A STUDY TO EVALUATE THE SUITABILITY OF STRATEGIC ALIGNMENT IN A CHANGING EXTERNAL ENVIRONMENT: A CASE STUDY OF MORELAND DEVELOPMENTS (PTY) LIMITED

By

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CONFIDENTIALITY CLAUSE

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TO WHOM IT MAY CONCERN

RE: CONFIDENTIALITY CLAUSE

Due to the strategic importance of this research it would be appreciated if the contents remain confidential and not be circulated for a period of ten years.

Sincerely

D CHETTY

DECLARATION

This research has not been previously accepted for any degree and is not being currently submitted in candidature for any degree.

Signed .....

Date 11.09.2003 .....

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ABSTRACT

Moreland Developments (Pty) Limited is KwaZulu-Natal's leading land developer, consistently delivering on its vision of providing sustainable, quality developments across the spectrum of its operating portfolios. However, the changing external environment has recently presented new challenges to the company, raising the question of the appropriateness of the differentiated focus land-only development strategy. The assessment of whether Moreland's business strategy addresses the environments in which it operates is based on a theoretical model. An assessment of the internal operations of Moreland together with an examination of the external environment in which the company competes has uncovered a misalignment between these environments and the strategic direction pursued. The model is used to provide a more appropriate response to the management dilemma of eroding profit margins brought on by, in the main, an increase in infrastructure costs. The outcome of testing strategic options against current internal and external conditions has presented a compelling argument for the shifting of the strategic thrust of Moreland: from pursuing a focused land-only development strategy to one of concentric diversification. By Moreland extending its operations to related businesses and downstream activities, the company is better positioned to extract a greater return where value-added is greatest. Since Moreland does not possess all the core competences and resources in order to undertake the value-added downstream activities, partnering such an initiative with a company that does have such resources will bridge the gap between pure land-only development and property development. The net effect of the concentric diversification strategy will be to spread the risk that Moreland is exposed to and to generate returns that are commensurate with the level of value-added activities.

TABLE OF CONTENTS **PAGE**

CHAPTER ONE – INTRODUCTION

1.1	Introduction	1
1.2	Background of the study	2
1.3	Motivation for the study	7
1.4	Value of the study	8
1.5	Problem Statement	8
1.6	Objectives of the Study	9
1.7	Research Methodology	9
1.8	Limitations of the study	10
1.9	Structure of the study	10
1.10	Chapter Summary	12

CHAPTER 2 – THEORY

2.1	Introduction	13
2.2	The Development of the Theoretical Model	14
	2.2.1 Gap Analysis	15
2.3	The Internal Environment	17
	2.3.1 SWOT Analysis	17
	2.3.2 The Value Chain	19
	2.3.3 Resource-based View	20
2.4	The External Environment	22
	2.4.1 The PEST Analysis	22
	2.4.2 Industry's Dominant Forces	24
	2.4.3 Porter's Five Forces Model	25
2.5	Strategic Options Available	29
2.6	Testing of Suitability, Acceptability and Feasibility	35
	2.6.1 Assessing Suitability	36
	2.6.2 Assessing Acceptability	40
	2.6.3 Analysing Feasibility	44
2.7	Chapter Summary	45

CHAPTER 3 – CASE STUDY

3.1	Introduction	47
3.2	Company background	47
	3.2.1 Structure of the company	50
	3.2.2 Business Philosophy	51
	3.2.3 Core Competencies	53
	3.2.4 Current Strategy	53

3.2.5 Company Operations 54
3.2.6 Internal Business Processes 55
3.2.7 Competitor Analysis 58

3.3 Impact of Changes in the Business Environment 59
3.4 Financial Performance 64
3.5 Chapter summary 68

CHAPTER 4 – EVALUATION OF CASE STUDY AGAINST THEORY

4.1 Introduction 70
4.2 Internal Assessment 72
4.2.1 SWOT Analysis 72
4.2.2 Resource-based View 74
4.2.3 Porter's Value Chain 76
4.3 External Assessment 79
4.3.1. PEST Analysis 79
4.3.2 Industry's Dominant Forces 82
4.3.3 Porter's Five Forces Model 84
4.4 Deduction of Appropriate Strategies 86
4.5 Testing of selected Strategy 91
4.5.1 Suitability 91
4.5.2 Acceptability 96
4.5.3 Feasibility 97
4.6 Chapter Summary 98

CHAPTER 5 – CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
5.2 Short-term Objectives 99
5.3 Short to Medium Term Objectives 100
5.4 Conclusion 104

REFERENCES 108

BIBLIOGRAPHY 109

LIST OF TABLES **PAGE**

Table 2.1	Life Cycle Analysis	37
Table 3.1	Financial Analysis – Turnover	64
Table 3.2	Financial Analysis – Operating and Attributable Profit	65
Table 3.3	Financial Analysis – Cash Flow	66
Table 3.4	Financial Analysis – Capital Employed	67
Table 3.5	Financial Analysis – Returns	68
Table 4.1	SWOT Analysis	72
Table 4.2	Strategic Options Available	90
Table 4.3	The Life Cycle Portfolio Matrix (Evaluation)	91
Table 4.4	Positioning (Test of Suitability)	93
Table 5.1	Joint Venture Contribution	101

LIST OF FIGURES

PAGE

Figure 2.1	Gap Analysis – Theory	16
Figure 2.2	Porter's Value Chain – Theory	19
Figure 2.3	Porter's Five Forces Model – Theory	25
Figure 2.4	Strategic Options – Internal Assessment (Theory)	28
Figure 2.5	Strategic Options- Internal or External Direction (Theory)	30
Figure 2.6	Strategic Options – Internal and External Assessment (Theory)	32
Figure 2.7	Portfolio Analysis (Theory)	39
Figure 2.8	Theoretical Model	46
Figure 3.1	Tongaat-Hulett Company Structure	47
Figure 3.2	Land Management Strategy	49
Figure 3.3	Moreland's Company Structure	50
Figure 3.4	Moreland's Service Departments	51
Figure 4.1	Gap Analysis – Evaluation	70
Figure 4.2	Strategic Options – Internal Assessment (Evaluation)	74
Figure 4.3	Porter's Value Chain (Evaluation)	77
Figure 4.4	Strategic Options – Choice of Internal or External (Evaluation)	78
Figure 4.5	Porter's Five Forces Model (Evaluation)	84
Figure 4.6	Strategic Options – Internal and External Assessment (Evaluation)	87
Figure 4.7	Portfolio Analysis (Evaluation)	94
Figure 4.8	Business Profile Analysis (Evaluation)	95

CHAPTER 1 – INTRODUCTION

1.1 Introduction

Moreland Developments (Pty) Limited is KwaZulu-Natal's leading private land developer, having successfully brought onto the market premier developments such as Zimbali Coastal Resort, Mount Edgecombe Country Club Estate, Umhlanga Ridge New Town Centre (of which Gateway Theatre of Shopping is part of) and the La Lucia Ridge Office Estate.

The company's concentrated growth strategy, focusing on differentiated niche market developments which have successfully delivered quality developments, has been susceptible to a series of environmental threats. These external drivers include reduced local government spending on bulk infrastructure (effectively shifting the cost burden onto private developers), the increase in property rates in excess of inflation and the cyclical nature of interest rates. The collective impact of these forces has substantially eroded Moreland's returns, creating a management dilemma for the organisation.

The intention of this study is to examine the validity of the current strategy against a theoretical model and to derive from the model what the most appropriate response should be.

The background of this research will provide an understanding of the nature of the company's dilemma, as well as theoretical information pertaining to this area of study. The theoretical area of the study will be used to develop a model which is derived from pertinent literature focusing on company strategy. An overview of the reason for this study, its importance to the company, its objectives and limitations will provide a clearer context that frames this study. A synopsis of the structure of the proceeding chapters will complete this chapter.

1.2 Background of the Research

Moreland Developments (Pty) Limited (Moreland) is one of four companies within the Johannesburg Stock Exchange listed Tongaat-Hulett Group stable. The company is a land-only developer, and through the land planning strategy, is responsible for adding and unlocking value to Group's landholdings.

Moreland operates within its four portfolios:

- Commercial (Umhlanga Ridge New Town Centre, La Lucia Ridge Office Estate)
- Industrial (River Horse Valley Business Estate, Briardene)
- Residential (The Mount Edgecombe Country Club Estate, Umhlanga Ridge, Somerset Park, La Lucia Ridge, The Gardens)
- Resorts (Zimbali Coastal Resort and project management of the Point Development)

1.2.1 The Land Development Process

Through the carefully co-ordinated land management strategy, specific Group landholdings are identified as having development potential on the basis of enhancing and realising (unlocking) value potential.

Depending on market demand, current stock levels and Moreland's objectives, a feasibility study is conducted by the portfolio team and presented to the Tongaat-Hulett Board, who assess the proposal in terms of the overall land management strategy and its profit potential. If the approval of the proposal is granted, Moreland then purchases the land from Group at market-related prices for agricultural land.

The process of unlocking value starts with a series of town planning processes, including the re-zoning of the property from agricultural to commercial or residential or mixed land use. After the planning approvals have been achieved, the project management team then appoints consultants and contractors to design and install the various infrastructure services to the property. These services include roads, storm water and sewerage drainage, electrical reticulation, telecommunications services and finally security and landscaping features. The level and extent of these services depends on the needs of the target market.

Once the sites are serviced, the process of sales and property transfer takes place, at which staged Moreland earns a return on the capital employed. A Management Association, made up of Moreland personnel and a limited number of lot owners, is then set up in order to control and manage issues such as architecture conformance, landscaping, security and the general maintenance of the integrity of the development. After a period at which the Association is deemed to be self-sustainable, Moreland withdraws its services by handing over control entirely to the management Association.

1.2.2 Moreland's strategy

The company pursues a focused differentiated strategy, targeting a narrow segment of the market with innovative, sought-after quality developments, many of which have become landmarks in the province. Moreland focus on creating balanced communities has led to substantial investments in public infrastructure including enhancing road networks, recreation facilities, private and public conservation zones and managed environments.

The differentiation strategy is enabled by the company's strategic access to Group's prime landholdings as well as the core competencies of the organisation. These resources have contributed to the organisation's competitive advantage, enabling a premium being levied on the value-added developments.

1.2.3 The Impact of Changes in the External Environment

Since 1996, fundamental changes in local government's policy regarding the funding of bulk infrastructure have resulted in substantial transfers of costs to private developers. Further, the year-on-year property rates levied in the Northern Durban Metropolitan Area has been far in excess of inflation, affecting Moreland in two ways:

Firstly, Moreland has vast stock of both serviced and un-serviced land, which attracts rates, and secondly, high rates increases dampen investor confidence in that returns are reduced. A further contributor to the thinning of Moreland's returns is the cyclical nature of interest rates, notably in periods such as 1998 where the company was forced to retrench staff during their cost-cutting programme.

Despite the reputation as the leading private property developer in the province, Moreland has been and continues to be susceptible to these external drivers, to the extent that the current strategy needs to be challenged in terms of its appropriateness to the changing environment. Overall, the returns generated are not commensurate with the level of risk that the company is exposed to, the dilemma caused largely by an ever increasing cost of sales.

1.2.4 Examination of the Management Dilemma

Environmental scanning is a critically important task for all organisations, a practice that ensures the alignment of the business strategy with the changing environment. Thompson and Strickland (2003) assert that the purpose of environmental scanning is to raise the consciousness of managers about potential developments that could have an important impact on industry conditions and pose new opportunities and threats.

Moreland's management dilemma of a changing external environment and the corresponding impact on the company's returns will be critically examined using a theoretical model. The model will then be used to define the most appropriate strategy that *should* be pursued by the company, given the extent of the environmental threats.

1.2.5 The Theoretical Model

The structure of the model is made up of a combination of theory from Pearce and Robinson (2000) and Johnson and Scholes (1999). The first part of the model development will focus on an accurate assessment an organisation's internal and external environment. Mintzberg (1988) states that a deliberate strategic process starts with an analysis of the company's existing mission and strategies.

The model first examines the internal environment using the core competency theory, the resource-based view and Porter's value chain analysis. The assessment of the internal resources is largely driven by the work of Hamel and Prahalad (1990), who contend that competencies are the glue that binds existing business and that they are the engine for new business development.
An extension of the assessment of a company's internal resources is provided by Porter (1985) in the value chain theory that is described as a collection of activities that are performed to design, produce, market, deliver and support its product.

The assessment of the external environment will be based on Porter's Five Forces model, an assessment of the industry's dominant forces and a PEST (political, economical, social and technological) analysis. The objective of Porter's Five Forces model is to investigate how the organisation needs to form its strategy in order to develop opportunities it its environment and protect itself against competition and other threats.

The assessment of the firm's internal and external environment completes the input for the SWOT (strengths, weaknesses, opportunities, threats) analysis, the aim of which is to match likely external environmental changes with internal capabilities, to test these out and challenge how an organisation can capitalise on new opportunities, or defend itself against future threats. Ambrosini (1998) contends that this exercise seeks to challenge the robustness of an organisations current strategy and highlights areas that may need to change in order to sustain or develop its competitive position.

The results of the SWOT analysis will then be used to position the company in terms of their internal strengths or weaknesses; and the environmental threats and opportunities, together with an appropriate generic strategy for each permutation (Pearce and Robinson, 2000).

The next step extends to assessing whether the company wants to overcome their weakness or to maximise their strengths. Each of these two options can be achieved by either re-directing resources within the firm or looking externally in the form of acquisitions or mergers to improve resource capability. This assessment positions the company further in terms of a selection of strategic options.

The final step in developing the first part of the model (the model according to Pearce and Robinson), will be to use the findings of the external analysis to plot the company's position according to market growth and competitive position. Here again, a number of strategic options are available according to the company's positioning.

This partnering of an appropriate strategy with the company and external environment circumstances completes the development of the first part of the model. Once a strategy is selected, further testing of the robustness of the selection will take place according to the criteria described by Johnson and Scholes (1999).

The three types of evaluation criterion that will be used are *suitability*, which is a broad assessment of whether the strategy addresses the circumstances in which the organisation is operating; *acceptability*, which is concerned with the expected performance outcomes if the strategy were implemented and finally; *feasibility*, which is concerned with whether the strategy could be made to work in practice.

The second part of the model completes the framework for the development of the theoretical model. The model will then be used to assess and provide solutions to Moreland's dilemma of the thinning of profit margins brought on by changes outside the control of the organisation.

1.3 Motivation for the research

Moreland's development initiatives have delivered on its vision by creating the most sought-after quality of life environments. The company has added value to the Group landholdings, customers, investments, the local authority (in particular a substantial rates base and attraction for economic development in the region) and surrounding communities. The common goal of the company and the region of driving development and economic growth in line with market needs has been met with new challenges. With the lower contribution from the local authority towards infrastructure costs, Moreland has had to bear the major proportion of these costs in recent years, which has eroded its margins.

This particular area of study was chosen because it represents a powerful impact on the financial health of the organisation. The changes in the external environment and a corresponding impact on Moreland's cost base has created the need to re-assess the strategic direction of the company, with particular focus on how the company can respond to external threats. Therefore, an understanding of the nature of the external threats and how this impacts on the organisation cannot be overstated.

1.4 Value of the Study

The aim of this study is to offer some clarity on the nature of the business dilemma and to recommend a workable solution that addresses and deals with the management problem of a thinning of the company's returns brought on by, in the main, an increase in the cost of sales. The solutions will be predicated on sound theory, which will offer credibility to the recommendations made to Moreland.

Since the issues of a changing external environment and its corresponding impact on the business are currently very topical within Moreland, the company is in the process of investigating how best to deal with aligning the business strategy with the issues of its increased cost base.

It is hoped that this study will elucidate the company's current position and provide clear strategic options that will delineate the way forward for Moreland.

1.5 Problem Statement

"How does Moreland Developments (Pty) Limited respond to the changing external environment in terms of its strategic alignment?"

The aim of this study is to resolve the management dilemma of the company's increase in cost of sales brought about by changes in the external environment.

1.6 Objectives of the Study

(a) To develop a theoretical model based on literature pertaining to company strategy.

(b) To use this model as an analytical framework in order to evaluate the current strategy that is pursued by Moreland as well as define a set of recommended strategies derived from the model.

1.7 Research Methodology

This study will examine secondary data from Moreland as well as related literature in the field of company strategy.

Chapter 2 – the theoretical model will be developed from the works of Porter (1985), Pearce and Robinson (2000) and Johnson and Scholes (1999).
This literature applies to the study in that it leads to the development of a model, which offers a specific strategic thrust given a set of company and environment circumstances.

Chapter 3 – The secondary data obtained from the company and industry publications was selected on the basis of accuracy, credibility and appropriateness to the study. Limited use of marketing material was made because of the bias potential that may be present. Given the limitations of this study with reference to the financial information that was restricted, the secondary financial data that was extracted from the company reports were manipulated to present trends rather than actual figures.

In Chapter 4, the theoretical aspect of this study will be used as a framework to examine the case study in Chapter 3 and provide recommendations at the end.

1.8 Limitations of the study

The fundamental limitations to this study are confined to the areas of financial information within Moreland as well as property developers operating in the Northern Durban Metropolitan Area.

Due to Moreland's strategic operations and being a company within the listed Tongaat-Hulett Group, the financial information relating to turnover, profits and cash-flows presented in this study are indicative of patterns of growth or decline only, and are indexed to a notional value.

With regard to acquiring financial data from other land and property developers in the area of study, a similar restriction presented itself. Further, data related to costs and returns vary markedly between developers and projects, depending on the area of operation, the target market, the size of the development as well as individual company's cost structures.

The implication of this limitation on the study is that the selected strategy cannot be constructively tested in terms of suitability, an area that measures the robustness of the strategic option according to financial risk and return. Accordingly, the test does not prove conclusively that a particular strategy is acceptable.

1.9 Structure of the Study

The methodical manner in which the study was undertaken and is presented will illustrate the structure that was followed in solving Moreland's management dilemma.

This chapter provides an overview of the thrust of the study, essentially a roadmap showing clearly the business dilemma, the objectives in resolving the dilemma and the method of how the dilemma will be resolved.

Chapter 2 forms the theoretical construct from with the theoretical model is derived. The framework of the model is based on the literature by Pearce and Robinson (2000) and Johnson and Scholes (1999). The theory establishes the context of the firm's internal and external environments, which underpin the strategic direction of the organisation. In addition, other theories by M E Porter and Hamel and Prahalad provide substantial input into examining the firm's environments.

This chapter concludes with the development of a model, which is used to examine and interpret the dilemma in the case study.

Chapter 3 examines the company Moreland Developments (Pty) Limited in terms of its background, the company's operations, internal resources, its marketing environment and its financial performance (related to a notional value). The management dilemma of eroding margins will be presented here, illustrating the impact of external factors that are beyond the control of Moreland.

Chapter 4 forms the focal point of the study; wherein the theoretical model developed in Chapter 2 is used as a framework to examine the case study. The critical assessment of Moreland will be carried against the backdrop of the model, and evolving from the assessment will be guidelines on what the most appropriate response of the company should be. The theoretical solutions to Moreland's choice of strategy will then be tested in terms of the company's context in order to filter the options to a narrow menu, which are both appropriate and achievable.

Chapter 5 will logically present the recommendations that were derived from preceding chapter. It should be noted that these recommendations are strictly contextual to the particular internal and external environments of Moreland at the time of study, and that changes in these environments would require a re-calibration of the strategic thrust of the company.

1.10 Summary

Moreland has, through its value creation initiatives, established an important economic node within the Northern Durban Metropolitan Area. Unfortunately, the company has not been able to translate these endeavours into a platform that generates adequate long-term returns. The local government's back stepping out of its core function of a service provider, the impact of the high level of rates levies and the cyclical interest rates have all contributed to this dilemma of eroding profits.

An overview of the proceeding chapters in this study was provided, which sets the scene for the logical and methodical manner in which the study was undertaken. This chapter presented the management dilemma, the reasons for undertaking the study, both in terms of providing current solutions to Moreland as well as providing a robust framework that can be used in the future to test strategic options in a changing environment as well as insight into the area of theory to be used. Against this backdrop, Moreland's management's dilemma will be assessed and finally, suitable recommendations will be presented.

