

STRATEGY
THE IMPACT OF MORTGAGE ORIGINATORS IN SOUTH AFRICA

BY

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RESTRICTION

Due to the confidentiality and sensitivity of the information, this dissertation should be restricted for a period of five years.

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Signature:

A handwritten signature in black ink, appearing to read 'K Naidoo', written in a cursive style.

Date: November 2002

DECLARATION

I, Kasanathan Naidoo, declare that the work presented in this dissertation is my own and has not been submitted previously to any other tertiary academic institution. Any work done by other persons has been duly acknowledged.

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ABSTRACT

This research investigated the impact of Mortgage Originators on the South African financial industry. Mortgage Originators, although an established industry in most western countries is a relatively new concept to South Africa. The study investigates the initial phase of this new industry in comparison to the trends established in countries such as Australia and USA.

As this new concept has resulted in financial institutions making drastic changes, it was imperative that the first part of the research concentrated on the theory of strategy. Recent developments in strategy were discussed with strategic models and the development of strategic planning. This formed the framework for the next discussion on international trends and the current South African mortgage origination situation. A comparison between the Australian, USA and South African markets show similar trends in the start-up phase of the mortgage origination industry.

A gap analysis was conducted and the findings have led to recommendations to South African financial institutions on how deal with the new mortgage origination concept.

The conclusion drawn from the study clearly show that some organisations have ample resources but lack aspirations, on the other hand there are organisations that are driven by high aspiration but have meagre resource bases. On the one hand, strategic intent envisions a desired leadership position and establishes the criterion the organisation will use to chart its progress. The concept also encompasses an active management process that includes focusing the organisations attention on the essence of winning; motivating people by communicating the value of the target; leaving room for individual and team contributions; sustaining enthusiasm by providing new operational definitions as circumstances change and using intent to consistently guide resource allocations.

Industry analysis is the key to strategy. The rule breakers know that it is increasingly difficult to define precisely where an industry begins and ends. *You*

should focus on your direct competitors. The rule breakers know that rivalry is not as simple as it used to be. For many companies today it is harder to distinguish competitors from collaborators from suppliers from buyers.

In Strategy it is you against the world. Today's smart leaders understand that it's difficult to know where the boundaries of the firm begin and end.

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CHAPTER 1 INTRODUCTION

1.1 Introduction

The literature on strategy and strategic management is extensive, containing many definitions that can serve to confuse rather than offer clarity. In the business context, the term strategy is used freely and often and is considered by many to be a high point of managerial activity. In answer to the question “what is strategy?” Michael Porter (1996) stated “Strategy is the creation of a unique and valuable position, involving a different set of activities.”

The following five chapters takes you through a journey, commencing with a discussion on the theory of strategy and concluding with recommendations on how this theory can offer assistance to NBS in the most difficult period of their existence because of a rapidly changing external environment.

Norton & Irving (1999) propose that strategy provides an organisation with a framework for *understanding its position* in the marketplace, *moving forward* with a sense of direction, purpose and urgency and *focusing on key issues* of customers and markets and the skills needed to deliver to those customers and markets.

Strategy is about what we want to do, what we want our organisation to be and where we want it to go. Tactics and planning are concerned with how we do things once we have decided what to do.

1.2 Background

The recent explosion of mortgage broking into the South African property market has resulted in the financial institutions having to make certain strategic decisions. Should the NBS enter proactive operational and/or equity agreements with the pioneers of this concept or should it wait until the impact of these intermediaries on the mortgage loan market is quantifiable? The financial sector of South is characterised by increasing competition amongst the five major banks for market share. Several new players have entered the sector as a result of mergers and acquisitions. New, niche banks, financial service companies and

more recently the advent of securitisation companies have entered the financial industry. The interest margins and cost ratios of the "big five" banks are under greater pressure and all are looking for ways to reduce their cost ratios by cutting down on fixed costs. All of the banks are toying in varying degrees with the idea of outsourcing or at the very least incentivising their sales forces. It is off this base that the pioneering mortgage origination companies are trying to sell their services as a way for the banks to outsource their sales forces and thereby reduce fixed costs and minimize wasted costs.

1.3 Value of the study

It is hoped that by investigating the benefits and pitfalls of this new concept of mortgage originators, which will assist NBS specifically, and other banks in general to make decisions on whether or how to form and build relationships for their benefit. By investigating the market forces that are changing the way the banks are doing business, it would be interesting to note which of the major players in the industry are capable of using their internal strengths to capitalize on the opportunities being presented in this dynamic industry.

