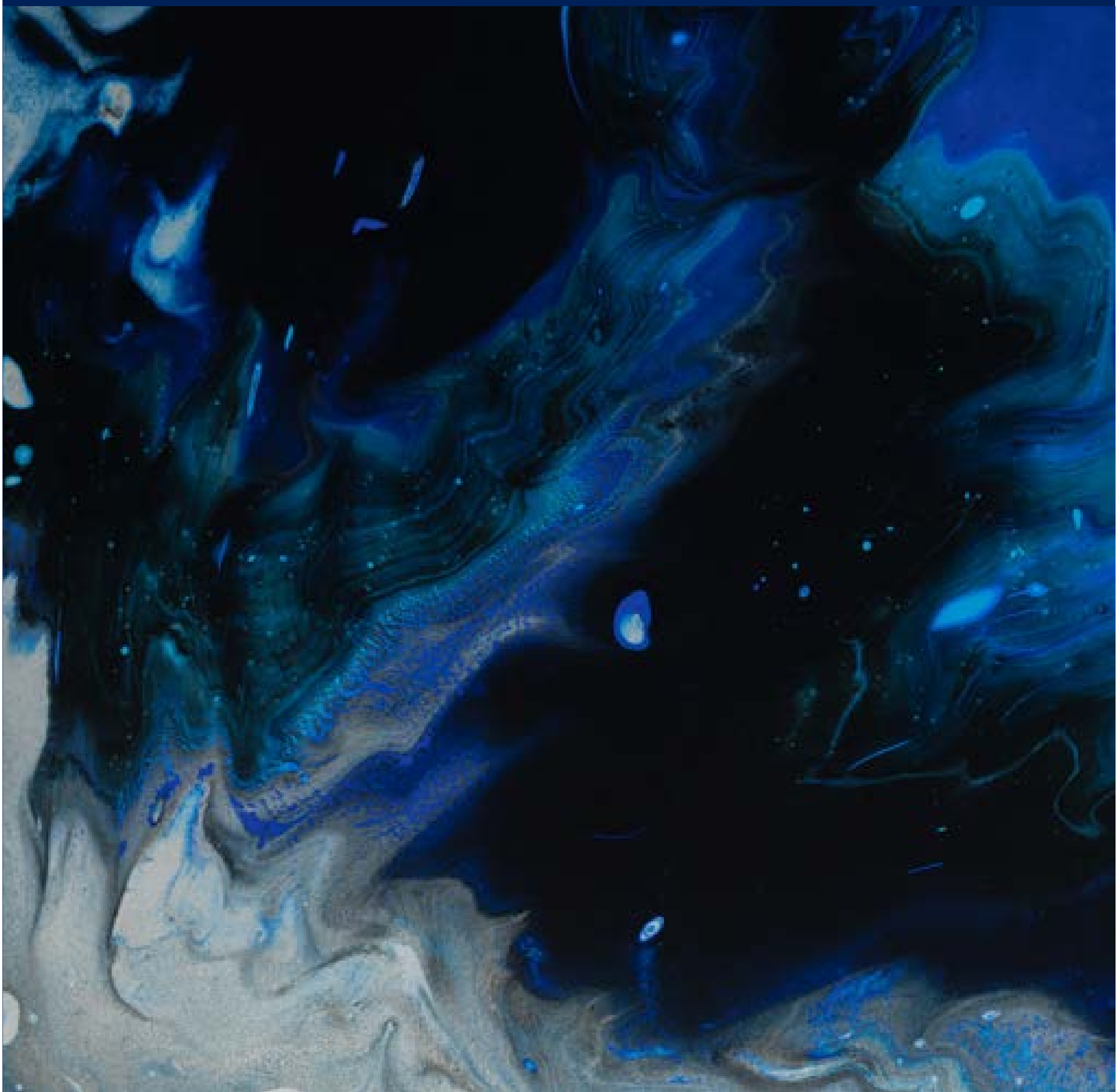
RAFFLES LEGACY LEARNING

BUSINESS STRATEGY MASTERCLASS

BOOK TWO - DEVELOPING YOUR OWN STRATEGY

PHASES OF STRATEGY I



MASTERCLASS COURSEBOOK

STRATEGIC OPTION SELECTION

This stage involves valuing the range of options specified at the end of the diagnostic phase and spelling out the pros and cons of each. Although there are many potential options, most real options can be captured in a limited set of choices.

The steps to select the best option are as follows:

- set out final list of options
- list criteria to evaluate with appropriate weighting for each
- apply evaluation framework to assess relative value of each option
- test emerging ranking by applying insights from experience, company history, industry standards, new global paradigm, implement ability risks, and other angles
- select option based upon balance of quantitative analysis and qualitative assessment

The best way to choose rationally between the contending options is to take a weighted approach, setting out specifically what factors are to be considered in the evaluation of each option, and assigning a specific weighting to each.

The relative value of each option can thus be properly assessed and weighted, and the overall value calculated by mechanical exercise of multiplication and addition.

