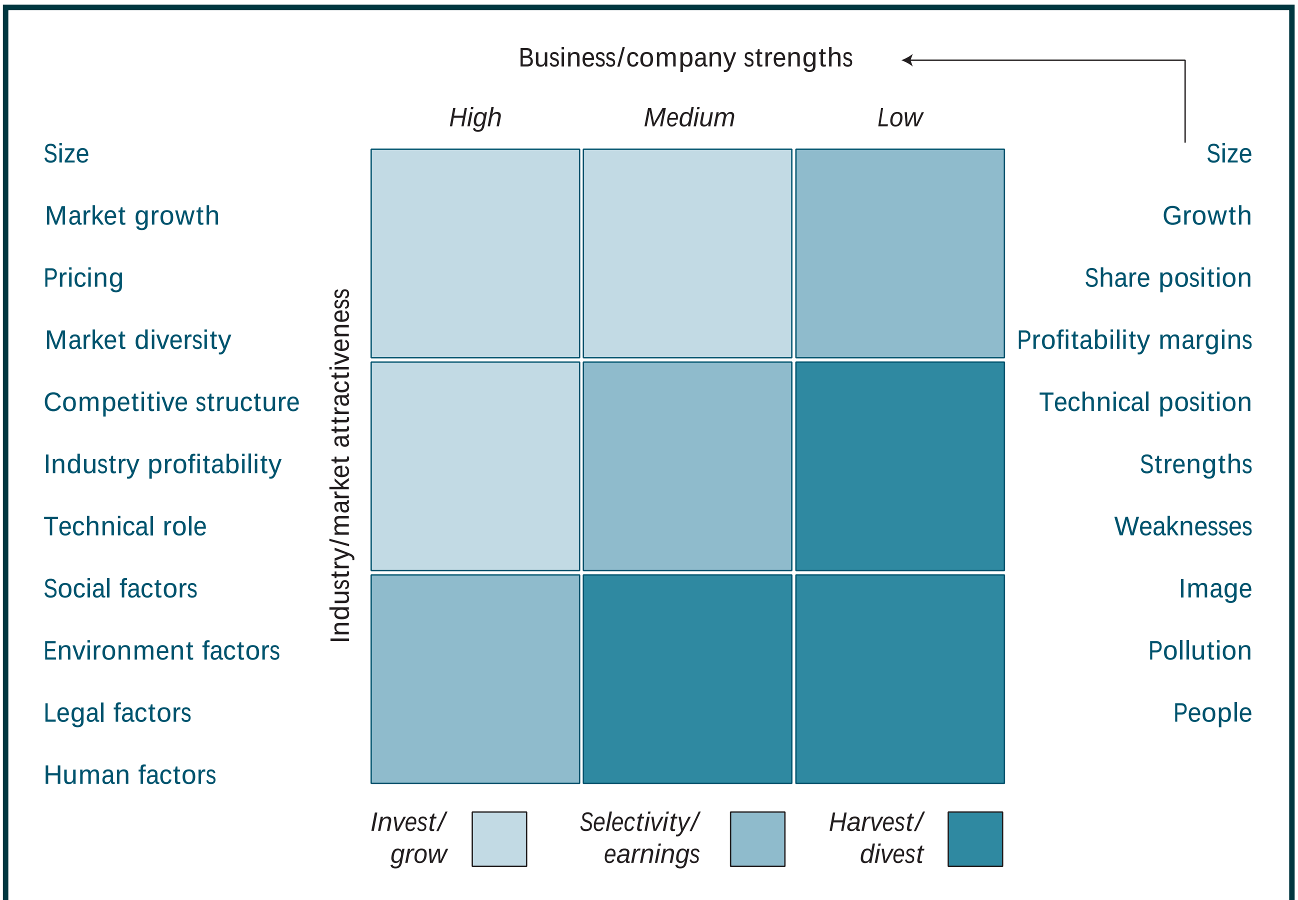

Figure 7 Directional policy matrix

To construct the axes, a series of criteria such as these are derived. They are then weighted in order of importance and scored, usually on a 1–10 basis. The overall score is then calculated by multiplying the score by the weight and summing for all the factors.

Strategic guidelines can be derived on the basis of the relative position of the product or other unit of analysis on the matrix measured against the axes, and this is indicated in the general advice to ‘invest’ or ‘harvest’, for example. However, we should be cautious about such generalised advice, as there are many issues to consider, and while the principle may be sound, the detail and specifics of our situation may not be so simple. All of these tools can be used to analyse products within a range, or indeed to analyse a market that includes competitors.

Marketing tools

Over the years, these matrix/portfolio tools have proved to be very popular with managers. Their visual, graphic nature can be powerful in demonstrating gaps in the market and in engendering discussion and debate as a result of the analysis. The ability to summarise so much information in one diagram with the lead in to strategy formulation is seductive.

However, an over-simplistic belief in these tools can quite literally lead to an inability to ‘think outside the box’. Also, the precision of the tools may mislead managers into thinking that they are in some way a ‘correct’ view of the situation. There are numerous ways in which estimations and subjectivity can creep in to the development of the matrix, and indeed it is not unknown for some managers, for their own reasons, to manage the selection of criteria and the way that they are scored carefully. In extreme cases, these tools can represent no more than quantified subjectivity. When being presented with such a matrix, be careful to question carefully where the source information was obtained and how the axes have been calculated before going on to question how the conclusions relate to the analysis as it is presented.

Conclusions

Analytical tools are used as part of the market audit process, whereby the external business environment, competitors, and the organisation's own products and other internal resources are regularly reviewed as a prelude to strategy development and planning. A full and comprehensive understanding of all the relevant issues helps managers to make better decisions, and in this way information has a critical role to play in reducing risk. These tools help marketers to formalise their understanding of markets. This then helps in defining the really significant issues usually crystallised using SWOT analysis (strengths, weaknesses, opportunities and threats).

All of this means that there comes a point when the marketer should say that enough is enough; the analysis is as complete as it can be within the constraints, usually of time and money. The time has arrived when the analysis should be reviewed, understood and used as the basis for future action, in other words, to decide strategy and develop competitive advantage. All this perspiration can then be supplemented by a degree of inspiration. Marketing is an art rather than a science, and there is room and indeed a need for a creative approach.