1.4 Motivation for study

The unpredictable volatility of the South African economy over the last eighteen months has contributed to the constantly changing property market. Traditional estate agencies had to take a long hard look at profitability issues and several have been threatened with economic survival. The above has lead to the real estate industry as a whole looking for additional sources of income and the increasing importance of mortgage commission income. The key trend to emerge as a direct result of the above is the formation of strategic alliances between real estate groups and related businesses evidenced by the mushrooming of mortgage broking businesses.

It would be interesting to investigate how the financial sector of South Africa responds to this emerging industry.

1.5 Problem statement

To what extent will NBS have the ability to adapt to changes in the homeloan industry through the introduction of mortgage originators who are emerging as key players in the supply of business?

1.6 Objectives

- a) To evaluate NBS ability to respond to pressures growing out of suppliers ability to exercise bargaining power and leverage
- b) To evaluate NBS's internal strengths and weaknesses in relation to the its competitors as well as in meeting the demands of the market
- c) To assess NBS's ability to radically change the way it has done business for many years in order to continue providing shareholder value.

1.7 Research methodology

- An extensive literature survey on strategy was conducted.
- A theoretical model was then developed showing the internal and external forces that impact on banks in South Africa.
- Data and information were collected from Australia and USA where the financial industry and homeloan market is similar to South Africa.
- Data was requested from NBS, other banks and mortgage originators in South Africa.
- A gap analysis was conducted between the theoretical model and the current state with emphasis placed on the trends overseas.
- Finally, recommendations were made on how banks in South Africa, especially NBS, will be able to capitalise on the opportunity presented by the new concept of mortgage originators.

1.8 Limitations

- Access to confidential records from all banks and mortgage originators
- Accurate data from the Deeds office, banks or mortgage originators on the actual amount of business registered in South Africa by mortgage originators were difficult to obtain because all originators were not registered and there were many unaccounted companies conducting mortgage origination business.
- The research required a lot of travelling and interviews with different companies that were located all over South Africa. Many of them were visited, but due to time and financial constraints follow-up interviews were not possible.
- Information and statistics obtained were for a specific time period. Mortgage origination is a rapidly changing industry and certain statistics may have changed during the course of the research.
- Analysis and recommendations were made from data obtained over a 12-month period. Ideally, it would be better to look at data that has been obtained over a longer period.

1.9 Structure of study

A systematic approach was followed during the study. The theory of strategy was discussed before viewing the current situation. Thereafter an analysis was made between the two. The recommendations and conclusion was based on the gap analysis.

Chapter two focussed on the theory of strategy. The diversity and the different schools of thought by many philosophers and academics were reviewed and discussed. Strategic models and recent developments in strategy were also looked at.

Chapter three defined mortgage origination. The international trends and the South African situation were investigated. NBS bank's strategy and strategic options was reviewed.

Chapter four analysed the 'gap' between the theory and current mortgage origination situation in South Africa with emphasis placed on NBS.

Chapter five provided recommendations and includes the conclusion.

1.10 Conclusion

Whether it has been called general management, business policy, corporate strategy, long range planning or corporate management, the sector has always been concerned with – addressed the same issue – determining how an organisation, in its entirety, can best be directed in a changing world (Moore1992).

Mintzberg et al (1998) argue that there may not be one simple definition of strategy, but they propose some general areas of agreement about the nature of strategy:

The following chapters expand on what has been touched on in this chapter with a discussion on the theory of strategy leading to current market analysis.

Strategy is placed in context and paves the way for an in-depth look at international and local current financial markets.

Chandler concluded that changes in strategy lead to changes in organisation structure. Structure should be designed to facilitate the strategic pursuit of a firm and therefore, follows strategy.

CHAPTER TWO STRATEGY IN CONTEXT

2.1 Introduction

"Where judgement begins, there art begins...Strategy theory, therefore, will content itself to assist the commander to the insight into things which, blended with his whole thought, makes his course easier and surer, but never forces him into opposition with himself in order to obey an objective truth. All principles, rules and methods exist to offer themselves for use as required, and it must always be left for judgement to decide whether or not they are suitable" (Karl von Clausewitz 1780 – 1831: 1).