The following chapter will examine the theoretical construct of the study.

CHAPTER 2 –THEORETICAL BASE

2.1 INTRODUCTION

The rate and the pace of change in the market place is constantly rising, and companies are more frequently being confronted with uncertainty and unpredictability, threatening to blow them off course. Globalisation, increased competition, increasingly diverse workforces, rapid pace of information technology development coupled with social, economic and political upheaval are shaping a competitive environment within which companies need to shape their business strategies (Fitzgerald, 1994)

In such a fast changing world, with unpredictable demand cycles, strategic flexibility can generate higher profits by helping a company stay perfectly tuned to the market and avoid getting trapped in dead-end business models. Hamel (2000) argues that strategic flexibility comes from portfolio breadth, operating agility, and a low breakeven point. In describing portfolio breadth, Hamel states that while focus is great, if the world moves against you, you may lack other options. Linking the fortunes of your company to the fortunes of a single market can be a high-risk gamble. A company with a broad offering may be more resilient in the face of rapidly shifting customer priorities than a more narrowly focused competitor. Hamel describes operating agility as a company that is able to quickly refocus its efforts is better placed to respond to changes in demand and can thereby even out profit swings. Finally, in describing lower breakeven, Hamel (2000) states that a business concept that carries a high breakpoint is inherently less flexible than one with a lower breakeven point. Capital intensity, a big debt load, and high fixed costs reduce the financial flexibility of a business model.

The objective of this study is to evaluate the different options and alternatives available to a firm in a changing environment. Because of the impact on existing and potential strategies, it is essential that the evaluation of alternatives be accurate and complete in order to ensure that the proper course of action is selected. The process of strategic evaluation deals with two issues:

1. How effective is the firm's existing strategy likely to be, given our analysis of the emerging environmental conditions?
2. Which of the possible strategic alternatives will be more effective is achieving desired goals, given the expected environmental conditions?

The outcome of the strategic evaluation process, then, is a strategy or game plan that is based on a model that will be most effective in positioning the firm in an uncertain future.

The model is developed from the work of both Pierce and Robinson (2000) and Johnson and Scholes (199). Before the model can be used to test the appropriateness of the strategy, a gap analysis is used to identify where the organisation is positioned between its current forecast and its objectives.

The first step in the development of the model is an accurate analysis of the internal and external environment of the company. The internal environment is analysed using the Strengths, Weaknesses, Opportunities and Threats technique (SWOT analysis), the value-chain analysis and the resource-based view. The second step is the examination of the external environment using, in the main, Porter's Five Forces model.

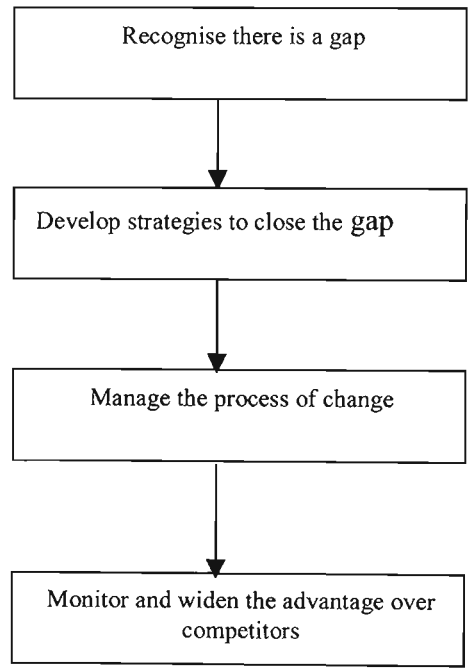
This assessment of the internal and external environment will delineate the most preferred strategy for the firm, the choice of which would be further tested against the three broad categories of suitability, acceptability and feasibility.

2.2 THE DEVELOPMENT OF THE THEORETICAL MODEL

This section is made up of two parts: First, a gap analysis is used to answer the important question of where the company would like to be, relative to its current position. Once this is established, the theoretical model will be used to shape the strategic direction of the company in order to achieved the desired position.

2.2.1 The Gap Analysis Model – A Brief Overview

The basis of gap analysis, according to Ansoff (1984) lies in strategic planning as opposed to long range planning. In long range planning, the future is expected to be predictable through extrapolation of the historical growth. However, in strategic planning, the future is not necessarily expected to be an improvement over the past, nor is it expected to be extrapolable. Gap analysis can help the manager better understand the dynamics of the competitive environment in the following way:



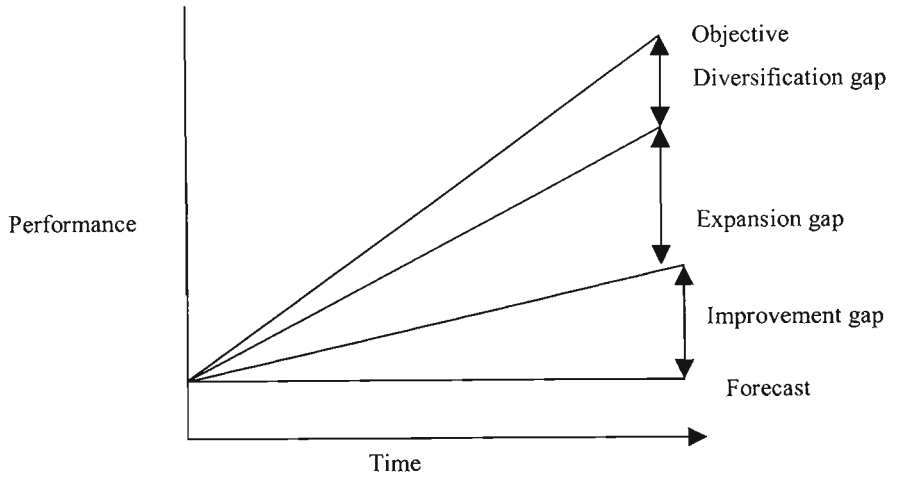


Figure 2.1 Gap Analysis

According to Ambrosini (1998), a company has three alternatives where gaps are found:

(a) Redefine the objectives

The first step is to check that the objectives are realistic and achievable. If objectives are set too high to stimulate action, it is advisable to set intermediate, more achievable objectives.

(b) Do nothing

Sometimes people become 'change-weary' where continual change can lead to defensive behaviour, increased staff turnover and lower levels of commitment. Sometimes giving people time to 'bed in' to a new structure and new ways of doing things pays greater dividends that another change (Ambrosini, 1998).

(c) Change the strategy

When a gap is found between objectives and forecast and the first two options have been considered and rejected, the only alternative is to change the current strategy and develop a new one.

Performance gaps consist of three segments: improvement gaps, expansion gaps, and diversification gaps:

- **Improvement gaps**

These are gaps which can be narrowed by internal changes to improve efficiency and effectiveness of existing operations, answering the question 'How can we do better what we already do?'

- **Expansion gaps**

These are gaps which can be narrowed by internal strategies that increase growth, such as increasing market penetration, product development and targeting new markets.

- **Diversification gaps**

When improvement and expansion strategies have been considered and found not to close the gap fully, the manager has to conclude that the objective cannot be met from existing businesses and therefore must consider strategies of organisational-level growth. These strategies include growth strategies of both diversification and integration, the stability strategy of harvesting, and the defence strategies of divestment and liquidation.

2.3 THE INTERNAL ENVIRONMENT

The assessment of a firm's internal environment will examine the following key elements, viz. a SWOT (strengths, weaknesses, opportunities, threats) analysis, a value chain analysis and finally a resource-based-view of the firm:

2.3.1 SWOT Analysis

The aim of SWOT analysis is to match likely external environmental changes with internal capabilities, to test these out and challenge how an organisation can capitalise on new opportunities, or defend itself against future threats. Ambrosini (1998) states that this exercise seeks to challenge the robustness of an organisation's current

strategy and highlight areas that might need to change in order to sustain or develop its competitive position. This is done by assessing the resource profile and competencies i.e. the enabling culture of the organisation. The internal strengths and weakness are related to the available resources, the competence of the organisation in undertaking its activities and the balance of its resources and mix of activities (Ambrosini, 1998). The identified strengths, weaknesses, opportunities and threats are collated into a matrix. A scoring mechanism is also used as an aid to provide clarity to the analysis and as a means of assessing:

- The environmental changes that are most critical
- The internal strengths that will remain as strengths or become weaknesses in the changing environment
- The internal element that is most influenced by each external change

Central to the assessment of the internal environment is the examination of the special resources that enable the organisation to deliver sustainable competitive advantage. Lynch (2000) divides the resources of an organisation into three broad categories:

- Tangible resources – the physical resources of the organisation such as plant and equipment
- Intangible resources – those resources that have no physical presence but represent a real benefit to the organisation such as brand names
- Organisational capability – the skills, routines, management and leadership of the organisation (organisational capability is the focus of this section)

According to Pearce and Robinson (2000), a SWOT analysis is based on the assumption that an effective strategy derives from a sound 'fit' between a firm's internal resources (strengths and weaknesses) and its external situation (opportunities and threats). A good fit maximises the firm's strengths and opportunities and minimises its weaknesses and threats.

2.3.2 The Value Chain

The fundamental role of resources in an organisation is to add value. Added value can be defined as the difference between the market value of output and the costs of inputs. The concept of value added can be used to develop the organisation's competitive advantage. This value chain, as described by Porter (1985), is a collection of activities that are performed to design, produce, market, deliver and support its product. A firm's value chain and the way it performs individual activities are a reflection of its history, its strategy and its approach to implementing strategy. Porter adds further that a firm's value chain is embedded in a larger stream of activities called the value system. Suppliers have value chains (upstream value) that create and deliver the purchased inputs used in a firm's chain. In addition, many products pass through the value chains of channels (channel value) on their way to the buyer. A firm's product eventually becomes part of its buyer value chain.

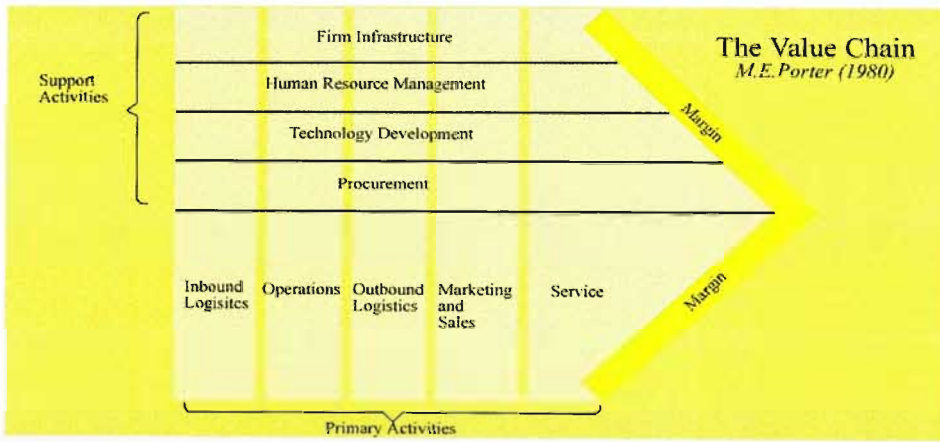


Figure 2.2 Porter's Value Chain

Porter (1985) contends that the ultimate basis for differentiation is a firm and its product's role in the buyer's value chain, which determines buyer needs. Therefore, gaining and sustaining competitive advantage depends on understanding not only a firm's value chain, but how the firm fits in the overall system.

2.3.3 Resource-Based View (RBV)

The starting point for the RBV is a careful exploration of the resources of the organisation, where those attributes that give an individual organisation its particular strengths need to be identified. Lynch (2000) argues that the RBV represents a substantial shift in emphasis towards the individual resources of the organisation and away from the market-based view that was emphasised by Porter and others. The identified elements that comprise the RBV, according to Lynch are:

- Prior or acquired resources – value creation is more likely to be successful if it builds on the strengths that are already available to the organisation, rather than starting from scratch in a totally new era
- Innovative capability – innovation is important because it is likely to deliver a real break-through in competitive advantage that others will have difficulty in matching
- Truly competitive – identifying the resource as being a real strength is not enough: the resource must be comparatively better that the competition.
- Substitutability – resources are more likely to be competitive if they cannot be substituted
- Appropriability – resources must deliver the results of their advantage to the individual company and not be forced to distribute at least part of it to others
- Durability – useful resources must have some longevity, the advantage must be sustainable
- Imitatability – resources must not be easy to imitate if they are to have a competitive advantage.

Lynch (2000) states that it is not essential that an organisation possess all seven elements as most successful strategies will involve only a few of the above. The precise combination that will deliver competitive advantage is totally dependent on the unique resource structure of each organisation – these can be considered as the core resources of the organisation.

A similar view of description of RBV is offered by Collis and Montgomery (Harvard Business Review, 1995). Here, RBV sees companies as very different collections of physical and intangible assets and capabilities. No two companies are alike because no two companies have had the same set of experiences, acquired the same assets and skills, or built the same organisational cultures. According to Collis and Montgomery, these assets and capabilities determine how efficiently and effectively a company performs its functional activities. Following this logic, a company will be positioned to succeed if is has the best and most appropriate stocks of resources for its business and strategy.

In a related area of study, Hamel and Prahalad (Harvard Business Review, 1990) have explored the area of core skills and competencies. The literature describes core competencies as the glue that binds existing businesses as well as the engine for new business development. Therefore, patterns of diversification and market entry may be guided by them, not by the attractiveness of markets.

To understand core competencies, Hamel and Prahalad liken the diversified corporation to a large tree. The trunk and the major limbs are core products, the smaller branches are business units; the leaves, flowers, and fruit are end products. The root system that provides nourishment, sustenance, and stability is the core competence. Hamel and Prahalad note that at least three tests can be applied to identify core competencies in a company: First, a core competence provides access to a wide variety of markets. A company is better positioned to branch out into related products. Second, a core competence should make a significant contribution to the perceived customer benefits of the end product. Finally, a core competence should be difficult for competitors to imitate.

Some examples of the relationship between core competencies and related diversification are illustrated by Hamel and Prahalad: Honda ahs moved from motorcycles to four-wheel off-road buggies, car engines, lawn-mower and generator engines (core competence is the manufacture of engines), 3M competence with sticky tape has diversified their business into related products such as post-it notes, coated

abrasives, pressure-sensitive tapes etc. (core competence is coatings and adhesives) and NEC which is the only global company to be among the leaders in computing, telecommunications, semi-conductors, and have a thriving consumer electronic business (core competence is digital technology). In these examples, what seems to be an extremely diversified portfolio of business belies a few shared core competencies.

According to Hamel and Prahalad, in the short run, a company's competitiveness derives from the price/performance attributes of current products. However, in the long run, competitiveness derives from the ability to build, at lower cost and more speedily than competitors, the core competencies that spawn unanticipated products. The real sources of advantage are to be found in management's ability to consolidate corporate-wide technologies and production skills into competencies that empower individual businesses to adapt to changing opportunities.

2.4 AN ANALYSIS OF THE EXTERNAL ENVIRONMENT

A host of external factors influence a firm's choice of direction and action and, ultimately, its organisational structure and internal processes. This section will examine the external environment using the PEST analysis, the Industry Dominant Forces as well as Porter's Five Forces model. Thompson and Strickland (2003) contend that an industry's economic traits and competitive conditions, and how they are expected to change, determines whether its profit prospects are poor, average, or excellent. Industry and competitive conditions differ so much that leading companies in unattractive industries can find it difficult to earn respectable profits, while even weak companies in attractive industries can turn in good performances.

2.4.1 The PEST Analysis (Political, Economic, Social and Technological)

The remote environment comprises factors that originate beyond, and usually irrespective of, any single firms operating situation. This environment presents firms with opportunities, threats, and constraints, but rarely does a single firm exert and

meaningful reciprocal influence. Pearce and Robinson (2000) refer to the following factors of the remote environment:

(a) Economic factors

Economic factors concern the nature and direction of the economy in which the firm operates. On both the national and international level, the organisation must consider the general availability of credit, the level of disposable income, and the propensity of people to spend. Prime interest rates and inflation rates are other economic factors that must be considered.

(b) Social Factors

The social factors that effect a firm involve the beliefs, values, attitudes, opinions, and lifestyles of persons in the firm's external environment, as developed from cultural, ecological, demographic, religious, educational and ethnic conditioning. Social forces are dynamic, with constant change resulting from the efforts of individuals to satisfy their desires and needs by controlling and adapting to environmental factors.

(c) Political Factors

The direction and stability of political factors are major considerations for managers on formulating company strategy. Political factors define the legal and regulatory parameters within which firms must operate. Since laws and regulations are most commonly restrictive, they tend to reduce the potential profits of firms.

(d) Technological Factors

To avoid obsolescence and promote innovation, a firm must be aware of technological changes that might influence its industry. Creative technological adaptations can

suggest possibilities for new products, for improvements in existing products, or in manufacturing and marketing techniques.

2.4.2 The Industry's Dominant Forces

Thompson and Strickland (2003) group the following factors in profiling an industry's economic features:

- Market size
- Scope of rivalry (local, regional, national, international or global)
- Market growth rate and position in the business life (early development, rapid growth and takeoff, early maturity, maturity, saturation and stagnation, decline)
- Number of rivals and their relative sizes – is the industry fragmented into many small companies or concentrated and dominated by few large companies (discussed in more detail under Porter's Five Forces model)
- The number of buyers and their relative sizes industry
- The types of distribution channels used to access consumers
- The pace of technological change in both production process innovation and new product introductions
- Whether and to what extent rivals are integrated backward or forward

In elaborating on the position of the business cycle, Lynch 2000 states that in cyclical markets, the size of the market grows for a period, declines, grows again and declines on a repeated basis. This may occur as a result of economic or political cyclical conditions over which the industry has no control. During the upward part of such a cycle, companies experience high profitability and during the downward part of the cycle, some companies face major profit problems, particularly those with high fixed costs and a lack of flexibility in their variable costs.

2.4.3 Porter's Five Forces Model

One important component of industry and competitive analysis involves delving into the industry's competitive processes to discover what the main sources of competitive pressure are and how strong each competitive force is. This analytical step is essential because managers cannot devise a successful strategy without in-dept understanding in the industry's competitive character. Porter's Five Forces model, as depicted below, is a powerful tool for systematically diagnosing the principal competitive pressures in a market and assessing how strong and important each one is. Not only is it the most widely used technique of competition analysis, but it is also relatively easy to understand and apply.

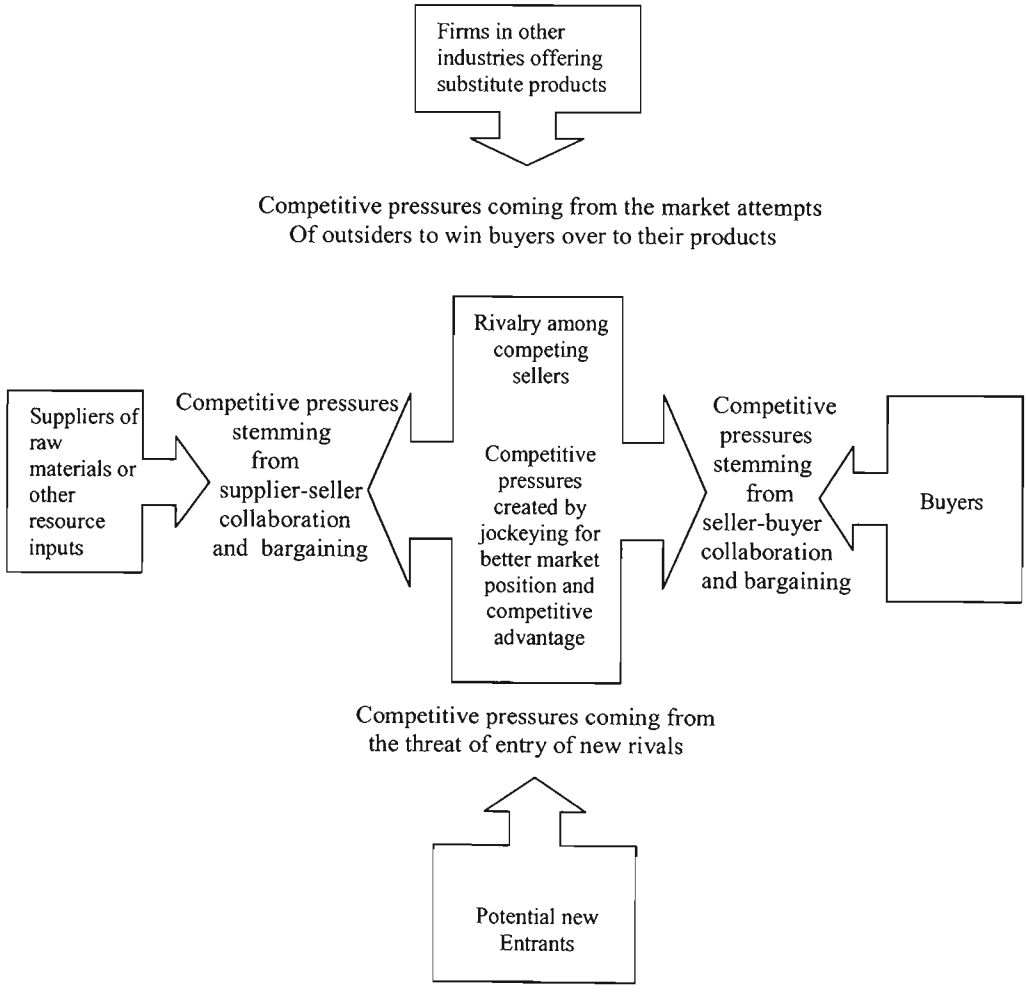


Figure 2.3 Porter's Five Forces Model

Porter (1985) contends that the five forces determine industry profitability because they influence the prices, costs, and required investment of firms in an industry – the elements of return on investment. The collective strength of these five competitive forces determines the ability of firms to earn, on average, rates of return on investment in excess of the cost of capital.