Further reading

- ***Principles of Marketing***

  Brassington, F and Pettitt, S (2000) Prentice Hall

  Anyone with a large gap on their shelves will find this book useful. It is almost too large, but it is comprehensive, well written and illustrated with many diagrams, photographs and examples. This is a standard and up to date reference work that is well illustrated and laid out with numerous examples.

- ***Marketing Plans* : *How to Prepare Them, How to Use Them***

  McDonald, M (1995) Butterworth–Heinemann

  This demonstrates very clearly how the analytical tools of marketing work and contribute to the marketing planning process. It discusses in more detail the way in which matrix tools are constructed and used. This is a very popular book with marketers, and it is recommended for its simple yet comprehensive style.

- ***Nuts, Bolts and Magnetrons* : *A Practical Guide for Industrial Marketers***

  Millier, M and Palmer R A (2000) John Wiley

  This book is primarily intended for those recently appointed to a marketing position, and it is concerned not just with the principles of marketing, but also with the practical issues of how to apply them in practice. If you are faced with having to attempt the task of marketing, this will be of interest.

- **'Matrix'**

  (2000) http ://www.market-modelling.co.uk (accessed 13 June 2000)

  This is the website of a software developer/ vendor that produces a Windows PC based application that automates the analytical process. In particular, the software produces a wide range of matrix applications in a sophisticated format. Visit this site to see detailed examples of the various matrix tools together with a brief discussion of each one. A download enables you to explore the use of matrix tools in detail.

Financial instruments

Company financing, in its simplest form, can be debt or equity. In this article, we explore some of the rich variety of financial instruments that lie on the risk–return continuum between these two extremes, and consider when their use might be appropriate. Various kinds of debt and equity are reviewed, together with hybrid instruments and other types of financing, such as securitisation and leasing.

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A fundamental question for any business is that of how to finance its operations. At the most basic level, there is a choice between equity and debt. However, there are many financial instruments that can be used to finance a business, including some that have the characteristics of both equity and debt. This article examines a range of such instruments, and identifies situations when their use is appropriate.

How to finance ?

Key issues to be considered when financing a business include

- availability of finance when needed;
- costs of finance;
- flexibility.

Previous finance articles in MQ have identified that equity costs more than debt, and that a suitable capital structure can optimise the cost of capital. However, different financial instruments offer different degrees of flexibility as well as incurring different costs. In essence, the holders of these instruments take different degrees of risk and therefore seek different returns.

A basic business is likely to be funded by a mixture of equity and debt. The basic differences between these are shown in *Table* 1.

There are

- many different types of debt;
- hybrid instruments (such as convertibles and warrants) which carry obligations for repayment and payment of interest like debt, but also rights to participate in the growth of the business as equity;
- different types of equity with different rights, particularly in any winding-up.

From the company's point of view, a high degree of debt is attractive, because that decreases the cost of capital (owing to the lower level of riskiness and the tax

Table 1 Debt and equity

Debt	**Equity**
Repayable	Usually permanent
Interest payments must be made	Dividends discretionary
Interest tax-deductible	Dividends paid out of after-tax earnings
Paid out before equity in a liquidation	Last in line in a liquidation
Lower cost to company	Higher cost to company
Lender can protect downside by security/ covenants	Shareholders' downside limited to amount paid for shares
No upside	Unlimited upside

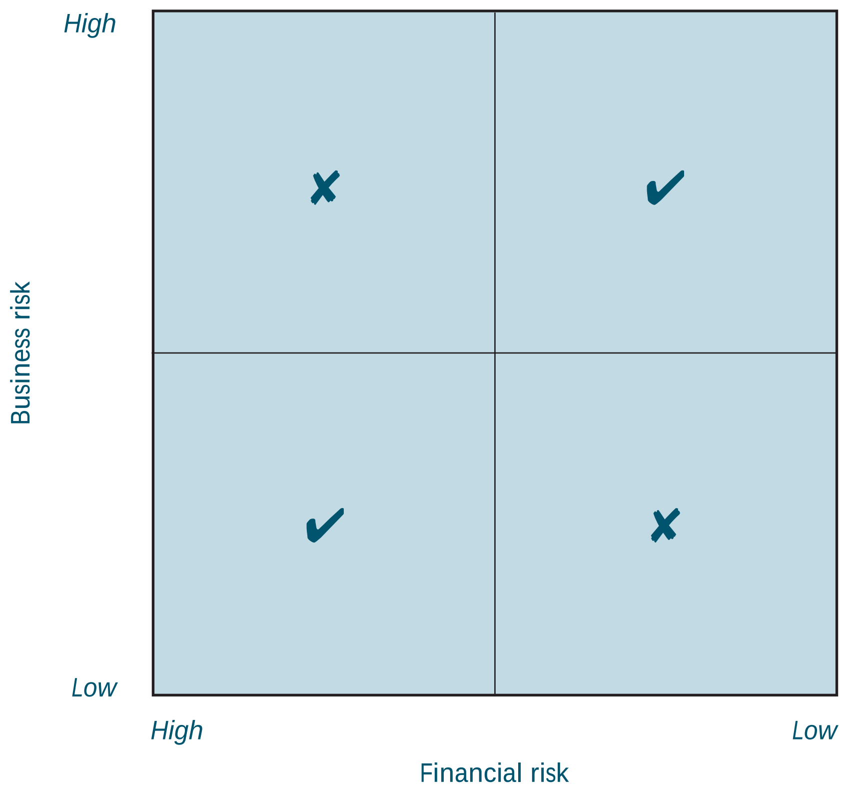

Figure 1 Risk matrix

deductibility of interest). However, there is a limit to the total level of risk that a business can bear as a result of the combination of business risk and financial risk. Therefore, the amount of risky debt that a company can take on is also a function of the business risk, represented by the volatility of future cashflows. See *Figure* 1.

Before examining individual instruments, it is helpful to set out instruments in terms of riskiness (defined as ranking in a liquidation and as reflected in the extra return demanded). Generally, the further an instrument is to the right of *Figure* 2, the higher is the effective cost to the company and the higher is the return expected by the provider of capital. The return in the form of ordinary shares will include dividends and capital growth, whereas the other instruments may have stated 'interest rate' type returns on either a fixed or floating rate basis. In some cases, the returns expected from hybrid instruments may exceed those of preference capital because of the expected additional returns from the equity component (see below).