2.2 The theory of strategy

Strategy theory is a diverse multidisciplinary academic field with competing schools of thought based on partly incommensurable basic assumptions, including disagreement about what strategy theory should seek to explain. This is underscored by the considerable effort during the last decade within the field to identify 'paradigms' (Schendel 1994) and search for new approaches (Rumelt, Schendel et al. 1994). The field of strategy is so diverse that it is probably correct to say that it neither can be treated as a Lakatosian research programme (Chalmers 1982) with a 'hard core' of commonly accepted basic assumptions, nor be regarded as constituting a Kuhnian paradigm (Kuhn 1970/1996). Mintzberg (1990; 1998) has identified ten schools of strategy theory, of which three schools are normative and together constitute the 'classical approach' to business strategy theory. The other seven are descriptive.

It is common to trace the roots of business strategy theory as an academic field back to the early sixties, with the publication of three important books; *Strategy and Structure: Chapters in the history of the industrial enterprise* by A. Chandler jr. (1962), *Business Policy: Text and Cases* (1965) by E.P. Learned, C.R. Christensen, K.R. Andrews and W. D. Guth (1969), and *Corporate Strategy* by I. Ansoff (1965). In addition, most will include Selznick's *distinctive competencies* (1957) as an early contribution. While the writings of Selznick, Chandler and

Learned *et al* together form the *design* school (in Mintzbergs taxonomy), Ansoff is recognized as the founder of the *planning* school. Together with the *position* school of Porter (1980; 1985), these form the classical strategy theory. These three schools have had a considerable impact on business life during the last four decades, and they have in common some important underlying presuppositions. Among these are; a positivistic view of knowledge, the CEO is recognized as sole responsible for strategy formation, centralized and planned processes produce full-blown and explicit strategies, and a notable ignorance of the complex inside of organizations. The differences may be summed up in the fact that while the design school emphasizes a centralized, but informal process, the planning school prescribes a formal process resulting in detailed programming of the organization. While both the design school and the planning school underscore that a viable strategy is unique to the organization, the position school of Porter only recognizes three generic strategies; cost leadership, differentiation and focusing. To this school, strategy is the choice of an attractive industry (Porter 1980) and good positioning within this industry (Porter 1985).

James Quinn (1998) defines strategy as the pattern or plan that integrates an organization' s major goals, policies and action sequences into a cohesive whole. A well-formed strategy helps to marshal and allocate an organization' s resources into a unique and viable posture based on its relative internal competencies and shortcomings, anticipated changes in the environment and contingent moves by intelligent opponents.

Kenneth Andrews (1998) writes corporate strategy is the pattern of decisions in a company that determines and reveals its objectives, purposes or goals, produces the principal policies and plans for achieving those goals, and defines the range of business the company is to pursue, the kind of economic and human contribution it intends to make to its shareholders, employees, customers and communities. Hax and Majluf (1996) point out that strategy is a multi-headed monster and states nine different dimensions:

1. Determines and reveals the organizational purpose in terms of long-term objectives, action programs, and resource allocation priorities;
2. Selects the businesses the organization is in, or is to be in;
3. Attempts to achieve a long term, sustainable advantage in each of its businesses by responding appropriately to the opportunities and threats in the firm' s environment, and the strengths and weaknesses of the organization;
4. Identifies the distinct managerial tasks at the corporate, business and functional levels.
5. Is a coherent, unifying, and integrative pattern of decisions;
6. Defines the nature of the economic and non-economic contributions it intends to make to its stakeholders;
7. Is an expression of the strategic intent of the organization;
8. Is aimed at developing and nurturing the core competencies of the firm;
9. Is a means for investing selectively in tangible and intangible resources to develop the capabilities that assures a sustainable competitive advantage.

Gregory D. Foster (1995) argued in a *Washington Quarterly* article that there is no official or accepted general theory of strategy in the United States. In fact, he notes that as a people Americans seem to regard theorizing in general as a futile intellectual exercise. If one were to construct such a theory, Foster continues, it should incorporate those elements found in any complete theory: essential terminology and definitions; an explanation of the assumptions and premises underlying the theory; substantive propositions translated into testable hypothesis; and methods that can be used to test the hypotheses and modify the theory as appropriate. Foster may have this theory thing right. There is little evidence that collectively as a nation there is any agreement on just what constitutes a theory of strategy. This is very unfortunate because the pieces for a good theory of strategy have been lying around the U.S. Army War College for years, although sometimes hard to identify amongst all the intellectual clutter. Arthur F. Lykke, Jr.'s (1989) Army War College strategy model, with its ends, ways, and means, is the centrepiece of this theory. The theory is quite simple, but it often appears unduly complex as a result of confusion over terminology and

definitions and the underlying assumptions and premises. One sees the term strategy misapplied often. There is a tendency to use it as a general term for a plan, concept, course of action, or "idea" of a direction in which to proceed. Such use is inappropriate. Strategy is the domain of the senior leader at the higher echelons of the state, the military, business corporations, or other institutions.