(a) Entry Barriers

The threat of entry determines the likelihood that new firms will enter an industry and compete away the value, either passing it on to buyers in the form of lower prices or dissipating it by raising the costs of competing.

(b) The Power of Buyers

This concept determines the extent to which have sufficient bargaining power to influence the terms and conditions of sale in their favour. Buyers have substantial bargaining leverage particularly when the buyer's costs of switching to competing brands or substitutes are relatively low.

(c) The Threat of Substitutes

This determines the extent to which some other product can meet the same buyer needs, and thus places a ceiling on the amount a buyer is willing to pay for a firm's product.

(d) The Power of Suppliers

Whether supplier-seller relationships represent a weak or strong competitive force depends on, a) whether suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favour, and b) the extent of supplier-seller collaboration in the industry.

(e) Intensity of Rivalry

This acts similarly to the threat of entry. It determines the extent to which firms already in an industry will compete away the value they create for buyers among themselves, passing it onto buyers in lower prices or dissipating it in higher costs of competing.

Porter (1985) states that the five-forces framework allows a firm to see through the complexity and pinpoint those factors that are critical to competition in its industry, as well as to identify those strategies that would improve the industry's and its own profitability. The five-forces framework does not eliminate the need for creativity in finding new ways of competing in an industry. Instead, it directs manager's creative energies toward those aspects of industry structure that are most important to long-run profitability. The framework aims, in the process, to raise the odds of discovering a desirable strategic innovation.

The examination of the company's internal environment as well as the industry situation will inform the choice of strategy that will achieve the long-term objectives in areas of profitability and competitive positioning as well as the choice of grand strategies based on a core idea on how the company can compete. This exercise forms the basis of the theoretical model.

An Examination of the Internal Environment in Determining Strategy Choice

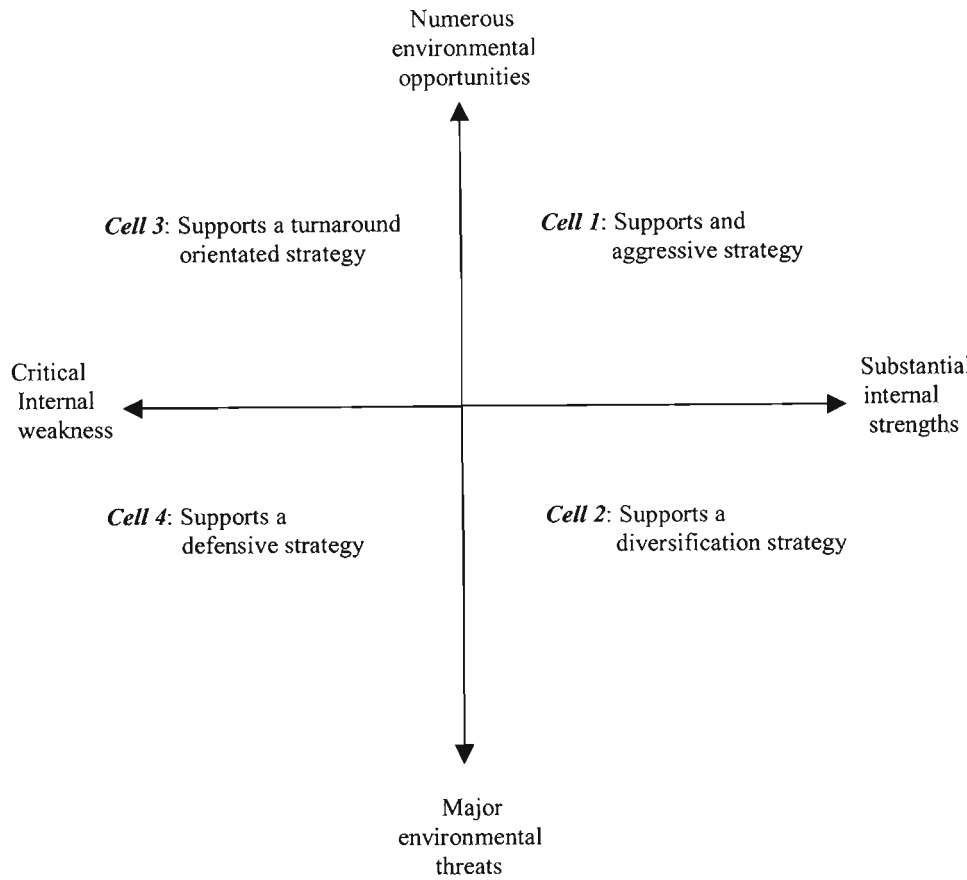


Figure 2.4 Strategic Options – Internal Assessment

Pearce and Robinson (2000) illustrate how the above diagram uses a SWOT analysis that builds on a RBV of a firm to aid strategic analysis. Key external opportunities and threats are systematically compared with internal resources and competencies. The objective is identification of one of four distinct patterns in the match between a firm's internal resources and external situation.

Cell 1: Is the most favourable situation; the firm faces several environmental opportunities and has numerous strengths that encourage pursuit of these opportunities. This situation suggests growth-orientated strategies to exploit the favourable match.

Cell 2: A firm who's RBV has identified several key strengths faces an unfavourable environment. In this situation, strategies would seek to redepoly those strong resources and competencies to build long-term opportunities in more opportunistic markets.

Cell 3: Here a firm faces impressive market opportunity but is constrained by weak internal resources. The focus of strategy for such a firm is eliminating the internal weaknesses so as to more effectively pursue the market opportunity.

Cell4: Is the least favourable situation, with the firm facing major environmental threats form a weak resource position. This situation clearly calls for strategies that reduce or redirect involvement in the products or markets examined by means of SWOT analysis.

2.5 STRATEGIC OPTIONS BASED ON THE INTERNAL AND EXTERNAL ENVIRONMENTS

The next step of the development of the model is to decide whether the firm wants to overcome their weakness or to maximise their strengths. Each of these two options can be achieved by either redirecting resources within the firm or looking externally in the form of acquisitions or mergers to improve resource capability. The choices available to the company are illustrated by Pearce and Robinson (2000) below:

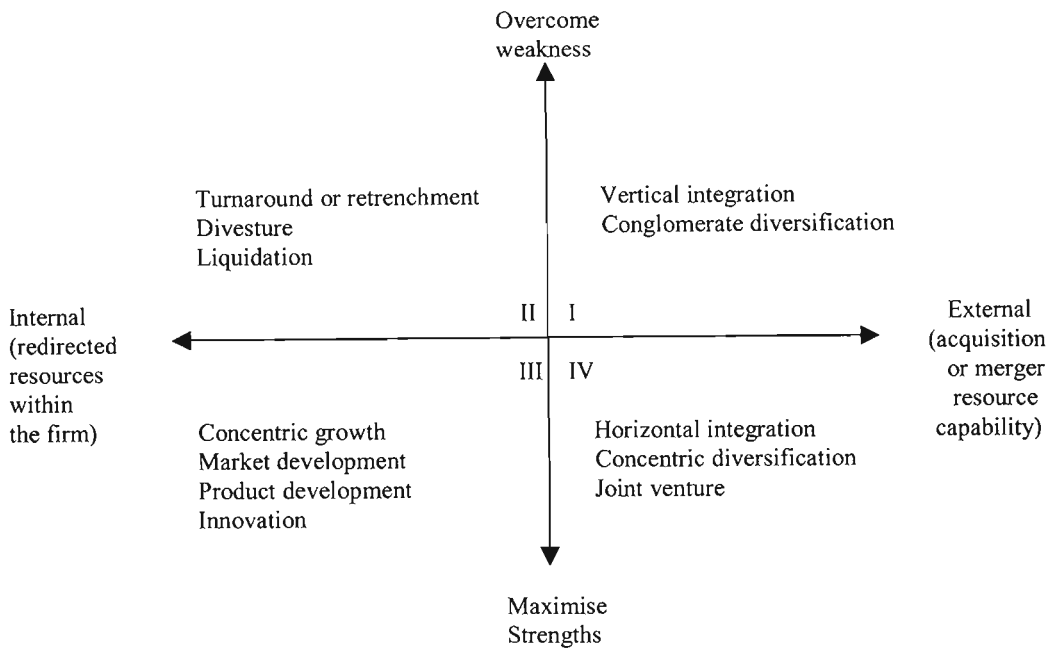


Figure 2.5 Strategic Options – Internal or External Direction

Pearce and Robinson (2000) contend that one valuable guide to the selection of a promising grand strategy is the matrix illustrated above. The basic idea underlying the matrix is that two variables are of central concern in the selection process: (1) the principal purpose of the grand strategy and (2) the choice of an internal or external emphasis for growth or profitability.

Quadrant 1 – Here the firm, with 'all its eggs in one basket', often views itself as over-committed to a particular business with limited growth opportunities or high risks. One reasonable solution is *vertical integration*, which enables the firm to reduce risk by reducing uncertainty about inputs or access to customers. Another option is *conglomerate diversification*, which provides a profitable investment alternative with diverting management attention from the original business. However, the external approaches to overcoming weaknesses usually result in the most costly grand strategies. Acquiring a second business demands large investments of time and sizeable financial resources. Thus, strategic managers considering these approaches must guard against exchanging one set of weaknesses for another (Pearce and Robinson, 2000).

In quadrant II, more conservative approaches to overcoming weaknesses are found. Firms often choose to redirect resources from one internal business activity to another. This approach maintains that the firm's commitment to its basic mission, rewards success, and enables further development of proven competitive advantage. The least disruptive of the quadrant ii strategies is *retrenchment*, which is pruning the current activities of a business. If the weaknesses of the business arose from inefficiencies, retrenchment can actually serve as a *turnaround strategy*. However, if those weaknesses are a major obstruction to success in the industry and the costs of overcoming them are unaffordable or are not justified by a cost-benefit analysis, then eliminating the business may be considered. *Divesture* offers the best possibility for recouping the firm's investment, but even *liquidation* can be an attractive option if the alternatives are bankruptcy or an unwarranted drain on the firm's resources.

In quadrant III, the emphasis here is that the firm should build from strength. The premise is that growth and survival depend on an ability to capture a market share that is large enough for economies of scale. If a firm believes that this approach will be profitable and prefers an internal emphasis for maximising strengths, four grand strategies can be used: The most common approach is *concentrated growth*, that is, market penetration. The firm that selects this strategy is strongly committed to its current products and markets. It serves to solidify its position by reinvesting resources to reinforce its strengths. Two alternate approaches are market development and product development. With these strategies, the firm attempts to broaden its operations. *Market development* is chosen if the firm believes that the existing products will be well received by new customer groups. *Product development* is chosen if the firm believes that existing customers would be interested in products related to its current lines. The final alternative for quadrant III is *innovation*. When a firm's strengths are in creative product design or unique production technologies, sales can be stimulated by accelerating perceived product obsolescence. This is the principle underlying the innovative grand strategy.

In quadrant IV, the emphasis is on maximising a firm's strengths by aggressively expanding its base operations which usually requires an external orientation. *Horizontal integration* is attractive because it makes possible an increase in output capability. *Concentric diversification* is a good choice for similar reasons. Because

the original and newly acquired businesses are related, the distinctive competencies of the diversifying firm are likely to facilitate a smooth, synergistic, and profitable expansion. The final alternative for increasing resource capability through external emphasis is a *joint venture or strategic alliance.* This alternative allows a firm to extend its strengths into competitive arenas that it would be hesitant to enter alone. A partner's production, technological, financial or marketing capabilities can reduce the firm's financial investment significantly and increase its probability of success.

The following step in the development of the model is using Porter' Five Forces model in the selection a grand strategy cluster. The approach is based on the idea that the situation of a business is defined in terms of the growth rate of the general market and the firm's competitive position in that market.

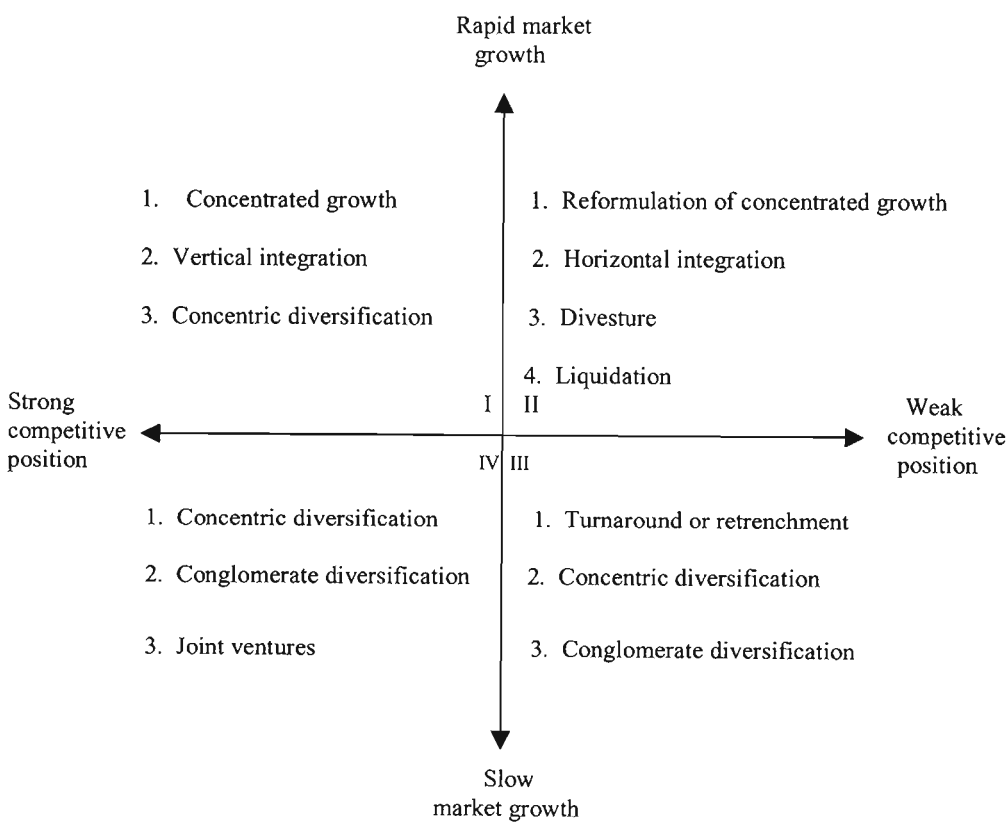


Figure 2.6 Strategic Options – Internal and External Assessment

When the growth rate of the general market and the firm's competitive position are considered simultaneously, a business can be broadly categorized in one of four quadrants: (I) strong competitive position in a rapidly growing market, (II) weak position in a rapidly growing market, (III) weak position in a slow-growth market, or (IV) strong position in a slow-growth market. Each of these quadrants suggests a set of promising possibilities for the selection of a grand strategy.

In quadrant (I), firms are in an excellent strategic position. One obvious grand strategy fro such firms is continued concentration on their current business as it is currently defined. Because consumers seem satisfied with the firm's current strategy, shifting notably from it would endanger the firm's established competitive advantages. However, if the firm has resources that exceed the demands of a concentrated growth strategy, it should consider vertical integration. Either forward or backward integration helps a firm to protect its profit margins and market share by ensuring better access to consumers or material inputs. Finally, to diminish the risks associated with a narrow product or service line, a firm in this quadrant may consider concentric diversification. With this strategy, the firm continues to invest heavily in its basic area of proven ability.

In quadrant (II), firms must seriously evaluate their present approach to the marketplace. Pearce and Robinson (2000) state that if a firm has competed long enough to accurately assess the merits of its current grand strategy, it must determine (1) why the strategy is ineffectual and (2) whether it is capable of competing effectively. Depending on the answers to these questions, the firm should use one of four grand strategies: formulation or reformulation of a concentrated growth strategy, horizontal integration, divesture, or liquidation.

Formulation or reformulation of a concentrated growth strategy is usually the first option that should be considered because in a rapidly growing market, even a small or relatively weak business often is able to find a profitable niche. However, if the firm lacks either a critical competitive element or sufficient economies of scale to achieve competitive cost efficiencies, then a grand strategy that directs its efforts towards horizontal integration is often the desirable alternative (Pearce and Robinson, 2000).

A final pair of options involves deciding to stop competing in the market or product area of the business. A multiproduct firm may conclude that it is most likely to achieve the goals of its mission if the business is dropped through divesture. This grand strategy not only eliminates a drain on resources but also may provide funds to promote other business activities. As an option of last resort, a firm may decide to liquidate the business. The decision to liquidate is an undeniable admission of failure by a firm.

In quadrant (III), a firm that expects a continuation of slow market growth and a relatively weak competitive position will usually attempt to decrease their resource commitment to that business. Minimal withdrawal is accomplished through retrenchment; this strategy has the side benefits of making resources available for other investments and of motivating employees to increase their operating efficiency (Pearce and Robinson, 2000). An alternative approach is to divert resources for expansion through investment in other businesses. This approach typically involves either concentric or conglomerate diversification because the firm usually wants to enter more promising arenas of competition than integration or concentrated growth strategies will allow. The final options for quadrant (III) businesses are divesture, if an optimistic buyer can be found, and liquidation.

Quadrant (IV) businesses (strong competitive position in a slow-growth market) have a basis of strength form which to diversify into more promising growth areas. These businesses have characteristically high cash flow levels and limited internal growth needs. Thus, they are in an excellent position for concentric diversification into ventures that utilise their proven acumen. A second option is conglomerate diversification, which spreads investment risk and does not divert managerial attention from the present business (Pearce and Robinson, 2000). The final option is joint ventures, which are especially attractive to multinational firms. Through joint ventures, a domestic business can gain competitive advantages in promising new fields while exposing itself to limited risks.

The development of the model follows from the selection of a grand strategy, based on an accurate assessment of the internal and external environment of the firm, to

subjecting the chosen strategy to a series of tests. Ultimately, the strategy chosen must stand up against a test of suitability, acceptability and feasibility.

2.6 TESTING OF SUITABILITY, ACCEPTABILITY AND FEASIBILITY

According to Johnson and Scholes (1999), there are three types of evaluation criterion which can be used to assess strategies:

(a) Suitability

This is a broad assessment of whether the strategy addresses the circumstances in which the organisation is operating. For example, the extent to which new strategies would fit with the future trends and changes in the environment; or how the strategy might exploit the core competencies of the organisation. The tools used in assessing suitability are the life cycle analysis, positioning, value chain analysis, portfolio analysis and business profile analysis.

(b) Acceptability

This area is concerned with the expected performance outcomes (such as return or risk) if the strategy were implemented, and the extent to which these would be in line with the expectations of stakeholders.