The differing characteristics of each type of instrument are examined below.

Equity

There are two basic types of share : ordinary shares and preference shares.

Ordinary shares

The investors who hold the ordinary shares of a corporation (called common stock in the USA) are the owners of the company. They have the right to share in the success and failure of the business indefinitely. In most countries, ordinary shareholders of publicly listed companies have the following common rights :

- a share in the profit of the business through the payment of dividends;
- voting rights at annual general meetings;
- limited liability if the company goes into liquidation;
- the last claim on the assets of a company that goes into liquidation;
- information in the form of an annual report that includes financial statements.

As noted above, ordinary shareholders receive a return through dividend payments

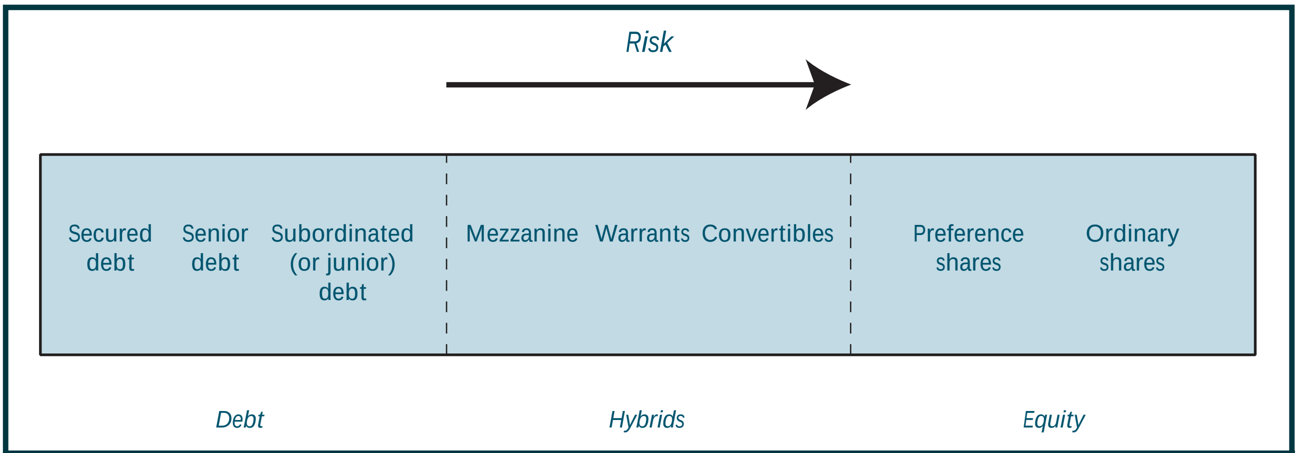

Figure 2 Risk continuum

as and when they are declared by the directors. Most shareholders also expect return through capital appreciation of the share price. Theoretically, ordinary shareholders' returns are unlimited.

Preference shares

Preference shares (preferred shares) are shares which carry defined rights to the profits and distributions of capital of a firm. These rights are usually limited to a specified dividend amount, which must be paid prior to the payment of dividends to ordinary shareholders. Common characteristics of preference shares include the following :

- *A fixed dividend* : This is usually set as a percentage of the nominal or par value of the share. (For example, a preference share with a par value of 100 pence might carry an 8% dividend, or 8 pence payable annually.)
- *Limited voting rights* : Preference shares typically carry no voting rights unless the payment of dividends is in arrears.
- *Priority over ordinary shareholders in a winding-up* : Preference shareholders receive the par value of their shares before ordinary shareholders in a winding-up. Both types of shareholder are subordinate to all debt holders.
- *Permanent capital* : Preference shares are generally a source of permanent capital.

Dividends on preference shares are often cumulative, that is, any arrears in the payment of preference share dividends must be caught up before non-cumulative or ordinary share dividends may be resumed. Non-cumulative shares are the opposite of cumulative shares. If a company misses a dividend payment on a non-cumulative preference share, it is not required to make up the dividend.

A typical reason for issuing preference shares is that a company needs equity capital, but does not wish to dilute the voting rights of the ordinary shareholders. As many preference shares have the requirement to make a fixed return, as in the case of debt, they are either issued to maintain voting rights, or they carry the right to be converted into equity at a later stage. In many jurisdictions, preference shares are counted as capital for banks and other financial institutions. In these cases, shareholders prefer the financial institution to issue preference shares, as they still provide capital for regulatory purposes, but otherwise have many of the characteristics of debt. Preference shares are often known for accounting purposes as 'non-equity' shares.

Investors in preference shares are looking for the additional return (for the additional risk) when compared with debt, but are not looking for the extra upside of ordinary shares.

Hybrids

The term 'hybrid' is used to describe a financial instrument that combines features of both debt and equity. Companies issue hybrids for a range of reasons. For smaller businesses, they are frequently used as part of the mezzanine financing in leveraged buy-outs in situations where the conventional debt capacity has been exhausted, and the ordinary shareholders do not wish to dilute their interests. Larger companies may issue hybrids either as part of a complex tax-based financing, or to manage equity issuance in the future (by requiring conversion).

Convertibles

The most common hybrid in the UK is the convertible bond (sometimes referred to as a convertible debenture). Convertible preference shares are also issued. Convertible bonds are discussed in this section of the article, but most of the principles apply to convertible preference shares as well.

A convertible bond pays interest (preference shares issue dividends) like a straight bond, but in addition, it gives the investor the option to 'convert' the bond into shares of the company at some date in the future. The conversion price is set at the time of issue, and it is typically above the share price at the time of issue (this is the conversion premium, which is typically around 25%). The right to convert the bonds into shares cannot be separated from the bond itself.

In order to exercise the right to purchase the shares, the investor must surrender the convertible bond to the trustee, who will then deliver the specified number of shares to the investor.

The interest rate paid is lower than that on a straight bond issued by the company with the same maturity, because the option to convert has a value for which investors are willing to pay. The coupon rate on the bond and its conversion premium are linked : the higher the conversion premium is, the higher the coupon is.