Henry Eccles (1965) describes strategy as "the comprehensive direction of power to control situations and areas in order to attain objectives." His definition captures much of the essence of strategy. It is comprehensive, it provides direction, its purpose is control, and it is fundamentally concerned with the application of power. Strategy as used in the Army War College curriculum focuses on the nation-state and the use of the elements of power to serve state interests. In this context, strategy is the employment of the instruments (elements) of power (political/diplomatic, economic, military, and informational) to achieve the political objectives of the state in cooperation or in competition with other actors pursuing their own objectives. The underlying assumption of strategy from a national perspective is that states and other competitive entities have interests that they will pursue to the best of their abilities. Interests are desired end states such as survival, economic well-being, and enduring national values. The national elements of power are the resources used to promote or advance national interests. Strategy is the pursuit, protection, or advancement of these interests through the application of the instruments of power. Strategy is fundamentally a choice; it reflects a preference for a future state or condition. In doing so, strategy confronts adversaries and some things simply remain beyond control or unforeseen.

Carl von Clausewitz's (1780-1831) concept of theory should be reviewed to gain a more complete picture. "The primary purpose of any theory," he wrote, "is to clarify concepts and ideas that have become confused and entangled. Theory should explain rather than prescribe. It should reflect *reality* or, in Clausewitz's words, the "world of action," which is governed, as he saw it, by a logical hierarchy consisting of laws, principles, rules, and prescriptions and methods. *Laws* are universal and absolute; they reveal the cause-and-effect relationship

between things, and determine action (e.g., Newton's Laws of Motion) [Clauswitz: Toward a Theory of Applied Strategy by Antulio J Echevarria II, 1995].

Strategy is all about how (way or concept) leadership will use the power (means or resources) available to the state to exercise control over sets of circumstances and geographic locations to achieve objectives (ends) that support state interests. Strategy provides direction for the coercive or persuasive use of this power to achieve specified objectives. This direction is by nature proactive. It seeks to control the environment as opposed to reacting to it. Strategy is not crisis management. It is its antithesis. Crisis management occurs when there is no strategy or the strategy fails. Thus, the first premise of a theory of strategy is that strategy is proactive and anticipatory. A second premise of a theory of strategy is that the strategist must know what is to be accomplished—that is, he must know the end state that he is trying to achieve. Only by analysing and understanding the desired end state in the context of the internal and external environment can the strategist develop appropriate objectives leading to the desired end state.

Looking at these definitions of strategy one cannot fail to reflect on the multifaceted and complex nature of the concept and one is left with the impression that the concept perhaps is constructed to embrace everything that is important in order to buttress the assertion that 'strategy is important'.

In this circular definition, the concept is in danger of being exhausted of meaning and thus becoming meaningless. Rumelt touches upon the same speculation in writing; the term 'strategy' has been so widely used for different purposes that it has lost any clearly defined meaning. For our purposes a strategy is a set of objective, policies and plans that, taken together, define the scope of the enterprise and its approach to survival and success. Alternatively, we could say that the particular policies, plans and objectives of a business express its strategy for coping with a complex competitive environment (Rumelt 1980).

In sharp opposition to the classical tradition discussed above, some scholars have emphasized strategy formation as a process of emergent nature (Mintzberg

and Waters 1985; Mintzberg 1987) or as an incremental process (Quinn and Voyer 1998) of strategic learning (Starkey 1996). A related field of research, not focusing on strategy as such, but highly relevant to understand strategic learning, and also to understand learning abilities as a strategic asset, is the literature on organizational learning (Argyris and Schön 1996), learning organizations (Senge 1990) and knowledge creating companies (Nonaka and Takeuchi 1995). Important are also direct attempts from strategy theorists to grasp the role of knowledge within firms (Schendel 1996).