(c) Feasibility

This area is concerned with whether the strategy could be made to work in practice. Assessing the feasibility of a strategy requires an examination of the practicalities of resourcing the strategic capability.

2.6.1 ANALYSING SUITABILITY

(a) Life Cycle Analysis

A life cycle analysis assesses whether a strategy is likely to be appropriate given the stage of the product life cycle. When combined with the relative strength or weakness of the organisation in its market, a life cycle portfolio matrix is developed. According to Ambrosini (1998), very deterministic rules are applied to this matrix for the calculation of competitive position and market maturity, leading to a position on the matrix which, in turn, leads to the recommendation of a very limited range of natural strategic thrusts.

Competitive position	Stages of industry maturity: Embryonic	Growth	Mature	Ageing
Dominant	Fast grow Start-up	Fast grow Attain cost leadership Renew Defend position	Defend position Attain cost leadership Renew Fast grow	Defend position Focus Renew Grow with industry
Strong	Start-up Differentiate Fast grow	Fast grow Catch-up Attain cost leadership Differentiate	Attain cost leadership Renew, focus Differentiate Grow in industry	Find niche Hold niche Hang-in Grow with industry Harvest
Favourable	Start-up Differentiate Focus Fast grow	Differentiate, focus Catch-up Grow with industry	Harvest Find niche, hold niche Renew, turnaround Differentiate, focus Grow with industry	Retrench Turnaround
Tenable	Start-up Grow with industry Focus	Harvest, catch-up Hold niche, hang-in Find niche Turnaround Focus Grow with industry	Harvest Turnaround Find niche Retrench	Divest Retrench
Weak	Find niche Catch-up Grow with industry	Turnaround Retrench	Withdraw Divest	Withdraw

Table 2.1 Life Cycle Analysis

The purpose of the matrix is to establish the appropriateness of particular strategies in relation to the two dimensions. The crucial issue is establishing where an

organisation is currently placed on the matrix, and therefore what types of strategy are most likely to be suitable.

(b) Positioning

According to Johnson and Scholes (1999), positioning is the key test of suitability. Positioning is concerned with the choice of generic strategy chosen by the firm and the required competences that underpin the chosen strategy. Key to the concept of positioning is assessing whether demand is likely to grow or decline. The extent to which an organisation is able to support a particular positioning in its markets will depend on: (a) Assessing the suitability of a particular strategy listing key resources and competences underpinning the strategy, (b) These key resources and competences are examined in terms of the different bases of the product or market strategy, for e.g., would a particular resource underpin the cost reduction strategy, and finally (c) each of these resources and competences is revisited to establish whether it is sustainable or difficult to imitate: in other words, whether it is genuinely unique resource or core competence.

(c) Value Chain Analysis

Value chain analysis describes the activities within and around an organisation and relates them to an analysis of the competitive strength of the organisation. Johnson and Scholes (1999) state that the key to sustainable success can be found in the way that the value system is configured – that the linkages between the value activities are just as important as the competence in the separate activities. Therefore, the suitability of strategic developments may also be tested by the extent to which the strategy will reconfigure the value chain in a way that improves value for money and the competitive position of the organisation.

The associated concept of synergy is concerned with how much extra benefit can be created from reconfiguring the linkages in the value chain. Synergy could arise through many different types of links or interrelationships: for example, in the market (by exploiting a brand name); in the company's operations (by shared purchasing, facilities) and in product/process development (by sharing information and know

how). Synergy is often used as a justification for product or market diversification, particularly through acquisition or merger.

(d) Portfolio Analysis

Portfolio analysis analyses the balance of an organisation's strategic business units. The tool used in this test of suitability is the BCG (Boston Consulting Group) matrix.

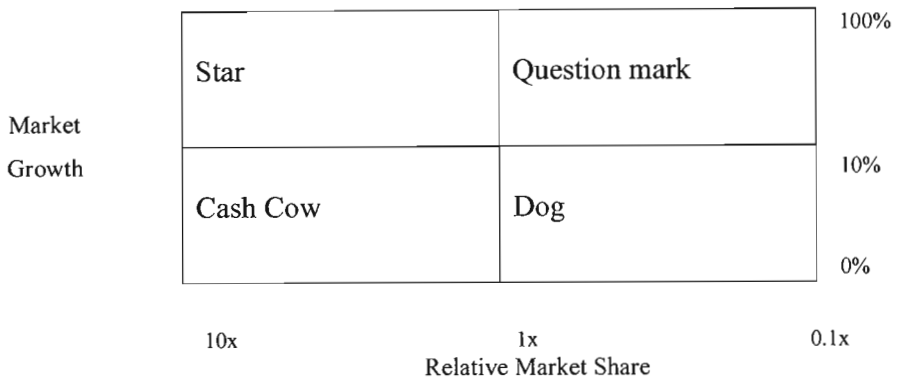


Figure 2.7 Portfolio Analysis

When evaluating specific options for the future, these can be plotted into the BGC matrix and the long-term rationale of business development can be highlighted. This can be done by asking the following questions:

- Will the strategy move the company to a dominant position in its markets? Which strategies are most likely to ensure a move from question marks through to stars and eventually cash cows? Question marks require a sufficient level of innovative capability. If this is not present then perhaps the organisation should 'side-step' questions via its acquisition strategy.
- Since question marks and stars generally require an investment of funds, will there be sufficient cash cows to provide this necessary investment?
- The matrix can also help in thinking about acquisition strategy. Companies that embark on acquisition programmes may forget that the most likely targets for acquisition programmes are not the stars and the cash cows, but the question marks or dogs. There may be nothing wrong with acquiring a

question mark, provided the resources and competences are there to move it towards stardom.

(e) Business Profile Analysis

According to Johnson and Scholes (1999), a business profile analysis shows the extent to which a strategy matches the favourable performance parameters from PIMS (Profit Impact of Marketing Strategy) analysis. This analysis examines the impact of a number of parameters on the marketing strategy. Each of the parameters is scored along a range of bad to good, depending on the effect each parameter has on the strategy. If the overall profile lies along the range 'bad', the strategy would serve to lower the firm's financial performance and the opposite would happen should the overall profile lie along the 'good' range. However, it must be noted that any strengthening of one parameter may weaken others and therefore not improve the business profile overall.

2.6.2 ANALYSING ACCEPTABILITY

Establishing the suitability of options is a useful starting point in an evaluation as it establishes the rationale or strategic logic behind a particular strategy. However, strategies also have to be acceptable to a variety of different stakeholders. Acceptability is concerned with the expected performance outcomes, such as risk or return, if a strategy is implemented. According to Johnson and Scholes (1999), the acceptability of strategies can be assessed in three broad ways:

(a) Analysing Return

The assessment of the returns likely to accrue from specific options is a key measure of the acceptability of an option. The three approaches in analysing return are:

- **Profitability Analysis**

The three approaches in measuring profitability are:

- Return on capital employed (ROCE) – which represents the return expected after a specific time after a new strategy is implemented (e.g. the new strategy will result in a return on capital of 15% by year 3)
- Payback period – is used when a significant capital injection is needed to support a new venture. The payback period is calculated by finding the time at which the cumulative net cash flow becomes zero. The judgement is then whether the calculated time period is an adequate outcome and if the organisation is prepared to wait that long for a return.
- Discounted cash flow – The DCF analysis is perhaps the most widely used investment appraisal technique, and is essentially an extension of the payback period analysis. Once the net cash flows have been assessed for each of the years, they are discounted progressively to reflect the fact that funds generated early are of more real value than those in a later period (years). The net present value (NPV) of the venture is then calculated by adding all the discounted annual cash flows (after taxation) over the anticipated life of the project. DCF analysis is particularly useful for comparing the financial merits of strategies which have very different patterns of expenditure and return.

- **Cost-benefit Analysis**

Johnson and Scholes (1999) state that in many situations, the analysis of profit is too narrow an interpretation of return, particularly where intangible benefits are an important consideration. Cost-benefit analysis attempts to put a money value on all the costs and benefits of a strategic option, including tangible and intangible returns to people and organisations other that the one carrying the project or strategy. The major benefit of this analysis is in forcing people to be explicit about the various factors which should influence strategic choice.

- **Shareholder Value Analysis**

This approach forms the basis for examining the creation of value and benefits to shareholder, which is the primary legal responsibility of company directors. Applying SVA within the strategic management process requires a new mindset which is called value management (Johnson and Scholes, 1999). Value management emphasises that discounted cash flow analysis should concentrate on evaluating strategies at the strategic business unit level, and not just separate investment projects. The financial analysis must be driven by an understanding of the value creation process and the competitive advantage which the organisation derives. In particular, it is critical to identify the key cash generators for the business, which are called the value drivers. Ultimately, the net present value (NPV) of a strategy or strategic decision is likely to be critically dependent on a relatively small number of these external value drivers. Value management's big contribution is to emphasise how important managing value divers is to making strategic decisions, and in implementation and control.

(b) Analysing Risk

The likely return from a particular strategy is an important measure of the acceptability of that strategy. However, another measure of acceptability is the risk which the organisation faces in pursuing a particular strategy. This section outlines some of the ways in which this risk can be assessed as part of an evaluation of specific options.

- **Financial Ratio Projections**

The projection of how key financial ratios would change if a specific option were adopted can provide useful insights into risk.

At the broadest level, an assessment of how the capital structure of the company would change is a good general measure of risk, for e.g. options which would require the extension of long-term loans would increase the gearing of the company and its financial risk. At a more detailed level, a consideration of the likely impact on an organisation's liquidity is important in evaluating options. Organisations may be tempted to finance short-term options by delaying payment obligations or using the

overdraft facility which, in both cases, reduces the liquidity and increases the financial risk of the organisation.

- **Sensitivity Analysis**

Sensitivity analysis is a useful technique for incorporating the assessment of risk during strategy evaluation. This is sometimes referred to 'what if' analysis. The technique allows each of the important assumptions underlying a particular strategy to be questioned and changed. In particular, it seeks to test how sensitive the predicted performance or outcome (e.g. profit) is to each of these assumptions. This process helps management develop a clearer picture of the risks of making particular strategic decisions and the degree of confidence it might have is a given decision. In turn this helps determine the way in which resourcing should be planned and controlled for key elements of strategy.

- **Simulation Modelling**

According to Johnson and Scholes (1999), strategic simulation models attempt to encompass all the factors pertaining to suitability, acceptability and feasibility into one quantitative simulation model of the company and its environment. An example of this technique is risk analysis using a financial model which seeks to assess the overall degree of uncertainty in a particular option by mathematically combining the uncertainties in each of the elements of the option. The limitations of this technique lie in the areas of:
(a) There is a danger that the model will become a gross oversimplification of reality, and fail to encompass the most important uncertainties and risks, (b) Attempts to incorporate a very large number of variables make the model highly complex, and (c) Some key data, such as competitor reactions, are difficult to assess or incorporate into the model.

- **Analysing Stakeholder Reactions**

Stakeholder mapping is presented as a way of analysing the 'political agenda' for an organisation. Johnson and Scholes (1999) state that this is a valuable tool is assessing

the likely reactions of stakeholders to new strategies, the ability to manage these reactions, and hence the acceptability of a strategy. Stakeholder mapping is a useful technique for encouraging managers to predict both the degree of interest that stakeholders are likely to exhibit for or against a strategy, and whether they have the power to help or hinder the adoption of that strategy.

2.6.3 ANALYSING FEASIBILITY

This final section of the theoretical model development deals with whether an organisation has the resources and competences to deliver the strategy. The following analytical approaches can be used to assess feasibility:

(a) Funds Flow Analysis

This technique seeks to identify the funds which would be required for any strategy and the likely sources of those funds. Such an analysis should quickly highlight whether the proposed strategy is likely to be feasible in financial terms, and would assist in identifying the timing of new funding requirements.

(b) Break-even Analysis

This technique is used to assess the feasibility of meeting targets of return (e.g. profit) and, as such, combines a parallel assessment of acceptability. Break-even analysis also provides an assessment of the risk of various strategies; particularly where different strategic options require markedly different cost structures (Johnson and Scholes, 1999).

(c) Resource Deployment Analysis

While the funds flow analysis and break-even analysis have concentrated on the assessment of feasibility in financial terms, the resource deployment method makes a wider assessment of the resources and competences of the organisation in relation to

specific strategies. The requirements of alternative future strategies should be laid out, indicating the key resources and competences for each strategy. A scoring system can be used to compare various strategic options against the current resources and competences of the organisation in order to judge two aspects: first, the extent to which the current resources and competences would need to change to reach or maintain the threshold requirements for each strategy, and second, the unique resources and core competences required to sustain competitive advantage.

There is a danger that resource deployment analysis will simply result in organisations choosing strategies which most closely fit the configuration of their present resources and competences. It should be remembered that the real benefit of such an analysis is the identification of those necessary changes in resources and competences which are implied by any strategy, and an analysis of whether these changes are feasible in terms of scale, quality of resource or timescale of change.

2.7 SUMMARY

In a changing environment, a strategy that has worked in the past may not be suitable under the new circumstances. In order to examine the alternative strategic options available to an organisation under these conditions of external changes, the organisation as well as the external environment in which it operates was examined using various tools and approaches. The findings then delineated a menu of strategic thrusts, which addresses the changes in the environment, and are further tested in terms of whether the organisation has the infrastructure to pursue the most suitable option. The following is a theoretical model that will provide the framework for the case study in Chapter 4:

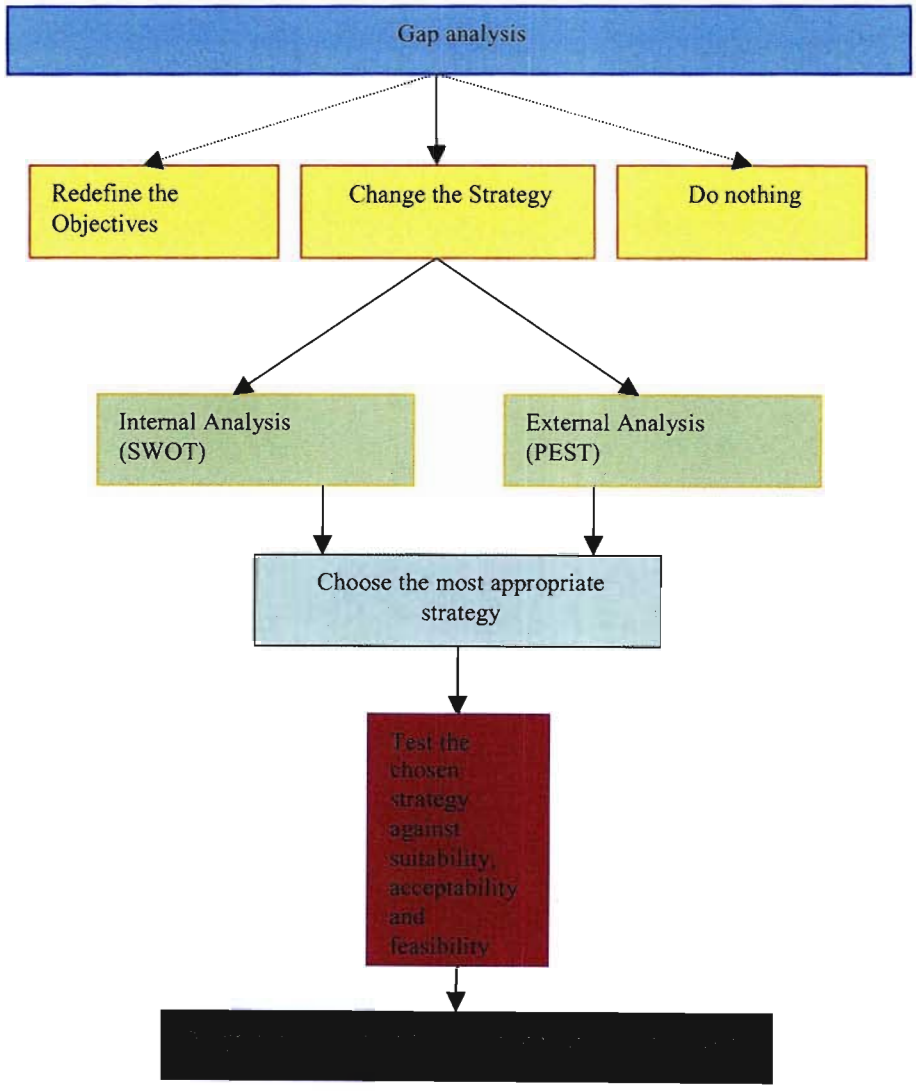


Figure 2.8 Theoretical Model

CHAPTER 3 – CASE STUDY OF MORELAND DEVELOPMENTS (PTY) LTD

3.1 INTRODUCTION

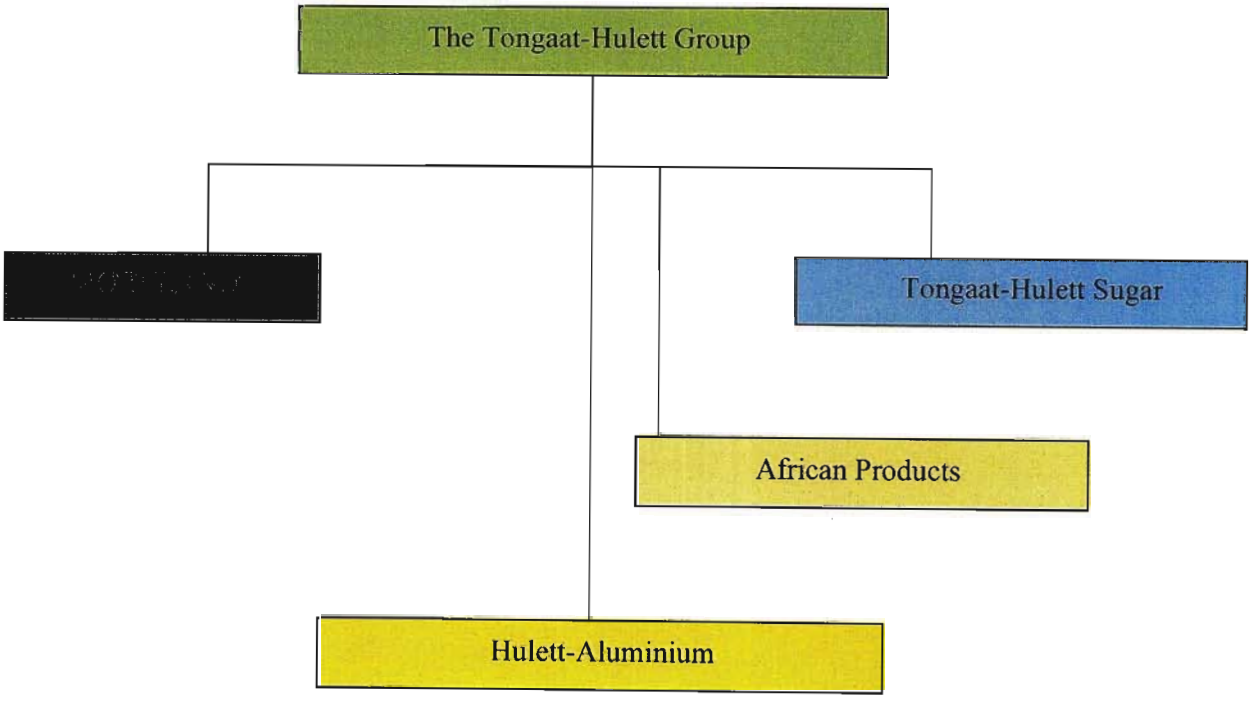
Moreland Developments (Pty) Limited is a land only developer operating predominantly in the Northern Durban Metropolitan Area. Recent changes in the company's external environment have impacted negatively on Moreland's returns, thereby challenging the suitability of their current focused differentiation (niche market) strategy.

The theoretical model that was developed in Chapter 3 will provide the framework for examining and testing a more appropriate strategy for the company, given the circumstances under which Moreland operates.

3.2 COMPANY BACKGROUND

Moreland is the property company of the Johannesburg and London listed Tongaat-Hulett Group, and is one of South Africa's leading property developers.

Figure 3.1 Tongaat-Hulett Company Structure



Moreland Property Operating Company comprises two strategic business units:

- Moreland Estates (Moreland) which is the property development arm of the Group.
- Tongaat-Hulett Properties (THP) which is the Group's property administration centre, with the key role to protect, unlock and realise value of the Group's land holdings.