Issuers are often attracted to convertible bonds because they view them as the issue of deferred equity or equity at a higher price than today. Convertibles typically have a longer maturity than straight bonds issued by the same company, although, if everything goes well and the shares increase in value, the bonds will be converted prior to maturity. There is no immediate dilution of ordinary shareholders when the convertible bond is issued, and its earnings per share are thereby maintained. Prior to conversion, the issuer is permitted to deduct the interest payments on the bond when calculating tax.

For large companies, convertibles may be offered because of the tax deductions available. Other companies may choose to issue convertibles at a stage when they wish to secure low current financing in order to develop the business, but reward the investor with upside potential if the business is successful.

Investors in convertibles are risk-seeking specialists. For quoted issues, there are sophisticated valuation models which allow investors to price their returns. For unquoted issues, as in buy-outs, the investors are high-yield specialist funds.

Warrants

The other common type of hybrid is the bond with equity warrants. In this case, a fixed-rate bond is issued (again at a sub-market rate), and a set number of warrants accompany each bond. These warrants entitle the holder to purchase a pre-determined number of shares at a predetermined price for a fixed period.

The great difference from convertible bonds is that the warrants are separable from the bond, and they normally are separated. This approach allows different investors to trade in the bond (risk-averse, fixed-rate investors) and the warrants (risk-seeking investors). From the issuer's point of view, the risk is that the bonds have to be repaid but the warrants are not exercised.

Debt

Debt comes in various forms, and it is typically provided by either banks (through a private market) or institutions (through a bond or public market). Different types of debt may have different risk characteristics and therefore cost different amounts. The main differentiating characteristics between types of debt are the following :

- secured or unsecured;
- priority ranking in a liquidation;
- committed or uncommitted (that is, is the lender obliged to lend ? – overdrafts are a typical type of uncommitted debt);
- fixed or floating interest rate;
- currency of borrowing.

The types of debt that are described below are normally used in specialist financing situations such as acquisitions, leveraged buy-outs and project financing.

Senior and subordinated debt

Senior debt is a term frequently used in acquisition financing. It is 'senior' as opposed to 'subordinated' : subordinated debt ranks behind senior debt in a liquidation (and also behind other lenders). Convertible bonds are frequently subordinated to other lenders. The characteristics of senior debt depend on the financial strength of the borrower, and they may not differ particularly from the terms for normal debt.

Mezzanine debt

In an acquisition (and frequently in the case of leveraged buy-outs), some lenders lend more than the cashflow of the underlying business would justify. Mezzanine debt fills the gap between the amount provided by conventional debt and equity. In this sense it is an alternative to diluting the equity base.

To enhance the return, lenders are frequently provided with warrants. This mezzanine debt is subordinated to the senior debt, and it also attracts a significantly higher interest rate than the conventional debt.

Interest on mezzanine debt may be ‘rolled up’ in the early years while the senior debt is being repaid and there is likely to be a prepayment penalty.

High yield bonds

High yield bonds are frequently referred to as junk bonds. A high yield bond, as one might expect, generally carries a high coupon offering the investor a high yield to maturity. It does so because high yield bonds are issued by companies with low credit ratings (BB+ or below as rated by Standard & Poor, or Ba1 by Moody).

The high yield market allows these companies (which are typically fast growing) to access the long-term capital market. In most cases, banks refuse to extend long-term fixed rate loans to non-investment-grade borrowers. When bank credit is available, it is typically offered only on a floating rate basis at punitive interest rates.

Specialist forms of financing

Securitisation

Companies are a mixture of assets financed by some combination of debt and equity. Companies should constantly attempt to minimise the cost of finance, and they will also need to raise further capital. If debt can be raised, then this will limit the amount of equity required, and it *should* increase the returns on the equity.

However, there are limits to the amount of traditional debt that banks (and other lenders) will lend.

Sometimes companies with specific assets will be able to finance those assets by issuing financial instruments that are then tradable. These assets may be

- physical (for example commodities);
- financial (for example credit card receivables);
- of another type, such as mortgage payments secured on loans made by a lender.

In effect, securitisation operates by repaying the debt (and interest) from the cashflows that arise from the assets that have been securitised. The advantage of this is that such assets may then be financed on attractive terms based on the risk of the underlying asset. For example, when the Tussaud’s Group was bought out, part of the re-financing involved securitising the income streams from Madame Tussaud’s and Alton Towers.

Investors in securitised issues are funds that will look for known cashflows with little risk, and will therefore be prepared to accept a lower return. In many cases, the extra risk is limited by the provision of backstop guarantees from the ultimate borrower.

Leasing

Leasing is a specialised form of asset finance. The lender (the lessor) owns the asset and retains the capital allowances. The user (the lessee) pays lease rentals to the lessor, which are then tax deductible. The attractiveness of leasing for many businesses is very often tax driven. Typical uses of leasing are when the following are the case :

- The lessee is a small business, and it does not wish to use its debt capacity to borrow for specific asset purchases (for example machinery).
- The lessee has no tax capacity, and it cannot make use of the capital allowances.
- The lessee does not wish to take the risk of technical obsolescence some time into using the asset (examples are computer equipment and motor vehicles).
- The asset being financed is very large relative to the size of the lessee’s business, and there is a ready secondary market (examples are ships and aircraft).

Conclusions

The specific type of finance to be used varies according to

- the nature of the asset or business to be financed;
- the underlying business risk and how much financial risk can be accepted;
- the desired capital structure and amount of available equity.

This means that many businesses normally just use conventional equity and debt. However, in certain circumstances such as buy-outs, acquisitions and major asset purchases, other types of financing are used, particularly if there is an underlying change in the capital structure with consequent changes in the costs of equity and debt.

The stage in the lifecycle of the business also determines the type of financing used. In the early stages, a higher level of equity is required; at stages of fast development, the use of hybrids may be considered as an alternative to debt. However, mature businesses with predictable cashflows are able to raise more debt, and thus reduce their cost of capital.

The most interesting and complex structures arise during leveraged buy-outs. In these situations, there is almost certainly a mixture of ordinary shares, conventional debt, high yield debt, and warrants. In some cases (as with the Tussaud's Group), part of the financing may be refinanced using securitisation.