One useful checklist for relative valuation of options is a seven-element model which allows managers to evaluate future strategic options against a well-grounded business framework:

Value impact in capital markets: Especially for listed companies, the impact of a strategy needs to be measured by the increase in shareholder value. This is usually measured in the improvement in shareholder wealth as reflected in the equity market capitalization of the business and total shareholder return.

For privately owned companies, the improvement in debt ratings, implied enterprise value or other standard can serve as a surrogate for an equity market value measure.

Net present value: The net present value is the most important of financial measures when assessing impact on an organization from different initiatives or investments. NPV, which is the discounted present value of all future cash flows, net of any initial cash investments, is one of the best measures by which to assess investments, make decisions, and track performance.

Maximizing NPV is the hallmark of any good operating management team. It also underlies many of the investment approaches of fabled investor gurus such as Warren Buffett and many highly successful owners of businesses. Perhaps the value of this cash flow-based measure is best captured in the simple statement that "Cash is King" in the business world.

Contribution to profitable growth potential: The current opportunities are not the only measure of full option value. The potential to create future flows of revenue, profits, and cash needs to be taken into consideration as well. Especially in a high growth business, where enterprise value in the capital markets is driven by expectations of future growth in revenues and earnings, the option value of future growth is an important factor.

Impact on organizational capabilities: As we have seen elsewhere, strategy is much about the ability of individuals and teams to design and execute predefined strategies, but is also about preparing an organization to profit from changes and developments in the business system.

An option which can significantly enhance that organizational capability should be valued more highly than one which does less to prepare a team to take advantage of the future.

Impact on strategic balance sheet: The potential to change the 'hard' and 'soft' assets and liabilities of a business is another measure of success which is difficult to assess mathematically, but which can have a profound impact on business success. Addressing both financial and strategic balance sheet categories ensures that all elements of value addition can be reviewed and accounted for.

Positive change in customer relationships: Serving the customer is the *raison d'etre* of any company. The ability to drive those relationships to a higher level is an essential element in strategic assessment and valuation. Taking into account both hard and soft variables of product, brand and service, the customer cannot be forgotten in any strategic evaluation.

Contribution to competitive differentiation: Although serving the customer better carries with it an implicit understanding of enhancing the competitive offer, it is important to assess directly the impact on truly different performance in the market. Options which create 'clear water' between a business and its rivals will create immediate and future value. On the other hand, an option which may create short-term profits at the expense of competitive capability may not be the most desirable pathway forward.

Weighting the Elements of Valuation

In defining the formula by which the various strategic options may be assessed, management teams may want to weight some elements more heavily than others. Not all variables in the criteria set out here are of equal value to different managers.

Attaching a different weighting to one or more elements to reflect the difference in importance can elevate the calculations to a more valuable plane. It should also be pointed out that the sale option of an entire business usually requires separate analysis and weighting of different factors.

The option is included here for consideration, although the real input for a decision of this magnitude for a family business of such longstanding importance would be more complex and very individual.

Evaluation framework for options (unweighted)

	OPTION A	OPTION B	OPTION C	OPTION D	OPTION E
	Status quo	Focus on international watch growth	Hybrid and network model	Breakthrough ★	Sell Company
Enterprise value	3	2	2	1	1
NPV	3	2	3	1	2
Growth potential	3	1	2	1	3
Impact on organization	3	2	2	1	3
Strategic balance sheet	3	2	2	1	3
Customer value	3	1	2	1	3
Competitive differentiation	3	1	2	1	1
Total (lowest is best)	**21**	**11**	**15**	**7**	**16**
Rank	**5**	**2**	**3**	**1=Selected Option**	**4**

Scoring : 1 = High 2=Medium 3 = Low

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EXECUTIVE SUMMARY EXPLANATION

In each of the three phases of strategy, it will be helpful to set out a short summary of the highlights of the preceding section.

The reasons for this are many, but include:

- Enforcing the discipline of clarifying priorities – highlighting what are the most important issues that need addressing and setting aside those that are less important.
- Reminding people of the most important elements in the diagnostic phase, a brief summary that can perhaps best be developed in a group context, so all team thought, and dynamics create consensus and unity of understanding before proceeding.
- Providing a useful foundation for the design phase, as it will give corporate strategists a checklist of elements from the diagnostic phase that will need to be addressed in the design and implementation phases that follow.

EXAMPLE - EXECUTIVE SUMMARY PHASE I: DIAGNOSIS

- After a long history of growth and leadership in the luxury watch business, the performance and strategic position of the Raffles Watch Company has deteriorated for more than five years:
  - Weak or non-existent positions in ladies' and high growth sports segments
  - Lack of understanding and management of key customer segments
  - Failed acquisition of Perso
  - Excessive costs and inflexible organization
  - Lack of exploitation of opportunity in product/market segments and service areas
  - Loss of momentum to competitors
  - The consequences of past strategy are measured in margin erosion, continued losses at Perso, organizational disillusionment and decline in enterprise value
- All trends and industry pattern reflect an increase in turbulence, globalization and acceleration of change in the core business.
- It is both important and urgent for Raffles to address all aspects of strategy and to define a better way forward to achieve the full potential of the business.

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