The Group owns approximately 36 000 hectares (ha) of land with some 12 000 ha in the Durban Municipal area and 10 000 ha on the Durban-Ballito coastal strip. The Group's landholdings have been categorised according to realisation initiatives strategic to Tongaat-Hulett Sugar for the farming of sugarcane and foreseeable urban development. The Property Division's strategic premise is to unlock Group property values. While the Group has extensive property holdings, these are not highly valued by investors, who tend to be earnings driven. The Property Division converts these assets into earnings, thereby generating shareholder value.

In the early 1990's, the Group's business portfolio suggested that its landholdings were a potential liability. However, the development and successful implementation of the Land Management Strategy, which directed effective planning, development co-ordination and careful and responsible land release strategies, has enhanced the value of Group's landholdings in the Northern Durban Metropolitan Area (NDMA).

Desired Future Scenario for The Greater Durban Metropolitan Area

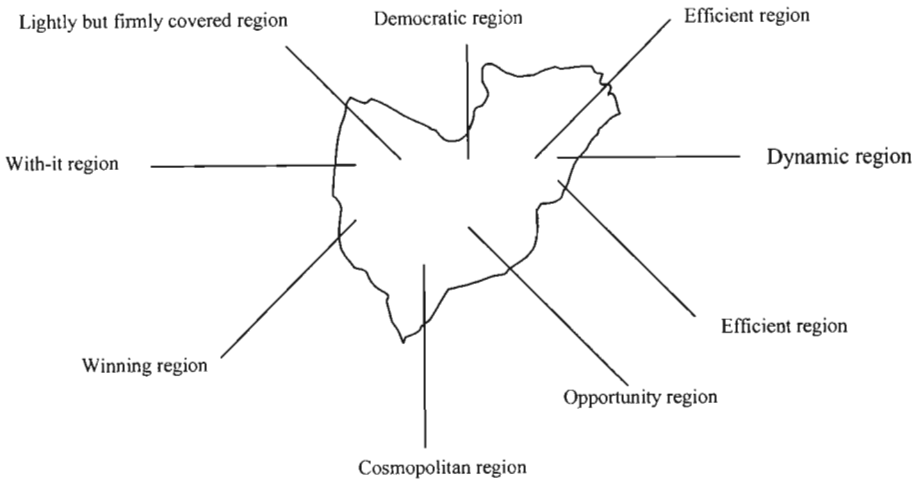


Figure 3.2 Land Management Strategy

As a result of the Planning Forum's findings, Moreland is guided by two key concepts:

- To create employment opportunities close to residential areas in order to reduce commuting times
- To establish mixed-use activity corridors along transport routes

Since 1992, Moreland has invested more that R700 million in land and infrastructure while cumulative land sales exceed R726 million. Given an investment multiplier of 3, growth investment potential in the region is approximately R2.2 billion.

To date, industrial and commercial buildings completed in Moreland's developments provide direct, permanent employment for approximately 30 000 people and housing sites for more than 3 400 families have been developed and sold.

Through its core competence of an innovative, co-ordinated and holistic planning approach, Moreland has ensured responsible property management and development through the creation of balanced community environments. The major focus for Moreland in recent years was to ensure that critical mass has been unleashed through

lead projects such as the Mount Edgecombe Country Club Estate, La Lucia Ridge Office Estate and the Umhlanga Ridge New Town Centre.

3.2.1 The Structure of the Company

The Portfolios of the Company

Residential

Resorts

Industrial / Commercial

Figure 3.3 Moreland's Company Structure

Service departments

Planning

Finance

Marketing

Human Resources

Figure 3.4 Moreland's Service Departments

3.2.2 The Moreland Business Philosophy

Vision

Is to create the most sought after quality-of-life environments in Southern Africa through developments of international standing.

Mission

Is to drive development and economic growth, in the greater Northern Metropolitan Area, on a co-ordinated planning basis in line with market needs and make it KwaZulu-Natal's number one and one of South Africa's top land investment areas.

098117

Key Objectives

Sustaining real growth in earnings, generating positive cash flow and adding more value than cost in respect of its product differentiation strategy.

Business Focus

Developing residential, industrial, commercial and resort land across a broad economic spectrum, -a one stop land shop- predominantly in the greater northern Durban Metropolitan Region. The business objectives are:

- To sustain real growth earnings-per-share and generate cash
- To add value to the land in our development areas

Values

Values committed to are honesty and integrity, initiative, passion and commitment; respect; trust and delivering on promises; professionalism and responsibility.

Environmental Policies and Strategies

Moreland is committed as a priority to administering, planning, developing and utilising natural and man-made resources on all land controlled by the company in such a way as to secure the optimal, sustainable use of such resources through various strategies, including:

- Environmental Management Systems
- Progressive improvement
- Auditing
- Transparency
- Environmental awareness

3.2.3 Moreland's core competencies

Is its ability to plan and develop a prime, extensive land area on a world-class basis forms the base from which its strategy is driven and include:

- Managing the strategic environment
- Sound regional planning
- Co-ordinated development planning
- Effective development, delivery and marketing management and,
- Professional and efficient property administration

The overarching element of the core competencies is the management of the strategic environment, without which the other elements would be difficult, if not impossible, to achieve. Consequently this is the foundation of Moreland's thrust to drive development and economic growth in the Northern Durban Metropolitan Area.

Moreland Developments follows the overall philosophy and consensus which was completed in the 1990s by the Tongaat-Hulett Planning Forum, a team of academics, businessmen, social, economic and political researchers who were tasked with creating a vision for the then equivalent of the current Durban Metropolitan Area.

3.2.4 Moreland's Current Strategy

Moreland pursues a focused (or niche market) strategy based on differentiation. The company's ability to assemble and market serviced property that is distinctly different and in-sink with buyer-desired attributes has enabled Moreland to command a premium price for its product as well as gain buyer loyalty to its brand. The source of this differentiation strategy lies essentially with the company's core competencies and superior management of its value chain activities, particularly in responding to the very diverse needs of a narrow market segment. The recent success of signature projects such as Zimbali, The Mount Edgecombe Country Club Estate and The La Lucia Ridge Office Estate notwithstanding, the cost of Moreland's efforts to achieve such differentiation and the increase in the contribution to bulk infrastructure costs, have reduced margins for the company.

3.2.5 Company Operations

Moreland operates within its four portfolios of residential, commercial, industrial and resorts. In recent years there has been a shift in focus between the residential and commercial portfolios as main drivers for turnover and profit growth for the company. The residential portfolio is now the principal contributor to turnover and profit.

Commercial

- La Lucia Ridge Office Estate (LLROE)
- Millennium Bridge Business Park (MBBP)
- Umhlanga Ridge New Town Centre (URNTC)

The opening of Old Mutual's Gateway Theatre of Shopping in 2001 and greater office space created in the La Lucia Ridge has established the stimuli for development of the New Town Centre in the La Lucia-Umhlanga-Mount Edgecombe (LUME) triangle. However, the sales in the Town Centre are at lower levels than what was anticipated.

Industrial

- Riverhorse Valley Business Estate

The public-private partnership between the eThekwini Municipality and Moreland has resulted in the development of a 300-hectare Business Estate for the construction of level platforms together with an interchange off the N2 freeway.

Residential

- Mount Edgecombe Country Club Estate 1 and 2
- Somerset Park
- The Gardens
- Broadlands
- Ilala Ridge
- Izinga Ridge

The reduction in the interest rate levels and the take up of commercial bulk in the URNTC and LLROE has created a burst in sales for Moreland's residential stocks. The current residential serviced stock levels are low, with delays in zoning and planning approvals by the local authority being an impediment to the continuing momentum of sales and transfers.

Resorts

- Zimbali Coastal Resort
- uShaka Island Marine Park – which is a development between Unicity Council and Moreland to fast track development at the Point, where Moreland has been appointed to project manage and deliver the world-class development.
- Sibaya Casino and Entertainment Node – this is an Afrisun KZN development, comprising a casino, entertainment areas, a multi-purpose indoor arena, a 300 seat conference centre and a 200 room hotel. Moreland was responsible for the provision of bulk infrastructure to the site.

3.2.6 Internal Business Processes

To optimise the attainment of Moreland's strategic objectives, effective internal business processes are in place to facilitate cost and time efficiencies. Ongoing review is conducted for improvement of the many corporate functions, which include planning and development co-ordination; sales and marketing; administration, accounting, secretarial and internal controls; IT and media liaison and public relations.

(a) Marketing and Customer Relations

Moreland's overall marketing objective is to optimise sales with the corporate marketing objective being:

- Identifying market and customer needs by conducting customer perception surveys as well as formal research by socio/economic researchers. The target

market group is male and female, LSM 7-10, regionally, nationally and internationally. The psychographics of the target group are individuals who tend to be upwardly mobile, who appreciate quality and who lead full, busy lives that require convenience.

- To participate in regional (i.e. KZN and DMA) promotional and tourism initiatives.
- The development and promotion of Moreland's brand and its awareness, particularly outside the DMA.
- Customer service focus, being addressed firstly through departmental teams, but is being given broader attention through the company's appointed marketing team.

(b) Environmental Considerations

Moreland, inline with all land planners and developers, is subject to environmental regulations as a key component of the development process. The company has formulated its Environmental Management System (EMS) and Open Space Plan on which it is evaluated for compliance.

All the Environmental Impact Analysis (EIA's) approvals the preparation of Environmental Management Plans (EMP's) which involve not only the preparation of the Management Plan for both construction and operational phases of the development, but also critically monitoring and reporting on adherence to the EMP Guidelines. These processes are co-ordinated by Moreland's Planning Department and Project Managers.

(c) Human Resources Development and Staff Motivation

Moreland's strategic plans have identified its team of employees as its key sustainable strategic competitive advantage and the company is committed to developing staff and improving efficiency. This is achieved through implementing Anglo American's performance management programmes. Kaplan's Balanced Score Card principles and

elements are being rolled out from the corporate to the departmental then employee level to achieve alignment throughout the organisation.

(d) Information Technology (IT)

Moreland's IT systems and applications are continually reviewed to ensure that maximum efficiencies are derived through the installation of the latest, effective and value adding infrastructure, applications and services. Broad objectives to achieve efficiencies include:

- Installation of robust business applications
- Improving system operational efficiencies and data integrity
- Enhancing electronic sales and marketing applications
- Raising user's IT proficiency levels
- Selective outsourcing and service provider management

To date, the following projects are in place or are in the process of being developed:

- Installation of MBIS (Moreland Business Information Systems) as an integration layer providing a view to all key data systems
- The extension of the GIS system (Geographic Information Systems) to cover all portfolio projects
- Extension of the GLASS (Group land and buildings register) project into the next phase (including intra-Group rollout)
- Update and enhancement of PIMS (Property Information Management Systems)
- Extension phases for the website development

(e) Black Economic Empowerment (BEE)

- **Direct outsourcing**

The company continues to emphasise its BEE principles to contractors as follows:

(i) BEE principles stipulated as a condition in the contract tender process

(ii) Through a regular agenda item on at the Project Managers' co-ordinating forum, emphasising Moreland's BEE requirements to contractors and at project and contractors' meetings.

(iii) Project Managers have been requested to set target levels for all contracts awarded. These levels are monitored on a monthly basis through the payment certificates.

- **Indirect Outsourcing**

  In addition, a number of Moreland's principal civil contractors continue to outsource or subcontract to BEE suppliers. Moreland's contribution to both direct and indirect outsourcing to BEE contractors is expected to increase substantially as major contracts are awarded in the Residential and Resorts portfolios.

3.2.7 Competitor Analysis

There is no serious competition from other developers in the NDMA (Northern Durban Metropolitan Area), in particular on the niche and gated developments such as Zimbali, Mount Edgecombe Country Club Estate, The Gardens, La Lucia Ridge Office Estate and Umhlanga Ridge New Town Centre, as barriers to these quality developments are high.

Competition exists in the Golf Course Sector (e.g. Umhlali – Prince's Grant in the North, San Lameer – Selborne in the south and Augusta/Camelot in the west). Notwithstanding this and that such competition is becoming more pronounced, Zimbali and Mount Edgecombe Country Club Estate are still recognised as the leading developments in both KZN and Africa and are favoured for their locality in the NDMA.

Competition in the low-medium density market is evident but the magnitude and quality of the projects undertaken by Moreland is a strong enough barrier against entry of any major competition. In fact, the greater competition is from re-sales of

existing houses and sites, both in Moreland's developments and other areas north of Durban.

The commercial, tourist and niche residential developments are secure against the threat of major competitors due to Moreland's access to the Group's prime strategic land holdings north of Durban, but competition does exist in other parts of the DMA and broader KZN, again largely from existing buildings. Industry property activity is relatively low and the only major threat of competition in KZN is the Durban South Industrial Basin and Pinetown-Marrianhill areas.

The importance of a growing regional market

Moreland has largely maximised its share of the local market (Durban) and the company has realised that the growth of Durban/ KZN economy is needed i.e. to create a larger market for continuing real turnover growth. To this end Moreland has and continues to participate and promote development within the greater provincial region to foster development initiatives for the good of all role-players in KZN. As a leading land developer in KZN, the company is able to influence major development proposals (e.g. Effingham-Avoca and Point Waterfront and perhaps the La Mercy Airport and adjoining Industrial Development Zone projects), which will assist in bringing critical mass into the DMA, which in turn creates a larger market for Moreland.

3.3 THE IMPACT OF RECENT CHANGES IN THE BUSINESS ENVIRONMENT ON MORELAND

- **The Strengthening of the Rand**

The recent surge in the value of the Rand has had an adverse affect on Group's profits. The profit drivers for the Group are the export of sugar and aluminium, both of which have become less competitive in world markets in recent months.

As a result, Group has looked to Moreland to deliver, within the short term, a number of key residential projects that are required to boost the shortfall in Group profits.

- **September 11 Acts of Terrorism**

South Africa, particularly the tourist destinations, benefited from the terror attacks by virtue of a surge in international tourists that perceived South Africa as a relatively safe holiday destination. Progressive increases in international visitors/tourists have a positive effect on positioning Durban and the Metropolitan area as an attractive destination, thereby creating spin-offs for the property/tourism industry.

- **Zimbabwe/SADC instability**

The repercussions of the Zimbabwe land crisis have negatively impacted on the stability of the SADC region, particularly from an international perspective. The perception that property rights are not governable has, to an extent, impacted negatively on the confidence of international investors.

- **Increase in Property rates in the DMA**

Consecutive increases of 12% in 2001 and 2002 in property rates has impacted on Moreland in two ways: First, Moreland has a vast stock of unsold sites and undeveloped land, both of which were targeted in recent rates hikes (increases form three cents on the Rand to nine cents on the Rand). This increase made the cost of holding land unviable. Second, secondary developers incur similar increases, which impact on the feasibility of projects. The margins for secondary developers are reduced to the point where property development for the purpose of leasing becomes less viable.

- **Interest Rates**

A negative relationship exists with the increase in interest rates and Moreland's turnover and profitability. In 1998, the interest rates rocketed to 25%, resulting in the worst recorded performance of the company in 1998 and 1999. The impact of an increase in interest rates impact the company's performance in two ways: First, Moreland is forced to borrow funds at a higher rate, increasing the cost of developments. Second, sales are reduced particularly in the commercial portfolio because the cost of borrowing is prohibitively expensive to make a scheme work financially. On the residential side as well, sales are deferred to later periods when interest rates are expected to reduce. Market sentiment, which is predicated on factors such as inflation and interest rates, ultimately determine timing of land purchases from Moreland.

- **Reduced Contribution from the Local Authority**

The disappointingly low levels of local government investment in infrastructure, public amenities and facilities in the area that Moreland operates has seen a substantial transfer of costs to the company. Professor Jeff McArthy, who regularly consults to Moreland, says "While reducing the historic imbalances between the richer and the poorer parts of metropolitan areas in South Africa are likely to be given priority, ignoring the need for public investment to achieve urban integration in corridor nodes is a short-term approach which is likely to prove costly in the medium to long term. Prof McArthy adds further that in general, the public sector is tending to treat the northern corridor (which is the area of Moreland's operations) as one of almost entirely private responsibility, with private sector investment of R4 billion against less than R110 million by the public sector. This is despite that fact that the rates income derived from the corridor translates into a rough estimate close to R100 million per annum.

With regard to the above, the following are key management challenges:

3.3.1 Delivering the Actuators by:

- Securing timeous rezoning of new planned projects. This is a key process that takes place when Moreland purchases agricultural land from the Tongaat-Hulett Group and rezones this land to the appropriate land use such as residential or commercial. The timing rezoning approval determines the progress of the further activities such as town planning and servicing of sites.

- Unlocking new key projects and phases within projects i.e. to continue with roll on phases within lead-catalyst projects, to ensure that the momentum of critical mass creation is maintained. The development of the La Lucia Ridge Office Estate and the Umhlanga Ridge Town Centre has led to a demand for residential property around these catalyst projects. New residential projects that are planned for the 2003/2004 development period are: Ilala Ridge, iZinga Ridge, Executive Village, Edgeview, Pinehurst (MECCE) and Mhlanga Forest Estate. The pent up demand for residential property along the northern Durban Metropolitan Area is, to a large extent, the result of companies moving out of the CBD into the Office Estate, Mount Edgecombe and New Town Centre.

- Concluding sales: securing sales timeously to ensure that the business objectives of earnings and cash generation are achieved.

3.3.2 Managing the External Value Drivers

- Minimising the property rates burden which has increased from R4 million in 1999 to R15 million Rand in 2002 and is now Moreland's major overhead cost. This involves lobbying government for concessions such as rates holidays for development companies on the basis that development creates spin-offs for an increase in economic activity, job creation and providing a sustainable rates collection base for the future.

- Securing higher local authority infrastructural investment – Moreland has been burdened with the responsibility of providing bulk infrastructure by way of road networks, bridges (The Moreland Millennium Bridge), bulk sewer and storm-water lines as well as intensive landscaping of public areas. Historically, these services were provided by the Local Authority, but in recent years, these costs have been transferred to private developers. The magnitude of bulk infrastructure costs is so onerous on private development to the extent that the viability of certain projects is questionable. This has been one of the biggest challenges for the company in recent years.

- Managing the impact of interest rate hikes which has the two fold effect of higher interest costs for Moreland arising from high levels of borrowings and, secondly, dampening property investment sentiment.

- Reducing planning approval delays through more efficient local authority approval processes. This refers to the approval granted by the Local Authority for a new project to start and will include the granting of certificates for roads, sewer, storm-water and electricity as well as approvals of the zoning and town planning scheme. The services certificates are issued after the services are installed or a financial guarantee is lodged in lieu of services not installed. At this stage can Moreland transfer sold property to clients and collect proceeds from the sales.

3.4 MORELAND'S FINANCIAL PERFORMANCE

Moreland's financial performance is examined over a period of three years, from 2001 to 2003. Due to the company's strategic operations and being part of the listed Tongaat-Hulett Group, actual figures are not indicted in this section. The financial information presented illustrates important patterns of growth or decline, which is indexed to a notional value (x) and a base date of year-end 2001.

3.4.1 Turnover

Dec 2001 Actual	Portfolio (R000's)	2002 Actual	2003 Budget
X	Commercial	- 5%	-5%
X	Residential	+ 39%	+6%
X	Resorts	+ 115%	-2%
X	Industrial	+ 165%	+ 36%
Total	Total Turnover	+ 33 %	+ 2 %

Table 3.1 Financial Analysis - Turnover

A turnover increases by 33% from 2001 to 2002 mainly due to the sales in Zimbali and the Sibaya Casino site under the resorts portfolio. In the residential portfolio, contributions in turnover in the 2002-2003 period are largely attributed to the MEECE (2), iZinga Ridge, Ilala Ridge and Executive Village. The commercial portfolio is projecting declining levels of turnover mainly due to the close out of the La Lucia Ridge Office Estate, which has a limited stock available for sale over the short term. Industrial sales have increased in line with the anticipated recovery in the industrial property market and mainly due to the launch of the Riverhorse Valley Business Estate.