However, for any business, there will be a regular need to examine the mix and cost of financing. The objectives will be to maximise the return to shareholders while minimising the cost of external finance and yet ensuring the availability of capital to grow the business. The choice of alternatives is wide, and financial organisations are regularly developing new alternatives. In the end, though, it is all about what degree of risk will be accepted for what return.

Further reading

- ***Corporate Financial Management***

  Arnold, G (1998) Pitman

  A UK-based standard finance textbook that sets out clearly some of the types of financial instrument and the reasons for their use.
- ***The Financial Times Guide to Using the Financial Pages***

  Vaitilingam, R (1996) Pitman

  A bit light on explanations of the instruments, but a very useful guide to how securities (and everything else) are reported in the financial press.
- ***Mastering Finance***

  (1998) Pitman

  A useful collection of Financial Times *articles on finance topics written by leading academics.*

Thinking outside the box

The problem with a small 'thinking box' is that it restricts the sources you might consider and the solutions you might produce. This article illustrates clearly the benefits of expanding your thinking space, and sets out some suggestions for mental exercises to do this.

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Thinking outside your box

Mohinder and his team at U-Hoo were having real difficulties with one of their key suppliers of electronic components. Although they kept agreeing prices and timescales for the delivery of parts, O-Kay were habitually demanding prices substantially above those agreed, and consistently delivering the parts late.

Although an obvious solution to the dilemma was to find another supplier, the O-Kay components had characteristics which made them an ideal fit for the U-Hoo products, and many of the companies' engineers had worked alongside one another to achieve the kind of synergies about which Tom Peters and other management gurus were so enthusiastic. Also, finding another supplier would take time, and time was, as we all know, money.

U-Hoo could impose penalty fees on O-Kay, but the worry was that if it threatened the supplier too much, O-Kay would just take its components elsewhere. In addition, U-Hoo had customers waiting for its products, and it could not really afford any more delays.

Mohinder was determined to find a solution to the problem that would keep O-Kay on board, but which would see them responding more reliably to agreements. He and his team had met several times to try and think of a new way of handling the issue, and this morning there would be yet another meeting to discuss possibilities. It seemed that lately they just kept going round and round over the same ground though. They really needed a new way of thinking about O-Kay and U-Hoo's relationship with it.

On the way into the office, Mohinder stopped to buy petrol. As he was paying his bill, he found himself looking at a box of continental chocolates beside the till. 'Hmmm,' he thought, and bought three family-sized boxes.

He was the last to arrive in the meeting room, and he put the boxes of chocolates down on the table with a flourish. The rest of his team looked at him as if he was behaving very oddly. 'We need a new way of thinking about O-Kay', he started, and began undoing the plastic wrap around one of the chocolate boxes. 'I just wondered, well, what particular kind of chocolate would you think of O-Kay as, and why ?' His team sat looking at him blankly.

Then Bill Sniv, the youngest guy on the team with the MBA from Warwick, said 'um … I think … I think they're a bit like one of these', fishing out a dark chocolate promising a caramel centre, 'because they're very smooth when you talk with them on the phone, but the more involved you get, the chewier and chewier they are to deal with'. With that, he popped the sweet into his mouth.

By the end of that meeting, Mohinder had a whole new raft of ideas about working with O-Kay, based on the new team insights generated by the chocolates metaphor.

Additionally, the team had been able to share ideas they never could have articulated before. For the first time in ages, they all left a two hour meeting smiling.

The above is a true story that was told to me by a student of mine who had decided to implement some of the ideas he had learned on my working with imagination course. He happily reported that, among the new ideas that his team had considered that morning, there was one to which O-Kay responded well. The exercise gave the team a new burst of energy and a belief that they could solve problems differently by thinking outside their habitual routines. 'Thinking outside the box,' the student said, 'doesn't necessarily give you *the* solution, but it could give you new ways of finding a solution you would otherwise not discover'.

Such thinking can be countercultural in a business environment that favours quick, if not immediate, results. Taking the time to think in metaphors, or to consider a range of scenarios, can seem to be inordinately more time-consuming than more conventional, linear ways of finding solutions to dilemmas. However, solutions which take into account the larger picture, and that strive to find solutions which expand rather than narrow a firm's capability, can be much more robust in the long term, and can save time downstream.

'Thinking outside your box' often requires you to consider the concerns and needs of many different stakeholders and stakeholder groups. It means seeing the problem that you are wrestling with in a broader organisational context. For example, a finance department might view cutting costs as being crucially important to the well-being of the firm, but if it is trying to do this in the face of an organisation with a strategy of growing so as not to be acquired by a larger firm, that concern may be of low strategic priority. By considering factors which impact on your own situation, such as the firm's strategic intent, economic or social factors outside your control, and the politics of any business decision, you may come up with solutions which are more easily taken on board than if you stick with only one viewpoint, no matter how 'correct' that conclusion seems.

This article sets out a few ideas about how you might start to flex your own 'thinking muscles' and come up with ideas other than those that most readily pop into your head. In fact, its title is a bit of a misnomer, as it is essentially impossible ever to think outside one's own 'box', or perceptual/attitudinal/knowledge framework. Instead, it may be more helpful to think of ways to expand the size of your 'thinking space', and improve the conditions within it to provide more fertile ground for innovative ideas. As a starting point, let us consider what your current thinking box is like.

How big is your box ?

How big is your current box ? To consider this question, you need to identify your current thinking habits. Everyone has their characteristic ways of approaching problems and reaching conclusions, and one of the reasons they stick with them is that they have worked well before. Why change a winning formula ? When people are under pressure, in particular, they resort to the way of thinking that has served them best in the past.

One of the most common ways in which people 'shrink' their thinking space is by using deductive reasoning. Deductive reasoning sees the question as the starting point of the enquiry. From there, it begins a funnelling process, tossing out data or ideas that do not fit into a logical pattern of cause and effect. It can be helpful to consider what information you habitually discard during that funnelling process. Do you ignore all the data from the marketing team, because they are always a bit flashy and do not know what they are talking about ? Do you habitually eliminate data that you do not understand ? If certain parts of the organisation are telling you something that you disagree with, do you disregard that before you even incorporate it into the picture ?