3.4.2 Operating and Attributable Profit

Dec 2001 Actual	Portfolio (R000's)	2002 Actual	2003 Budget
x	Commercial	+ 10 %	– 45 %
x	Residential	– 17 %	+ 88 %
x	Resorts	– 1 %	-21 %
x	Industrial	– 860 %	+ 40 %
x	Operating Profit	+ 7.14 %	– 6 %
x	Corporate Overheads	+ 29%	+ 18%
x	PBIT	+ 2 %	– 13 %
x	Interest	– 1 %	– 32 %
x	PBT	+ 6 %	+ 10 %
x	Taxation	+ 8 %	+ 9 %
x	Attributable Profit	+ 5.5 %	+ 10 %

Table 3.2 Financial Analysis – Operating and Attributable Profit

Operating profit levels are under pressure due to property rates charges as well as the increase in the cost of servicing land. Management is in negotiation with the Local Authority on securing higher rebates on rates randages and appeals on property valuations to reduce the company's rates burden. The major challenge for management with regard to profit generation is to improve operating margins and reduce the interest burden to ensure that all operating profit generation efforts are suitably supported.

The interest bill decrease by 32% (projected) in 2003 due to improved cash flows through the reduction of serviced land stock levels and increases attributable profits substantially over the 2-year period.

3.4.3 Cash Flow

2001 Actual	Portfolio (R000's)	2002 Actual	2003 Budget
x	Commercial	+ 128 %	+ 217 %
x	Residential	+ 5 %	+ 20 %
x	Resorts	+ 270 %	- 82 %
x	Industrial	- 692 %	+ 196 %
x	Operating cash flow	+ 2198 %	+ 3 %
x	Corporate	- 358 %	-26 %
x	Cash flow before interest	+ 926 %	+ 11 %
x	Interest	- 1 %	- 32 %
x	Pre-tax cash flow	+ 253 %	+ 31 %
x	Tax payments	0	0
x	Pre-dividend cash flow	+ 253 %	+ 31 %
x	Dividends paid – Group	+ 5 %	+ 10 %
x	Net cash flow	+ 219 %	+ 34 %
x	Land payments	+ 85 %	- 29 %
x	Cash flow excl. land payments	+ 391 %	+ 11%
x	Pre-dividend cash flow ex. land payments	+ 496 %	+ 11 %

Table 3.3 Financial Analysis – Cash Flow

Management's objective of being cash flow positive is largely being achieved, with the exception of Industrial in 2002. The Riverhorse Valley Business Estate has absorbed substantial development costs prior to sales. In the Commercial portfolio, particularly the La Lucia Ridge Office Estate and the Umhlanga Ridge New Town Centre, the bulk of the infrastructure development took place in 2001, as indicated by the negative cash flow. The turnaround in 2002 and 2003 is as a result of the serviced stock being sold, with substantially lowered development expenditure. The increase in the Resorts cash flow during 2002 is attributed to large sales concluded in Zimbali as well as proceeds from the Sibaya casino site.

3.4.4 Capital Employed

Dec 2001 Actual	Portfolio (R000's)	2002	2003 Budget
x	Commercial	- 68 %	- 12 %
x	Residential	+ 369 %	- 27 %
x	Resorts	+ 112 %	+ 118 %
x	Industrial	+ 7 %	- 35 %
x	Total	- 10 %	+ 5 %

Table 3.4 Financial Analysis – Capital Employed

The substantial development expenditure under the Commercial portfolio in 2001 has been reduced in 2002 and 2003, largely because the Office Estate is nearing development completion and the New Town Centre has substantial saleable stock.

The increase in development expenditure in the Residential portfolio is in line with addressing the current demand in residential property in the La Lucia, Umhlanga and Mount Edgecombe triangle.

The Resorts portfolio has increased development expenditure substantially over the 2002 and 2003 period. Servicing of the casino site as well as the proposed re-routing of the M4 around the Zimbali Estate are predominantly the reason for the increase in capital employed.

3.4.5 Returns

Dec 2001 Actual	Measure	2002 Actual	2003 Budget
x	Turnover	+ 33 %	+ 2 %
x	PBIT	+ 2 %	- 13 %
x	NOPAT	+ 2 %	- 13 %
20.7%	PBIT margin	15.9%	13.5%
10.9%	PBIT return	11.3%	11.0%
7.7%	NOPAT return	7.9%	7.7%

Table 3.5 Financial Analysis - Returns

3.5 SUMMARY

Through its core competence of an innovative, co-ordinated and holistic planning approach, Moreland has ensured the delivery of quality value-added developments that have become the hallmark of the leading property developer in KZN. Moreland's focus on creating North Durban as the most sought after quality of life environment in South Africa is being realised as the skyline is rapidly reflecting the company's efforts in delivering on this vision.

The continued delivery of quality projects is important in ensuring sustainable value-added, but it is the economic viability of the business that will enhance its position of continuing with its significant contribution towards the Group's landholdings and development in the region. The main challenge is to ensure that an adequate return is achieved for additional costs of value-added.

Recently, the public sector is tending to treat the northern corridor as one of almost entirely private responsibility, resulting in substantial transfers of costs to private developers like Moreland. This trend, coupled with excessive property rates well in excess of inflation and the cyclical nature of the level of interest rates, has resulted in the level of return achieved which is not commensurate with the risk that the company

is exposed to. The Net Operating Profit After Tax (NOPAT) in 2001, 2002 and 2003 (projected) of 7.7%, 7.9% and 7.7% under-achieves in terms of the company's objectives.

In light of the under-performing margins brought about, in the main, through an increase in the cost of sales, Moreland's current strategy of focus (or niche market) strategy based on differentiation appears to be inappropriate. The following chapter will examine the strategic options available to the company in light of the environmental changes.

CHAPTER 4

4.1 INTRODUCTION

Moreland Developments (Pty) Ltd current dilemma of an eroding profit base due to external environmental threats will be examined against the backdrop of the company's internal and external environment. The theoretical model developed in Chapter 3 will provide the framework against which the company's environments will be examined and the most appropriate strategic options will then be deduced given these findings. The selected choice of strategy will then be further tested against the concepts of suitability, acceptability and feasibility in order to examine whether the selected strategy option is achievable within the limitations of the company.

Gap Analysis

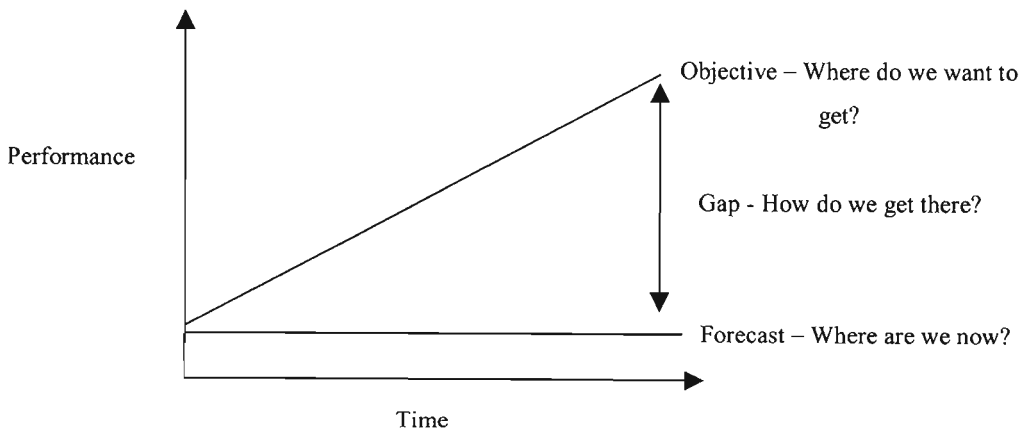


Figure 4.1 Gap Analysis - Evaluation

Forecast – where are we now?

Moreland, as a land only property developer, has recently experienced insufficient ROCE largely due to the increase in its cost of sales. The profit margins have been squeezed and is not commensurate with the company value-added activities.

Objective – Where do we want to get to?

Limit the company's risk exposure brought on by the environmental forces that have resulted in an increase in the cost of sales. The environmental forces include, in the main, high property rates, reduced contributions from the Local Authority, and the cyclical nature of interest rates.

Gap – How do we get there?

The environmental factors that have impacted on the company's cost of sales are key components of the focused differentiation strategy that is currently pursued by Moreland. The current strategy exposes the company to changes in the environment that are essentially out of Moreland's control. The options presented at this stage are:

- Re-define the objectives – the objectives of limiting the risk exposure to the company is not unrealistic and can be achieved. Hence, the objectives do not require a re-definition.
- Do nothing – The changes in the environment are expected to continue as noted in the trend of the ROCE. The burden of the provision of bulk services that have fallen on private developers is a trend that is expected to continue, in line with local governments increase in contributions to social improvement programmes. The do-nothing approach will lead to margins being reduced even further.
- Change the strategy – With the above two options being considered and rejected, the only alternative is to change the current strategy and develop a new one.

The technique of strategy selection will involve a series of steps that will define the choice and test the appropriateness of the selected strategy. The first step in applying the case study to the theoretical model is to assess the firm's internal environment. The tools used in this assessment are a SWOT (Strengths, weaknesses, opportunities, threats) analysis, a value chain analysis and the resource-based-view that examines core competencies.

4.2 INTERNAL ASSESSMENT

4.2.1 SWOT Analysis

Environmental change (opportunities and threats)	Reduced local government spending on bulk services	Cyclical nature of interest rates	Turnaround time for granting of town planning approvals	Buoyant property market	Economic and regional stability	Public-private partnerships	+23	-39
Strengths								
Strong brand name	-1	0	-1	+3	+1	+3	+7	-2
Strategic land holdings	-3	0	+1	+2	+1	0	+3	-3
Tongaat-Hulett backing	-3	0	0	+1	+1	+1	+3	-3
Internal business processes	0	0	+1	+1	+2	+2	+6	0
Product leadership	-3	0	+2	+1	+1	+1	+5	-3
Weakness								
Lack of flexibility	-3	-3	-1	-2	-2	-2	0	-13
High cost of sales	-3	-3	0	-2	0	0	0	-8
Limited number of products	-2	-2	+2	-1	0	-2	+2	-7
Environmental impact scores	+2	0	+11	+12	+10	+9	+43	
	-10	-8	-2	-5	-2	-4	-31	

Table 4.1 SWOT Analysis

The SWOT matrix suggests that, overall, Moreland has substantial internal strengths (score +43), compared to critical internal weaknesses (score –31). The analysis of the company's existing strengths shows that the majority have remained as strengths and will help Moreland react to the environmental changes.

However, the company's status as a leading private developer involved in niche developments and being part of the dominant Tongaat-Hulett Group, has resulted in the perception that Moreland achieves superior returns (which is clearly incorrect as illustrated in the previous chapter). This perception has contributed to the policy of local government to re-direct funding away from private developers. In this regard, these strengths have become weaknesses in the changed environment.

Moreland's weaknesses have remained as weaknesses and to a certain extent; have been exacerbated by the environmental threats.

The SWOT analysis also indicates that the threats that have arisen (score of -39) outweigh the opportunities (score of +23) substantially. This phenomenon is evidenced by the reduction in margins as illustrated in Chapter 3.

Overall, the SWOT analysis indicates the Moreland is placed in a dilemma of possessing substantial internal strengths in a changing environment wherein there are major threats.

In terms of the theoretical model developed in Chapter 3, Moreland will fall in Cell 2, which suggests that the company's strategies would seek to re-deploy those strong resources and competencies to build long-term opportunities in more opportunistic markets.

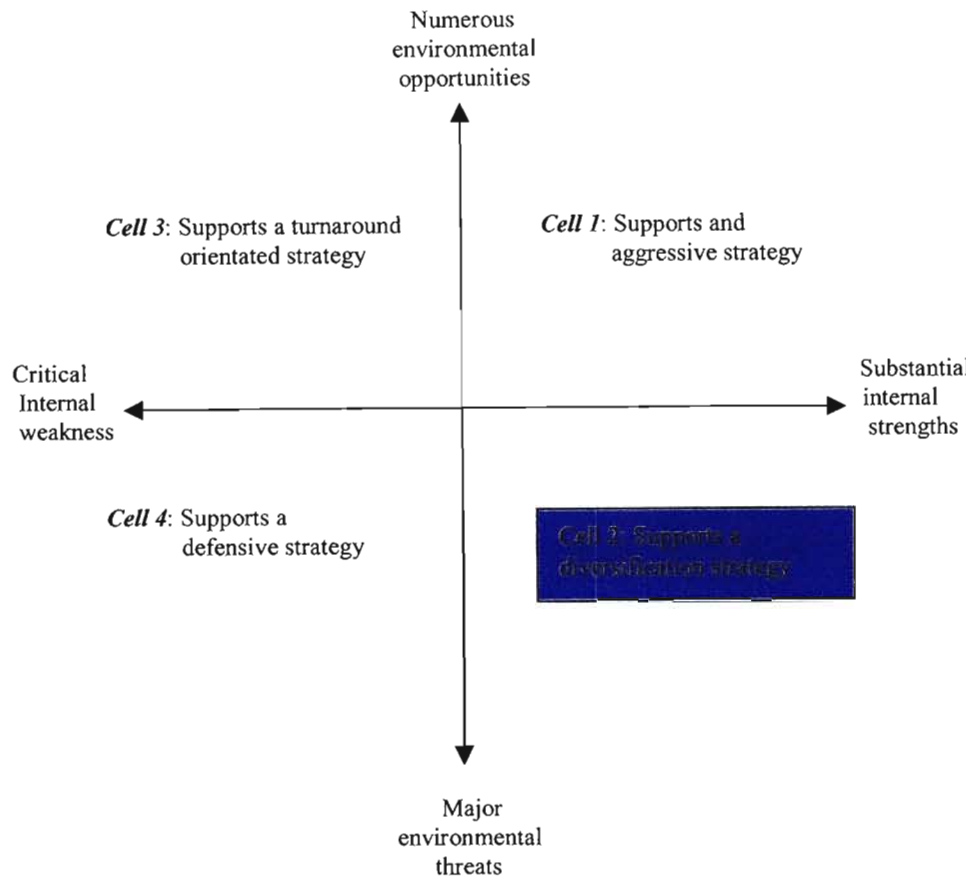


Figure 4.2 Strategic Options – Internal Assessment (Evaluation)

The resource-based view and Porter's value chain will be used to illustrate and validate Moreland's internal resources as substantial strengths.

4.2.2 The Resource-based View

In applying the resource-based view in examining Moreland's internal strengths, a systematic assessment of the internal resources takes place in the context of the company's competitive environment. The following resources generate core competencies and are resources of sustained competitive advantage:

- Divisional Directors who define the corporate strategy

- Portfolio, general and project managers who implement the strategy to achieve corporate goals
- Support activities including human resources, finance, marketing and information technology.

The resources listed above are determined as being valuable in accordance with the following resource-based view guidelines:

- **Competitive superiority**

The land management strategy pursued by the Directors of Moreland forms the basis of unlocking value to Group's extensive landholdings and has enabled Moreland to fulfil their client's needs by offering niche market products.

- **Resource scarcity**

Moreland is the leading property leader in KwaZulu-Natal and there are not many property developers in the country that have been able to package developments that are offered to a very narrow segment of the market. The skills and core competencies used to manage and develop land is unique to Moreland particularly in light of the company's strategic access to prime coastal property.

- **Inimitability**

Moreland's core competencies are difficult to copy because they have evolved after approximately a decade of successful developments. The company is able to generate long-term competitive advantage through extensive development in a concentrated area, having gained the knowledge and understanding of a defined geographic region in which Moreland operates.

- **Appropriability**

The key resources listed above are developed and controlled by Moreland and the profits generated by these core competencies in the role of value creation are accrued to the company. These resources are not bought, sold or moved from one company to another.

- **Durability**

Moreland's strategic resources are essentially intangible assets that do not depreciate with use. These resources become more valuable with time and drive the vision and the culture within Moreland and are the most important contributors to the company's long-term survival.

- **Substitutability**

The resources and capabilities of the company cannot be easily substituted particularly because the embedded skills have over the years been nurtured, protected and, enhanced with use. These resources have collectively spawned the product leadership status that is enjoyed by Moreland.

4.2.3 Porter's Value Chain

In applying Porter's value chain in examining Moreland's internally resources, the following diagram is used to illustrate how the various linkages are configured to add value to the end products:

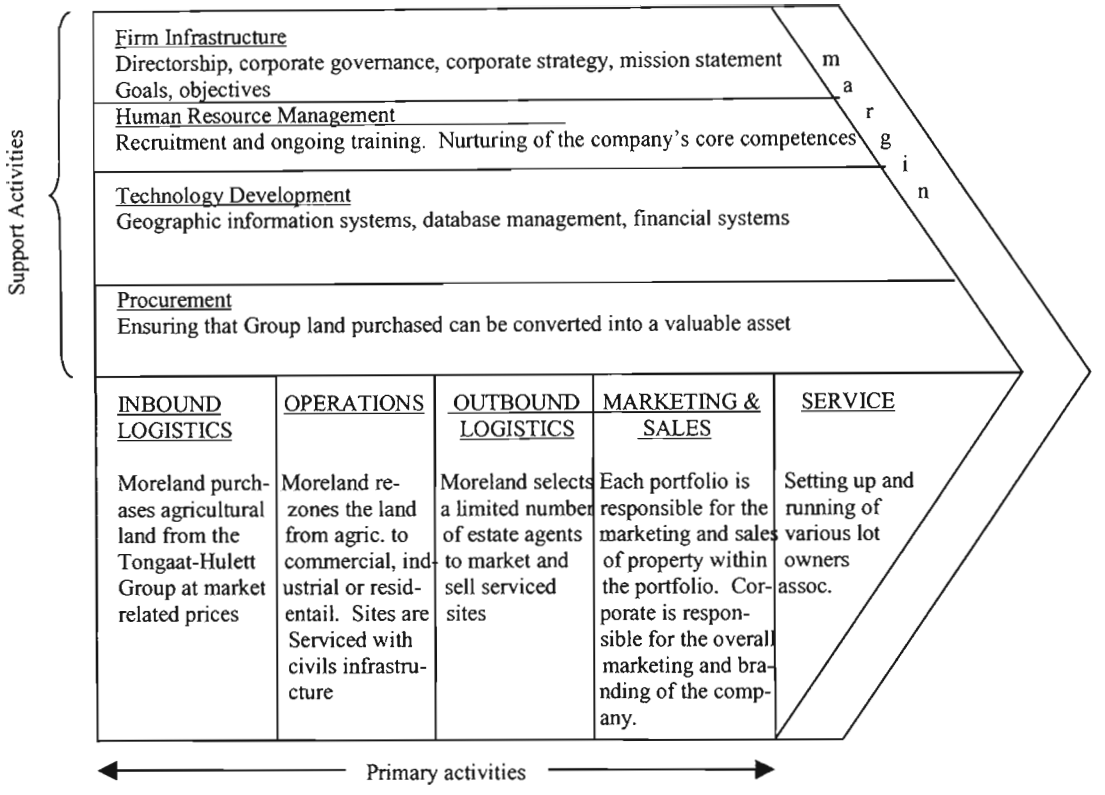


Figure 4.3 Porter's Value Chain (Evaluation)

The value chain and resource-based view complete the analysis of More/land's internal resources, which can be confirmed as a significant strength of the company.

With regards to the theoretical model, Moreland has a choice whether to overcome their weakness or maximise their strengths. Clearly, the company exhibits substantial internal strengths, which logically it would want to maximise. With reference to the diagram below, Moreland is placed in either quadrant III or quadrant IV.

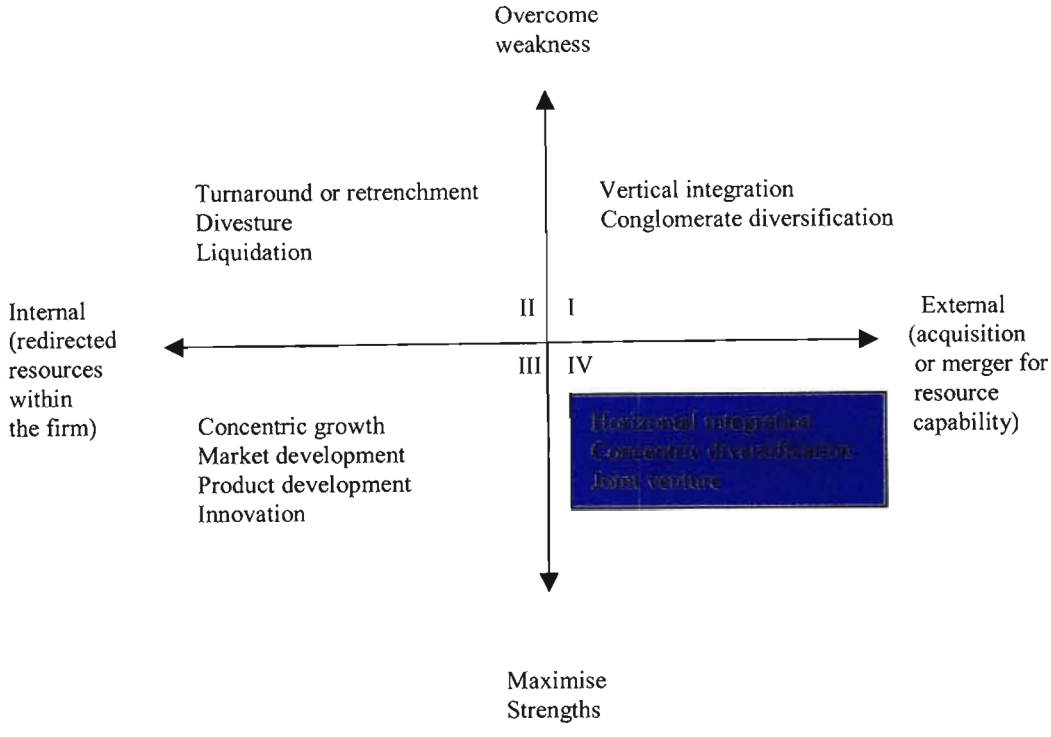


Figure 4.4 Strategic Options – Choice of Internal or External Direction (Evaluation)

The choice that Moreland is faced with is whether it wants to redirect resources within the company or does it want to maximise its strengths by looking externally in the form of acquisitions or mergers.

The redirection of resources within the firm would not circumvent the external threats that the company is faced with, i.e. an increase in the cost of sales brought on by a change in government policy. The model presents the only alternative of external orientation in the form of horizontal integration, concentric diversification or a joint venture. These options should limit the risk that Moreland is faced with, as the company seeks to look for opportunities downstream of its current focus.

The next step is to examine the external environment that Moreland trades in. Here, a PEST (political, economic, social and technological) analysis, the industry's dominant forces and Porter's Five Forces model are used to examine that nature of the market and remote environment.

4.3 THE EXTERNAL ASSESSMENT

4.3.1 PEST ANALYSIS

(a) Economic factors

Moreland has enjoyed good success in the property market relative to the slump in the 1998/1999-period wherein interest rates surged to 25%. The cyclical nature of interest rates impact directly on Moreland, with investor confidence and property market sentiment being more cautious in times of rising and high interest rates. The slower sales take-up in the Commercial portfolio in the 2001/2002-period is a reflection of the increase in both interest rates and inflation, which renders investment projects less attractive. A further and equally important impact of interest rates increases on the company is that the cost of borrowing increases, that which cannot be built into the selling prices of weakened markets. The net-result is an increase in the cost of sales together with a significantly depressed market.

(b) Social factors

The nature of Moreland's core business involves the creation of developments often from a green-fields stage. Hence, the company is constantly monitored by various environmental watchdogs, ensuring that Moreland develops is a responsible manner and achieves a balance between environmental conservation and land development. With regard to the type of developments that the organisation is involved in, there has recently been pressure on the Group and the company to engage with local government in the provision of affordable housing within the Northern Durban Metropolitan Area. The relatively low margins generated by such programmes as well as the sensitivities of locating these developments close to niche market environments need to be managed carefully.

(c) Political factors

Local government spending

Local government policy changes have resulted in significant transfers of costs to Moreland. Coupled with this, low levels of local government investment in infrastructure, public amenities and facilities have resulted in the company carrying out much needed infrastructure development that is the responsibility of local government.

These policy changes have re-defined the initiatives that Moreland is carrying out or planning, to the extent that such projects have become financially not viable for the company. Essentially, the burden on providing bulk infrastructure such as public road networks, storm water, sewer and electrical reticulation has fallen on Moreland in the areas where the company develops. The completed infrastructure is then handed over to local government, who become the custodians of the assets that have been funded by the private developer. Further, local government receives the rates generated from purchases of developments completed by Moreland in perpetuity.

The rationale behind this policy is that firstly, local government, within its limited public spending budget, needs to undertake social improvement programmes in areas that have been historically disadvantaged. Secondly, the rates generated from the developments undertaken by private developers, is being used to further fund social upliftment programmes.

Increases in rates

The increases in property rates in the LaLucia-Umhlanga-Mount Edgecombe region far in excess of inflation has a two-fold effect on Moreland: Firstly, the company has vast land resources in both the developed and undeveloped form. The rates increases have impacted directly on the company's bottom line. Secondly, purchasers of property from the company have to incur greater costs in the form of higher rates, which, could dampen investor confidence particularly in commercial property transactions. The relatively higher rates levied in the La Lucia-Umhlanga-Mount

Edgecombe area impacts on the affordability of end users purchasing property and living in the area.

Turnaround times for granting approvals

As part of the land development process, Moreland requires agricultural land purchased from Group, rezoned to the appropriate land use; either commercial, residential or mixed use. Further approvals that are required from the local authority include the town planning scheme, PTB applications as well as the granting of servicing certificates. These are prerequisites for the sale and transfer of property in purchasers and are legally required in terms of the transfer of fixed property from Moreland to the purchaser.

Delays in the processing and approval of planning applications from Moreland have a knock-on effect on the programme for selling and transferring property, which delays the receipt of proceeds of sales. This ultimately has cash-flow and profit implications for the company.

Technological factors

Innovative technology of managing databases and geographical information has led to the company adopting the latest technological management tools to optimise the attainment of its strategic objectives. As part of its competitive advantage make-up, effective internal processes are in place to improve efficiencies and information management. The speed of change of technology means that it is critical that the company aligns itself with the changes in order to maintain competitive advantage.

4.3.2 THE INDUSTRY'S DOMINANT FORCES

(a) Market size

The market for residential, commercial and resorts is comprised of a regional, national and international combination of end-user purchasers as well as developers. Moreland's marketing efforts are concentrated regionally, but do extend nationally and internationally particularly in the resorts portfolio. Typically, the target market is a narrow segment or niche market, and represents purchasers that aspire to quality, sought-after environments offering value-added features.

(b) Scope of Rivalry

Moreland's strategic access to prime coastal land has created a significant barrier to competitors particularly in the residential and resorts portfolios. Moreland's success in establishing successful gated communities such as The Mount Edgecombe Country Club Estate and Zimbali has contributed to the company's status as the leading private developer in KwaZulu-Natal. However, there is significant competition in the golf course and industrial markets both regionally and nationally.

(c) Market growth rate and position in the business life

The residential portfolio has recently enjoyed a burst of sales, created predominantly by the establishment of the La Lucia Ridge Office Estate as well as the Umhlanga Ridge New Town Centre. Further, the creation of purchaser-desired gated communities has increased the take-up of residential offerings by buyers who place a premium on enhanced security.

The commercial market has, up to the end of 2002, experienced cautious sentiment as a result of the increase in interest rates. However, there has been a significant turnaround since the interest rate reduction in the second half of 2003. The industrial market is also susceptible to interest rate fluctuations, and the renewed interest in the market is evidenced by a number of sales in the Riverhorse Valley Business Estate.
The resorts portfolio has benefited from the increase in tourists visiting the South Africa, and particularly KZN. The acts of terror in the US and the corresponding positioning of South Africa as an attractive international destination has created

significant demand in the resort/tourist market. These triggers have initiated new projects for Moreland in the form of the expansion of Zimbali Coastal Resort as well as the Durban Point Development project.

Generally, the position of each of the portfolios in the business cycle changes from year to year according to the buoyancy of the particular market. Currently, the residential market is the strongest, with commercial and industrial experiencing a resurgence.

(d) The number of buyers and their relative sizes in industry

The number of buyers is portfolio specific, with typically a larger number in the residential compared to the other portfolios. The number of buyers is a function of the value and size of property that is purchased. The residential portfolio has a larger number of smaller properties that are offered to a wider segment of the market, while the other portfolios have a relatively narrow segment as the target market; with very high value larger sites that are offered.

(e) The types of distribution channels used to access clients

Moreland has established two forms of serving the market via channels: The direct channel wherein the company deals directly with the purchaser and, the indirect channel, wherein Moreland appoints a selection of agents, that have a good understanding of the market and product, to sell property to purchasers.

4.3.3 PORTER'S FIVE FORCES MODEL

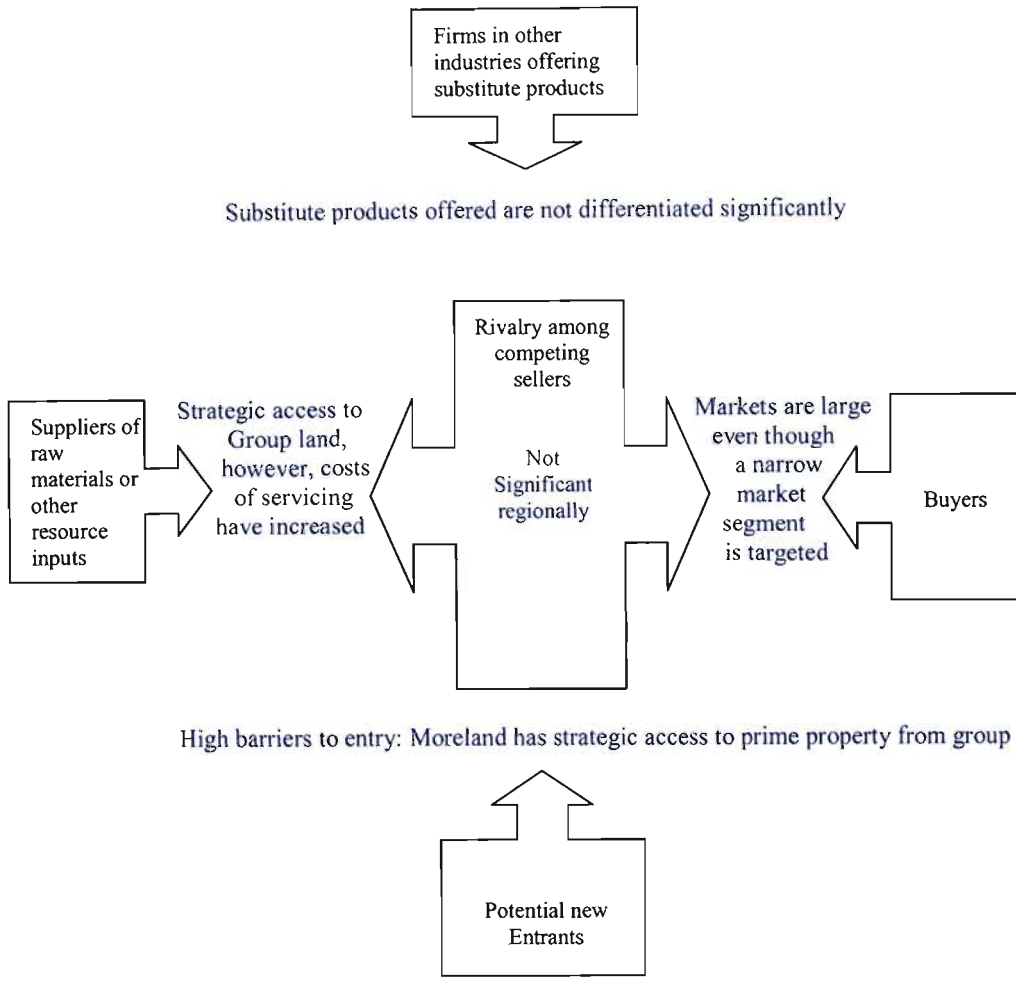


Figure 4.5 porter's Five Forces Model (Evaluation)

Entry barriers - High

Moreland enjoys significant protection by virtue of the company's access to Tongaat-Hulett's vast land resources. Potential competitors would not be able to access Group's strategic land resources and thus could not compete with Moreland in the Northern Durban Metropolitan Area where the development of similar product offerings is concerned. Further, the company's core competencies in land development pose a significant barrier in the industry.

The power of buyers - Weak

Regional competition to Moreland is not significant to afford purchasers sufficient bargaining leverage. This advantage has allowed the company to levy a premium on its differentiated products and enjoy higher than average returns particularly when contributions from local government maintained acceptable levels of cost of sales.

The threat of substitutes - Weak

The value-added features that are built into developments that Moreland carries out, especially the upper-market end residential and resorts developments, have purchaser-desired attributes built-in which are costly and difficult to replicate. However, the commercial and industrial developments offered by Moreland are susceptible to switching risk, as the product-attributes are easier to replicate at similar cost-base to Moreland. Some examples of substitute industrial and commercial developments are: Westway Office Park (Westville), Kingsmead Office Park (Durban), Springfield Business Park (Value Centre in Springfield), Umbogintwini Industrial Park (South Coast) and the Mount Edgecombe Business Park.

The power of suppliers – Very strong

This aspect of the competitive forces is somewhat of an anomaly in that Moreland purchases all land for development from Group at market-related price for undeveloped land. In this regard Group, as supplier of the key input which is land, does not exercise supplier power. However, the development of the agricultural land purchased from Group requires significant amounts of infrastructure in order for the property to become saleable. Historically, the cost of the provision of bulk services was provided by local government, thereby limiting the company's infrastructure costs to that of the internal reticulation of services.

Recent policy changes by local government have resulted in the cost burden of both the bulk infrastructure and internal servicing passed onto Moreland. Hence, local government, acting as a supplier in this case, has significant power in determining the company's costs of inputs.

Intensity of rivalry – Weak to moderate

Moreland's access to prime Group property, its entrenched core competencies and the company's success record of developing quality, balanced environments have created significant barriers to entry into the land development market in the Northern Durban Metropolitan Area. This market position has limited the extent of rivalry in the region.

4.4 DEDUCTION OF APPROPRIATE STRATEGIES

The analysis of Moreland's external environment using the PEST analysis, the industry's dominant forces as well as Porter's Five Forces model deduces that the company is in a market where there is either rapid market growth or slow market growth depending to the portfolio in a particular period, and the company itself is in strong competitive position (regionally). In applying these deductions to the theoretical model, Moreland is positioned in quadrant I and quadrant IV in the diagram below:

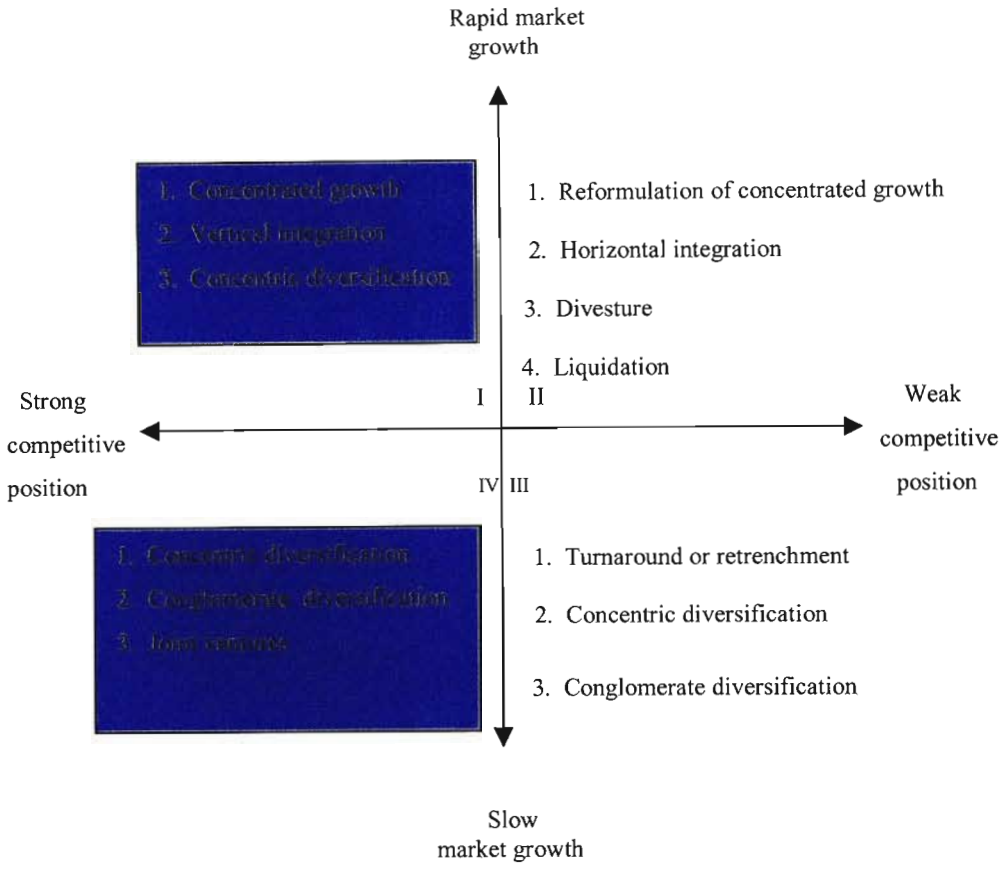


Figure 4.6 Strategic Options – Internal and External Assessment (Evaluation)

AN ANALYSIS OF THE OPTIONS PRESENTED IN QUADRANTS I AND IV:

- **Concentrated growth**

This is the current strategy that is pursued by Moreland. The return on capital employed presently is not commensurate with the risk that the company is exposed to. The external threats of interest rate fluctuations, limited local government spending and the increase in property rates are expected to continue and will impact negatively on the profits of a concentrated growth strategy. This option, therefore, is not appropriate given the extent of the threats that are beyond the company's control and are likely to continue into the long term.

- **Vertical integration**

The two choices that Moreland is faced with under this strategy option are forward or backward vertical integration, the latter not an option since Group owns the land resource. However, Moreland could purchase land outside the Group for development, a move that is a fundamental shift to Moreland's purpose in the Group as unlocking value to Group's assets.

The more likely and workable option is forward vertical integration, where Moreland purchases a property development company that is closer to the ultimate purchaser. This option will be tested further.

- **Concentric diversification**

This strategic option will involve distinctive departures from Moreland's land-only development operation. These departures would involve the acquisition or internal generation of a separate business with synergistic possibilities that would counteract the strengths and weaknesses of the two businesses. The related and logical diversification would be for Moreland to stretch its present operations to downstream development i.e. property development as opposed to land-only development. These downstream operations are not susceptible to the major external threats of local government contribution reductions and property rates increases on vacant land.

The recent local government policy change of limiting its responsibility in terms of providing bulk infrastructure to private, gated developments has resulted on the cost burden of internal reticulation on Moreland. This means that the company has to pay for the design, installation and maintenance of internal infrastructure that would ordinarily been provided by the local authority. In this case, all internal infrastructure will not be handed over to council on completion and will remain the property of Moreland. This would enable the company to become a "mini-local authority", where Moreland would buy bulk services to the boundary of its gated developments from council and retail these services to individual purchasers within these developments. The concentric diversification option will be tested further.

- **Conglomerate diversification**

This strategic option will be based principally on profit considerations, where Moreland will seek to balance out their portfolio between current businesses having cyclical sales, with counter-cyclical sales. Moreland, as a land development company, has very specific competencies and internal infrastructure that are industry specific. The acquisition of an unrelated business, therefore, would seem to achieve only on the short-term profit opportunity and not deliver long-term sustainable advantage to the company.

- **Joint ventures**

Moreland is starting to pursue this option in the Industrial and Resorts portfolios. Joint ventures present new opportunities with risks that can be shared. A joint venture option could be investigated in the Residential and Commercial portfolios where Moreland contributes the serviced land, a building contracting company constructs the buildings, and the complete package is sold to the end user with an acceptable profit share between the two companies. This option will be tested further.