These habits of selective perception, which are often unconscious, affect the size of your habitual thinking space. Many people, for instance, only add to their thinking space from sources with which they already agree, and which offer no surprises. The newspapers that people buy are a good example. There are *Daily Telegraph* readers, and *Sun* readers, and *Daily Mail* readers, and *Guardian* readers, and the world might seem a very different place to them if they picked up a copy of a different paper and leafed through it.

How might you expand the size of your thinking space ? One way is to identify those factors that bound it and gently (or not so gently) push against them.

For instance, professional identity often plays a key role in bounding a person's perceptual frame. Such frames are strengthened by distinct languages, establishing members as 'insiders', and those who do not speak the language as 'outsiders'. Accountants speak 'finance', marketers talk 'marketing lingo', and computer technologists converse in a third profession-specific language. You can expand your

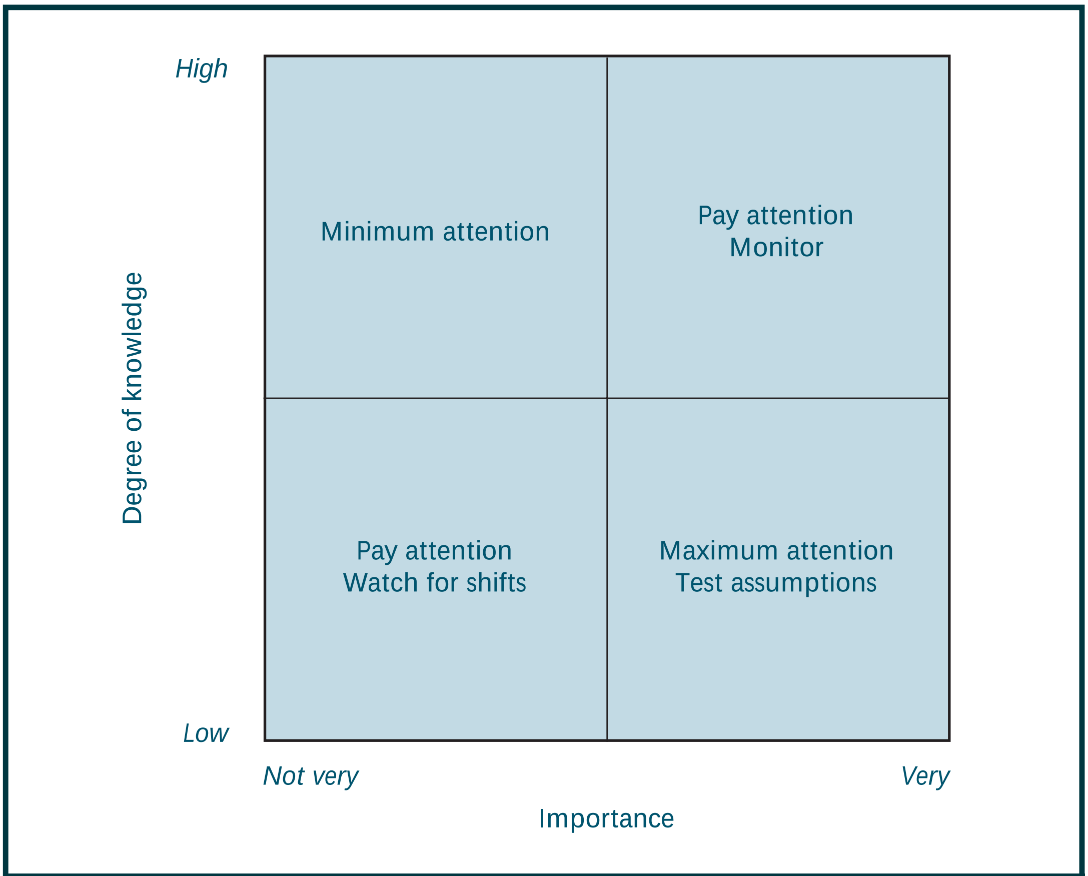

Figure 1 Assumptions matrix

thinking space very quickly by learning key words and phrases in a different professional language, and considering what that profession's viewpoint can add to your understanding of an organisational dilemma.

MBA programmes and other general management programmes offer the learning of these various professional outlooks as a key benefit to participants. However, you do not need to have an MBA to be curious and learn about a business from an operations point of view, for example.

There are other, more subtle ways in which thinking space is held intact. Cultural boundaries are an overarching way of holding the thinking of particular groups of people 'in place'. We think certain things because our culture says it is all right to do so, and other thoughts are disallowed because the culture denounces them.

Travel offers an almost inevitable mind-expanding experience, demonstrating clearly that our way of living is not the only one. We can also metaphorically travel in ways that expand thinking capacity. Asking questions such as 'I wonder what this situation looks like from two levels below me in the organisation' or 'if I zoom this picture out and get a broader view, will I be able to see what factors are impinging on what's going on that I miss if I keep looking at it so closely ?' can bring about such changes of perspective.

Perhaps the most difficult thinking boundaries to recognise and shift are those that relate to our underlying assumptions. By their nature, assumptions are seldom articulated, although they guide our actions and choices. They are the hardly noticeable undercurrents that do not affect us until we bump into someone else's.

In their book *The Unbounded Mind*, Ian Mitroff and Harold Linstone suggest that surfacing key assumptions is essential for those trying to engage in new thinking patterns. As assumptions are held by particular stakeholder groups, they suggest a process of uncovering assumptions by identifying key stakeholders and asking them how they see the situation.

Once the assumptions have been articulated, they can be placed within a four-box matrix (see *Figure* 1). The horizontal axis of the matrix represents the importance of the assumption, and the vertical axis represents the degree of knowledge that is possessed about the assumption. There are then four groups of assumptions :

- those that you know a lot about but that are unimportant;
- those that you do not know much about and that are unimportant;
- those that you do not know much about but that are important;
- those that you know a lot about and that are important.

By placing the stakeholder assumptions within the most appropriate quadrant, managers can identify those key assumptions that are most important and least known about. They can then concentrate their efforts on that particular area, rather than tackling all of them at once.