The examination of Moreland's internal and external environment has revealed the following strategic options:

Analysis of Moreland	*Strategic option*	*Appropriateness*
Internal Analysis		
Internal analysis (SWOT)	Diversification strategy	Yes
Internal analysis (RBV)	Horizontal integration	Yes
	Concentric diversification	Yes
	Joint venture	Yes
External analysis		
PEST, Porter's Five Forces and	Concentrated growth	No
Industry's dominant forces	Vertical (forward) integration	Yes
	Concentric diversification	Yes
	Conglomerate diversification	No
	Joint Ventures	Yes

Table 4.2 Strategic Options Available

The strategies marked as appropriate are listed as follows:

- Diversification
- Horizontal integration
- Concentric diversification
- Joint venture
- Vertical (forward) integration

In company operation terms, all of these strategies can be applicable to Moreland stretching its business focus from that of land only development to downstream property development, thereby spreading its risks further down the value system. The short-term implementation of the broadly concentric diversification strategy could commence in the Residential portfolio, where developed residential property has experienced year-on-year growth of 20-25% over the last 3 years (Applicable to the La Lucia-Umhlanga-Mount Edgecombe area). The basis of this new strategy is that Moreland services the land and constructs the superstructure for sale to the end purchaser, effectively cutting out the 'middle-man' property developer. This strategy will be tested against suitability, acceptability and feasibility.

4.4 TESTING OF SUITABILITY, ACCEPTABILITY AND FEASABILITY

This is a broad assessment of whether the strategy of concentric diversification address the circumstances in which Moreland is operating. The tools used in assessing suitability are:

4.5.1 SUITABILITY

(a) Suitability

The life cycle portfolio matrix:

Competitive position	Stages of industry maturity: Embryonic	Growth	Mature	Ageing
Dominant	Fast grow Start-up	Fast grow Attain cost leadership Renew Defend position	Defend position Attain cost leadership Renew Fast grow	Defend position Focus Renew Grow with industry
Strong	Start-up Differentiate Fast grow	Fast grow Catch-up Attain cost leadership Differentiate	Attain cost leadership Renew, focus Differentiate Grow in industry	Find niche Hold niche Hang-in Grow with industry Harvest
Favourable	Start-up Differentiate Focus Fast grow	Differentiate, focus Catch-up Grow with industry	Harvest Find niche, hold niche Renew, turnaround Differentiate, focus Grow with industry	Retrench Turnaround
Tenable	Start-up Grow with industry Focus	Harvest, catch-up Hold niche, hang-in Find niche Turnaround Focus Grow with industry	Harvest Turnaround Find niche Retrench	Divest Retrench
Weak	Find niche Catch-up Grow with industry	Turnaround Retrench	Withdraw Divest	Withdraw

Table 4.3 The Life Cycle Portfolio Matrix (Evaluation)

The life-cycle portfolio matrix, which takes into account the stage of Moreland's product life cycle and the company's strengths in the market, leads to the recommendation of a very limited range of natural strategic thrusts for the company. These are outlined in the diagram above and include the following:

- **Fast grow**

Although the various portfolios within Moreland are often at different stages in the product life cycle at any given period, currently all portfolios are in the growth to maturity stages of the industry life-cycle. The fast-grow option can be achieved by concentric diversification where Moreland extends its current business towards servicing the end-user i.e. the purchaser of completed residential or commercial units or time share/rental options in the Resorts portfolio.

- **Catch-up**

This strategic thrust is not applicable to Moreland who are the regional land development leaders. However, a shift in business focus to property development will involve the organisation bridging the gap with more established companies in the Northern Durban Metropolitan Area.

- **Attain cost leadership**

This strategy is difficult to pursue while the company's focus is in creating differentiated developments that encompass purchaser-desired attributes. The niche-market targeted developments are developed at a premium, which reflects the value-added features that separates Moreland's market offerings to the rest of the industry.

- **Differentiate**

Differentiated developments underlie Moreland's vision and is the reason why the company is able to charge a premium over a large spectrum of its developments.

These strategic thrusts define the types of approaches available to Moreland under the prevailing industry conditions as well as the company's position in the industry. Of the four available options, two (catch-up and cost leadership) are

inappropriate in that they do not apply to Moreland. The fast-grow and differentiation strategies are in-sink with the concentric diversification generic strategy, which is being tested.

(b) Positioning

In looking at positioning, firstly, it must be established whether demand for completed land and building packages are likely to increase in demand. Secondly, positioning is concerned with the required competencies that will underpin the concentric diversification strategy. These required competences should be difficult to imitate and sustainable.

Resources and competences underpinning the concentric diversification strategy	Which of these resources/competences are likely to contribute to		Which will be sustainable/difficult to imitate			
	Joint ventures	Vertical (forward) int.	Valuable To Buyers	Rare in industry	Complex (several processes)	Embedded in tacit routines
Prime land resource	yes	yes	X	x		
Strong cash flow	yes					
Understanding of market	yes	yes				x
Town planning	yes					x
Project management		yes				x
Financial competencies	yes					
Sales & conveyancing	yes	yes				x

Table 4.4 Positioning (Test of Suitability)

The above illustration is indicative of the key resources and core competences that will match the concentric diversification strategy, particularly joint ventures where Moreland provides that valuable land resource and a construction company develops the super structure which is then sold off as a package to the end-user. Moreland's core competencies in the areas of town planning, project management, understanding of the market; and sales and marketing can be used to initiate and implement the joint venture development.

(c) Value chain analysis

The suitability of the concentric diversification strategy is tested by the extent to which the strategy will reconfigure Moreland's value chain in a way that improves the competitive position of the company. Synergy could be achieved with downstream developers in the market; by exploiting the Moreland brand name, pooling of marketing and selling activities; in the company's operations by a sharing of project management functions, conveyencing functions as well as financial control. In this regard, the linkages within Moreland's value chain can be reconfigured to create the extra benefit of a joint venture or a start up/buy out of a construction company. Further, better use can be made of the company's Project Managers who possess a quantity surveying or building management qualification, a background that is most suitable for managing building activities other than pure land development.

(d) Portfolio analysis

This test of suitability of the concentric diversification strategy measures the effect of the strategy on Moreland's balance of portfolios.

Market Growth			
	Star	***Question mark*** Industrial, Residential, Commercial (URNTC) and Resorts	100% 10%
	Cash Cow Commercial (LLROE)	***Dog*** Group Housing	0%
	1x	0.1x Relative Market Share	10x

Figure 4.7 Portfolio Analysis (Evaluation)

The concentric diversification strategy will be able to unlock the pent up demand for residential development in the La Lucia-Umhlanga-Mount Edgecombe triangle. Moreland could find a higher return if the company partnered with a property

developer to release niche market residential developments in the LUME area, as opposed to its present strategy of selling land only which has a high cost component to Moreland. Moreland could use its cash generated from the Office Estate (Commercial cash cow) and its land resource to move the residential and resorts portfolios from *question marks* to *stars*.

The Umhlanga Ridge New Town Centre was developed with a strong mixed-use vision, which has to date under-achieved on attracting a sufficient residential component. This dilemma poses a classic case for the use of the concentric diversification to deliver the residential component: Moreland has stock of serviced land, developers have a ready market and the know-how of assembling packages to this market, but cannot afford the land. The idea of the concentric diversification strategy is that Moreland would contribute the land at no cost and would jointly develop units for the end-user and ultimately share in the profits. Such a strategy would similarly move other portfolios from *question marks* to *stars*.

(e) Business Profile Analysis

This analysis shows the probable impact of the concentric diversification strategy on a number of Moreland's performance parameters.

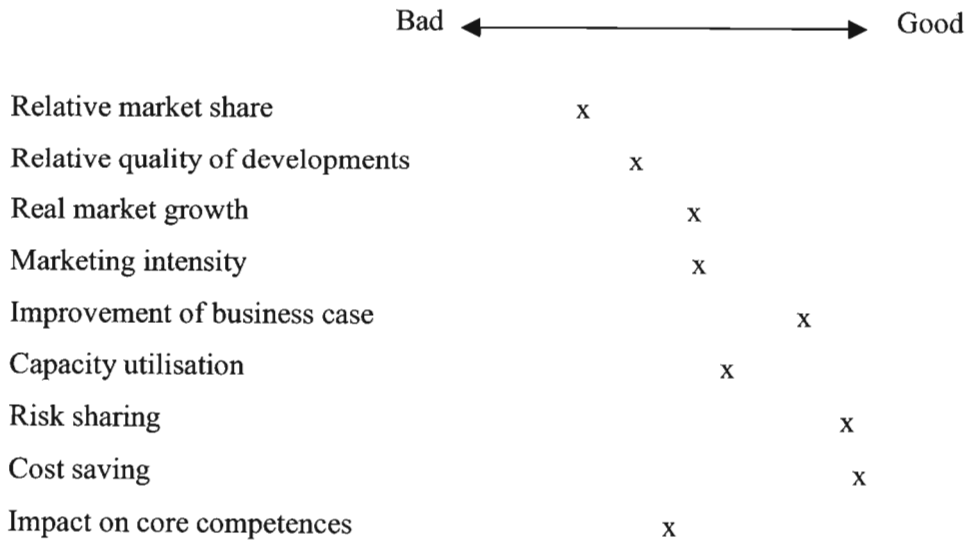


Figure 4.8 Business Profile Analysis (Evaluation)

In the main, the concentric diversification strategy through joint ventures or acquisition of a construction company, has a benefit to Moreland. With the exception of a loss of relative market share (through sharing with other companies), impact on core competences (Moreland is traditionally a land-only developer and has developed competences around this activity) and a possible loss of company sovereignty, this strategy has an overall positive effect on the business.

4.5.2 ANALYSING ACCEPTABILITY

This test of the concentric diversification strategy is concerned with the expected performance outcomes, such as risk and return, if Moreland adopts the strategy. The limitation of this study is that property developers are not willing to divulge the returns that are earned on developments. Further, returns are project specific, and may vary depending on the developers cost base, the location, stage of the life cycle, target market and market demand.

Therefore, the link that with Moreland stretching its activities to downstream operations, which will lead to greater returns, cannot be conclusively demonstrated. However, the company has a history of repeat business from prominent property developers, which, to an extent, is indicative of the positive returns that are made when dealing with the end-user. Further, residential property prices have been reported to have increased by an average of 25% per annum in the LUME triangle, which underscores the observation that high returns accrue to end-users and downstream property developers.

4.5.3 ANALYSING FEASIBILITY

This final test of the concentric diversification strategy deals with the questions of whether Moreland has the resources and competences to drive the strategy.

(a) Funds Flow Analysis

It is expected that Moreland will use the funds generated out of cash cows such as the Office Estate (Commercial) and the older Residential (Mount Edgecome Country Club Estate) projects to initiate and drive the downstream activities. However, the company's poor cash-flow position over the last 3 years is not expected to provide an adequate source of funds. The alternate option is for the company to use the borrowings facility that is provided by Group at a preferential rate.

(b) Resource deployment analysis

A wider assessment of the resources and competencies of Moreland needs to be made in order to test whether the alternative future strategy can be carried out. The key competences and resources that will be required will be the town planning, marketing, project management, financial and marketing resources. The necessary changes in the configuration of these resources that are required to maintain the threshold of the diversification strategy will have to be tailored to suit a wider set of operations.

While the options of extending the company's operations closer to the end user are carried out, albeit within certain limitations, care must be exercised not to neglect the existing business strategy by over stretching current resources. In this regard, Moreland's finance department, which currently close to or at capacity, would have to resource upwards. From the operations point of view, the branding of the company needs to be protected through ensuring that quality issues and architectural guidelines are carried through all operations that Moreland is associated with. This architectural service will have to be outsourced through architects that share the company's vision.

4.6 SUMMARY

Moreland's strategic access to prime development land from Group as well as the company's core competences in land management and development has contributed to the early success of the company. However, from 1996, local government has fundamentally shifted its capital contribution to bulk services such as road networks, storm water, sewer and electrical services away from private development. This short-sighted policy has not only threatened the sustainability of a revenue source in the form of property rates from private developments, but also has dampened private-sector property development initiatives to the extent that such initiatives are unaffordable. Further, property rates levied in excess of inflation as well as the cyclical nature of the country's interest rates have contributed to Moreland's returns being substantially eroded and has exposed the current focused differentiated (niche market) strategy as being inappropriate under the current circumstances.

- In examining the strategic options available to the company, an accurate and detailed analysis of the internal organisation was done, followed by an examination of the external environment in which the company operates. This study filtered a limited number of strategic thrusts available to Moreland as well as having a greater relevance to the changing environment.

- These options are horizontal integration, concentric diversification, joint venture and vertical (forward) integration. These strategies fall under the all-encompassing concentric diversification strategy, which is further tested in terms of suitability, acceptability and feasibility. Notwithstanding the limitations of the study in testing the financial robustness of the concentric diversification strategy option, the analysis has confirmed that this strategy is both appropriate as well as achievable in terms of the resources required to implement the change. The following chapter will examine the recommendations made to Moreland in terms of diversifying into related businesses.

CHAPTER 5 – CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

This study has provided valuable insight into how Moreland should respond to a changing external environment. The options available under the broad concentric diversification strategy have been tested in terms of workability, and have proven to be both appropriate and possible to implement. The concentric diversification strategic option presents many opportunities to Moreland, and includes, but is not restricted, to the following:

While the recommended strategy should be phased in over a period of time (6-12months), the following short-term actions are required to improve the business case:

5.2 SHORT-TERM OBJECTIVES

5.2.1 Lobbying of local government to re-consider the property rating structure in the Northern Durban Metropolitan Area, including the granting of rates holidays to land developers. Further, the increases levied in the LUME triangle needs to be challenged in terms of it not being commensurate with the level of services provided. The various Home and Lot Owners Associations together with Moreland present the ideal vehicle for addressing problems of such magnitude.

5.2.2 Acceleration of the sales of serviced sites where the costs have been absorbed previously. Unsold services sites do not require further capital expenditure; therefore sales will translate directly into profit.

5.2.3 Negotiating with the local authority more acceptable turn-around times for critical town planning approvals. Often delays in obtaining the required

approvals mean that sales and property transfers cannot be concluded, putting pressure on the company's cash flow and borrowings.

5.2.4 Release a limited number of developments in the prime areas where sufficient value has accrued. These pockets of valuable sites will over time create pent up demand that could attract a premium selling price. This practice, however, will have to be carried out in such a way that the short-term business objectives of achieving a positive cash flow and profits are not undermined substantially.

While the short-term action plans would provide some relief to the thinned margins of the company, it is the long-term change of the strategic thrust of Moreland that would lead to sustainable competitive advantage. To this end, the following concentric diversification strategies are recommended to shift the company's current niche-market land-only development strategy to related but different businesses:

5.3 SHORT TO MEDIUM TERM OBJECTIVES

5.3.1 Form a joint venture with a property developer or a construction company

Moreland, as a land only developer, has substantial development areas that are either serviced or could be serviced in the short-term, particularly in the New Town Centre, where there is a certain need for residential development as part of realising the urban vision. In addition to Moreland requiring a faster sales take up in the Town Centre, the market has indicated a pent up demand for residential units within this area. Moreland could service this need by contributing the key resource i.e. land to a joint venture with a developer/construction company undertaking the construction aspect.

The advantages for Moreland are that the value-added activities on their land only resource should realise a greater return and the joint venture would not require a

monetary input, thereby preserving the company's cash flow. The advantages for the developer/construction company is that the land would be contributed by Moreland, and Moreland's branding would underpin the initiative. Moreland's internal value-chain would have to be configured accordingly to create the synergies in the area of sales, marketing, project management and conveyancing. Moreland ultimately reduces its land stock and at the same time enjoys a higher return by virtue of the high land cost being absorbed by the completed development.

Contributions to the Joint Venture	
Moreland	***Property Developer***
• Contributes key land resource	• Undertakes the construction aspect
• Access to borrowing of funds at a preferential rate	• Has intimate knowledge of end-user needs as well as the market overall
• Has core competencies in the areas of land management, town planning and servicing of land	• Has core competencies in the areas of designing and implementing the construction of developments
• Strong branding in KZN and the NDMA region	• Company branding could partner with Moreland's branding to add to the credibility of proposed developments
• Value chain activities could be extended to marketing, project management, sales and conveyancing	• Company's internal marketing, sales and conveyancing could attain potential synergies with Moreland's value chain

Table 5.1 Joint Venture Contribution

This strategy is aimed at Moreland benefiting from the exponential relationship between value-added activities and the premium paid by the end user. Since Moreland does not possess all the core competences and resources in order to undertake the value-added downstream activities, partnering such an initiative with a company that does have such resources will bridge the gap between pure land-only development and property development.

5.3.2 Acquisition or start up of a construction company

As an extension of land development, Moreland could stretch its operations into superstructure development i.e. the construction of commercial and residential buildings. The sale of packaged developments would realise a higher premium for the value-added processes. The rationale for this approach is similar to a joint venture with a property development company, in that the high cost of sales base for serviced land could be spread over a completely developed site, as opposed to the status quo of the high servicing costs of land being contained in the land-only sale, resulting in a lower profit margin.

The skills required for this strategy lie the Project Management resource, where Moreland's project managers, as part of their job description, are currently involved with superstructure development, albeit on a limited basis.

5.3.3 Hiring out Moreland's core competencies

This approach is currently being tested on the Point Development Project, where the Resorts portfolio team has been appointed as Project Managers, for a fee. This service can be extended to other portfolios in Moreland, especially during periods where internal resources have capacity. This hiring out of core competencies would obviously be appropriate where there are spin-off advantages for the company, such as unlocking development nodes that Moreland is unable to carry out itself.

Related to the company's core competencies, an opportunity exists in Moreland setting up a facilities management operation or separate division. For a large part of the project management activity, the company already is instrumental in setting up policies, procedures and processes in place that ensure the sustainability of its developments. These value-added activities are in effect similar in nature to what a facilities management company performs in order to ensure that developments function in a co-ordinated and efficient manner. In this regard, Moreland could 'sell' this service to the various Home and Lot Owners Associations of the Moreland

created communities as well as extend this service to other developments that fall outside the company's realm.

5.3.4 Retailing of utility services

The local governments decision to provide bulk services only up the boundary of gated, private developments has in effect increased Moreland's costs of servicing private developments but at the same time has created an opportunity in retailing services such as water, electricity and sewerage drainage. If Moreland pays for the internal servicing of private roads, these are effectively owned by the company, in which case Moreland is entitled to revenues generated from the asset. Moreland could negotiate bulk tariffs for bulk services, which is then sold to individual purchasers at a retail rate. The revenue will be comparable to what the local authority receives and will accrue to Moreland for as long as the service is provided.

Although related to Moreland's operations, such an approach will require the company to set up a division or a separate company that manages this business, because the nature of this venture will detract from Moreland's core business. The new business would have to engage the services of a managing agent company that will be responsible for reading of individual meters, invoicing and receiving payment.

In the event of this being opposed by the local authority on the grounds that this practice competes directly with their revenue generating function, a build-operate-transfer option can be investigated. In this case, Moreland would build the infrastructure, operate the service for a period (depending on when a payback period could be obtained), and then transfer the service to the local authority. In this way Moreland would be reimbursed for its bulk services costs in the form of revenues generated from retailing services, and the local authority becomes the ultimate custodians of these services.

5.4 CONCLUSION

Notwithstanding the obvious advantages of the focused differentiated strategy that Moreland currently pursues, the limitations of such a strategy has exposed the company's lack of agility in dealing with changes in the business environment. In such a dynamic environment, linking the fortunes of Moreland to the fortunes of a single land-only development market can be a high-risk gamble. A company with a broad portfolio breadth may be more resilient in the face of a rapidly external environment by virtue of its operating agility in responding to the changes. The concentric diversification strategy will provide Moreland with the opportunity to stretch its current operations closer to the end-user, thereby extracting higher returns from the accumulated value-added.

The combination of the short and medium term objectives would stem the pattern of an eroding profit base as well as provide a mechanism in dealing with future external changes; and ensure that returns are commensurate with risk and capital employed. By moving out of the realm of land-only development, the company would be able to detach itself, albeit not entirely, from that aspect of the value system which is most prone to an increase in costs of sales i.e. land development. The greater flexibility offered by diversifying into related businesses would assist in evening out the profit-swings and provide Moreland with an opportunity to dominate the lucrative property development (as opposed to land-only development) market in the region.

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