Exercise : the size of your thinking space

Find a comfortable place to sit, and relax for a minute or two. Then start to focus in on your stream of consciousness. Just see if you can capture the thoughts that go on in your head for 15 minutes. Most people find the first five minutes of this exercise unbearable, but by the final five minutes they are wondering where the time went.

Then review what you have done. You may like to analyse your stream of consciousness in the following ways :

- How much of it was sensory-oriented, and what was the sense in question ? (Do you write about what you see, hear, feel, taste or smell ?)
- Were your thoughts focused mainly in the past, the future, or the present ?
- What was the quality of the voice ? Was it largely critical, or was it supportive, curious or affirming ?

If you can discern a particular pattern, it might be just because of the situation that you were in at that moment, or it might reflect a wider overall pattern in your thinking. You might try to alter your thinking consciously by noticing when you are thinking about the past, and bringing your thoughts into the present, or projecting into the future. How much will this matter in five years' time, for instance ?

This exercise leads into considering how you might improve the quality of your thinking space.

What is the quality of your thinking space ?

What is it like in your thinking space ? Is it a place that is conducive to the generation of new ideas that can be tested gently before being put aside for later consideration ? Alternatively, is there a metaphorical big ogre sitting in the middle of your box ready to bash any fledgling idea you have into smithereens with his club ?

We are often our own worst critics when it comes to nurturing and supporting new ideas. The truth is, there may be 100 bad ideas for every good one, but without generating the 100 bad ones, you will probably not hit on the one winner. The more you let yourself free fall, 'blue sky', and daydream, the more likely you are to discover the real gems of thinking : the ideas that are truly unique.

Our ability to make judgements about the relative merits of various options is, of course, essential, and being able to discern which of the 'out of the box' ideas are good, as opposed to hopeless, is vital. However, in generating ideas, it is important to distinguish between using judgement and being judgemental, that is, overly critical. Our internal critic can both keep us safe and stifle us and our ideas to the point where we forget *how* to have a new idea.

To deal more effectively with your internal critic (that is, have him or her come on duty when you are at the assessment stage of possibilities, rather than at the generation stage of new ideas), you need to identify his or her voice, and the things he or she is likely to say. The next exercise is a first step in recognising and working with your internal critic.

Exercise : identify your critic

Take out a sheet of paper, and write at the top of it a sentence about something to which you might aspire, for example 'I am the world's most creative thinker'. Then write it again … and again … and again. Keep writing the sentence over and over. If you pay attention, you will probably hear your inner voice start to give you 'blurts', such as 'oh no you aren't', or 'who do you think you are to say such a thing ?'. Write these blurts down in a different colour. Keep going, and keep recording the blurts.

When you have written for 15 minutes, examine the quality of the blurts, and notice what happens as you continue to write. Do they change ? Do they become more supportive ? If your critic steps in aggressively every time you think of something that falls outside your normal way of thinking, you may have to keep going for quite a while before he or she will be quiet and let you have those creative thoughts.

This exercise is taken from Cameron (1995).

Fertilising your thinking

Creative capacity is something we all have as human beings. This capacity can be developed through practice and through engaging regularly in activities that nourish the imagination. Consider the list below as a starting point for developing your own creative thinking habits.

- Feed your thinking space with images, colour, and other sensory inputs, as opposed to just words. Identify images to which you are drawn in magazines and books, and cut them out and pin them on the walls around you.
- Nourish your body as well as your mind. Thinking differently involves the whole body. Give yourself time to relax, to notice the smells around you, and to really taste that cup of coffee.
- Engage in metaphors. What is this like ? What does it remind you of ?
- Collect and tell stories. People remember stories, and so when you are thinking about a problem, consider what the underlying story is. Who are the main protagonists ? Who has the most power in this fable ? What is the eventual moral ?
- Engage in curiosity. One good way of remembering the curiosity with which we were all initially blessed is to take a small child for a walk. Notice the way in which he or she interacts with the world and asks questions about it. Try to bring this kind of curiosity to situations you encounter, asking questions such as ‘I wonder why that is’, ‘what happened to get it like it is now ?’ or ‘what would happen if … ?’.
- Warm up. If you want to engage the creative mind, the mind that wants to think outside the box, give it some warm up time. Free associate (list all the words that remind you of a certain situation, no matter how far fetched the linkage is), mind map (draw all of the linkages you can think of that connect to the issue), or brainstorm metaphors for the problem. Know that this is a warm up time during which you are not required to come up with the answer.
- Reduce stress. One of the great killers of creative thinking is stress. Take time out. Try to set yourself and others realistic deadlines. *Have lunch*.
- Make time for *fun*.

References

For those of you who are interested in something with an artistic bent, there is the following title.

- ***The Artist’s Way***

  Cameron, J (1995) Pan
- ***The Unbounded Mind***

  Mitroff, I and Linstone, H (1993) Oxford University Press

Further reading

Many books have been written in the area of creative thinking for managers. Three of my favourites are the second title above and the two below.

- ***Six Thinking Hats***

  de Bono, E (1985) Penguin
- ***The Creative Manager***

  Evans, R and Russell, P (1989) Unwin

COMING SOON ...

MQOnline

In response to the very positive feedback we have received from the membership about *Management Quarterly*, the Faculty is working on a new initiative : *MQOnline*.

MQOnline will be a web-based series of streamed multimedia lectures that cover and expand upon the subjects addressed in the *Management Quarterly* journal. When the series is up and running, members will be able to access these 20–30 minute lectures via the Faculty website.

MQOnline is about to be trialled with a series of finance lectures covering aspects of shareholder value. The Faculty is seeking volunteers to take part in these trials. If you are interested, or if you want to find out more about *MQOnline*, please contact Chris Jackson by email on CDJackson@icaew.co.uk.

The Faculty of Finance and Management
The Institute of Chartered Accountants in England & Wales

OUTLINE SYLLABUS

Management Quarterly is designed to be a three-year endeavour, setting out key management techniques in core disciplines. Over that time, it is expected that the content may develop and change. However, here we set out the current anticipated syllabus for the journal.

Strategy

What is strategy ? ✔ *Part* 1, *October* 1998
What does corporate HQ do ? ✔ *Part* 2, *January* 1999
Strategic alliances ✔ *Part* 3, *April* 1999
Competitive strategy ✔ *Part* 4, *July* 1999
Strategic analysis tools – the external environment ✔ *Part* 5, *October* 1999
Strategic analysis – assessing internal resources ✔ *Part* 6, *January* 2000
Assessing internal capabilities ✔ *Part* 7, *April* 2000
Strategic choice ✔ *Part* 8, *July* 2000
Strategic decision making
Strategic change
International strategy
The future of strategy

Human resources management

Introduction to people management ✔ *Part* 1, *October* 1998
Changing roles and responsibilities ✔ *Part* 2, *January* 1999
Strategic HRM and the management of change ✔ *Part* 3, *April* 1999
Performance management : motivating and monitoring ✔ *Part* 5, *October* 1999
Developing the organisation ✔ *Part* 6, *January* 2000
Personal development and people management competencies ✔ *Part* 7, *April* 2000
Dealing with conflict ✔ *Part* 8, *July* 2000
The role of trade unions and collective representation
Impact of the European Union
International HRM
Ethics and corporate governance

Marketing

Marketing in today's world ✔ *Part* 1, *October* 1998
Marketing planning ✔ *Part* 2, *January* 1999
Understanding customers – the consumer ✔ *Part* 3, *April* 1999
Understanding customers – the organisation ✔ *Part* 4, *July* 1999
Relationship marketing ✔ *Part* 5, *October* 1999
Market research and information technology ✔ *Part* 6, *January* 2000
Market segmentation and positioning ✔ *Part* 7, *April* 2000
Analytical tools for marketing ✔ *Part* 8, *July* 2000
Managing the marketing mix
Developments in marketing
Branding
International marketing

OUTLINE SYLLABUS – *Continued*

Finance

Planning and reporting ✔ *Part* 1, *October* 1998

Operating and business systems ✔ *Part* 2, *January* 1999

Interest and discounted cash flow ✔ *Part* 3, *April* 1999

The cost of equity ✔ *Part* 4, *July* 1999

The cost of capital ✔ *Part* 5, *October* 1999

Shareholder value ✔ *Part* 6, *January* 2000

Valuation of companies ✔ *Part* 7, *April* 2000

Financial instruments ✔ *Part* 8, *July* 2000

International finance

Mergers and acquisitions

Project finance

Venture capital

Articles are being commissioned to cover a range of other management topics. Further material on people management that concentrates on the individual rather than the organisation is also included.

Copies of the journal articles referred to can generally be obtained through the Institute library. A charge is made for these articles, based on the number of pages to be copied.

IN THE NEXT ISSUE ...

Strategy *Strategic decision making*

This article reviews decision making styles, and looks at how context influences decision making. Decision making is often a political activity, and this aspect is also considered.

Human Resources Management *Trade unions and collective representation*

The history of trade unionism is discussed together with current trends. Various forms of employee and employer collectives are reviewed, and the advantages and disadvantages of collective representation are considered.

Marketing *Managing the marketing mix*

The article introduces and explains how to manage the 4Ps of marketing : price, product, place and promotion. Other marketing models that expand or replace the 4Ps model are also discussed.

Finance *International finance*

The financial implications of doing business overseas are described. In particular, foreign exchange risks, exchange rate management tools, and strategic management issues for companies based in more than one country are considered.

Working practices *Remote working*

More and more people are working remotely away from their offices. This article sets the context for remote working, and considers the softer issues (quality control, training, and people issues), and the problems and benefits of this type of working as seen from the points of view of both the employee and employer.

MANAGEMENT QUARTERLY

Management Quarterly aims to deliver the basic building blocks in core management disciplines. It is produced in association with Cranfield School of Management. Each issue will usually contain articles on strategy, human resources, marketing and finance, with other occasional subjects such as project management and knowledge management. Over a three-year period this will build up to a comprehensive overview of practical business knowledge, and modern management ideas.

Management Quarterly will provide a comprehensive grounding in the knowledge needed to operate a successful business. It will enable the reader to understand current issues and debates in these areas, and distinguish core ideas from current fads. A wide ranging programme of CPE will be provided that will be suitable for members both in business and advising businesses.

Each part of *Management Quarterly* will be self-standing and include recommended further reading. Writers are selected from Cranfield School of Management and other leading business schools. Experts in each field explain and discuss the relevance, practicality and usefulness of key new concepts and ideas, thus enabling the senior executive to keep really up to date. A message board is available on the faculty Internet site. Chartered accountants often have limited reading time. *Management Quarterly* is succinct and the writers will direct the reader to other, and often fuller, expositions on the subject. The programme is no substitute for an MBA but it will follow some of the major threads on an MBA.

Management Quarterly will act as an aide-memoire for members, provide new ideas, and encourage good practice, but the Faculty cannot accept responsibility for the accuracy or completeness of issues of *Management Quarterly*. Being general in nature, the points made in *Management Quarterly* may or may not be relevant to specific circumstances.. Responses from the membership will be a very important part of the successful development of the series. Comments please, to Chris Jackson on 020 7920 8486 (or by e-mail to CDJackson@icaew.co.uk).

Management Quarterly is compiled and edited by Ruth Bender, who joined Cranfield School of Management as a lecturer in 1994, having completed her MBA there. Prior to this, she was a corporate finance partner in Grant Thornton. Ruth is a member of the Faculty committee. The executive editor is Chris Jackson.

Feedback

Comments and suggestions should be addressed to Chris Jackson BA FCA, Head of Faculty, telephone 020 7920 8486, e-mail CDJackson@icaew.co.uk, or write to the Faculty at the address below.

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Faculty members

Each member of the Faculty in the year of publication will receive one copy of every *Management Quarterly* published by the Faculty free of charge. Copies are not available to non-Faculty members.

Parts of *Management Quarterly* published to date are :

Part 1 :	October 1998	Part 7 :	April 2000
Part 2 :	January 1999	Part 8 :	July 2000
Part 3 :	April 1999		
Part 4 :	July 1999		
Part 5 :	October 1999		
Part 6 :	January 2000		

Any members who have not received the above should contact Chris Jackson at the Faculty using the contact details set out below.

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