2.3 Recent development within strategy

Resource-based theory (RBT)

While Mintzberg and his like-minded contested the classic strategy theory primarily with respect to the strategy formation *process*, another field of scholars questioned the *content* of especially the industrial analysis approach to strategy prescribed by Porter (1980), where profit is explained by choice of industry and the gaining of market power. These scholars sought to explain superior performance due to the firms' resources and their ability to utilize these. Wernerfelt was the first among these with his article, *A resource-based view of the firm* (1984), which also gave name to the field of research.

While authors within the field are careful to stress that their approach is at par with the 'classics' in strategy theory (see for instance Amit and Shoemaker 1993; Peteraf 1993), they claim the intellectual roots of the field to be the work of Penrose (1959), Nelson and Winter (1982) and to some degree Schumpeter (1934). RBT also draws on insight from economic theories of the firm, focusing on the economic rationale of a firm's existence (Conner 1991). These are important in order to understand firms as *value creators*, in contrast to the *value appropriative* focus in traditional approaches. The field of RBT consists of a number of related, but distinct branches; *resource-based theory* (Grant 1991; Mahoney and Pandian 1992; Peteraf 1993), *dynamic capabilities* (Teece, Pisano et al. 1997), and the *core competencies* approach (Prahalad and Hamel 1990; Hamel 1994; Markides and Williamson 1994). There are also attempts to merge

resource-based theories with evolutionary theories of the firm (Montgomery 1995) and to form a competence theory of the firm (Foss and Knudsen 1996).

A good summation of resource-based theory is provided by Peteraf (1993), who underscores four cornerstones of competitive advantage; heterogeneity among competitors, imperfect mobility of strategic resources, *ex ante* limits to competition of these assets, and *ex post* limits to competition so that economic rents can prevail. A bridge between resource-based theory and organizational learning is offered by Dierickx and Cool (1989), who explicitly discuss the strategic value of organizational learning processes protected against imitation by causal ambiguity and time compression diseconomies.

The ever-increasing importance of knowledge intensive firms, and the general recognition of knowledge as perhaps *the* strategic asset in a majority of businesses {Drucker, 1993 #195}, raise important question whether traditional strategy theory provides adequate understanding of this business logic. Probably, traditional strategy theories fails both on *process*, where strategizing is better explained as a learning process, and *content*, where the resource-based view provides better understanding of the multifaceted inside of organizations and their complex interaction with their surroundings. The next step in strategy theorizing will then be to combine these two perspectives, strategizing as learning processes and knowledge as the main strategic asset, into a coherent whole, emphasizing strategizing as something one *do* in contrast to strategy as some-thing one *have*.

2.4 The development of strategic planning

According to Mintzberg (1994) when strategic planning arrived on the scene in the mid 1960's corporate leaders embraced it as the "one best way" to devise and implement strategies that would enhance the competitiveness of each business unit. This one best way involved separating thinking from doing and creating a new function staffed by specialists strategic planners.

Strategic planning is often used to refer to a programmatic, analytical thought process. It is the part of strategic management that which aims at the formulation

of a firms' strategy, it is argued that the process of strategic planning should consist of a logical sequence of steps. The process requires a high degree of coordinated decision-making provoked by the dictates of strategy. By the 1960's strategic planning had superseded long-range planning – the suggestion as that extrapolation of trends was fundamentally unsafe and that a more rigorous and consideration of external factors impacting on the firm was necessary (Botten & McManus 1999). The influence of the proponents of strategic planning in the 1970's grew to have an enormous impact on the practice of strategic management (Mintzberg et al 1998).

One of the criticisms levelled at strategic planning is that the future is too uncertain to predict. Locking an organisation into a plan causes problems when things change. The pace of change no longer allows planning for 15, 10 or even 5 years ahead. The questions we ask; where are we, how did we get here, what business are we in, will we need to change, if so to what; what internal & external factors will have an effect; where do we want to be in the future; need to be asked continually (Norton & Irving 1999).

According to Heracleous (1998) over 15 years ago Mintzberg argued that the meaning of the term strategic planning was ambiguous and that there was a need for a clear understanding of that term.

Mintzberg concludes "all this time therefore strategic planning has been misnamed. It should have been called strategic programming, distinguished from other useful things that planners can do, and promoted as a process to formalise, when necessary the consequences of strategies that have already been developed. In short, we should drop the label "strategic planning" altogether.

2.5 Strategic management

"The term strategic management entered the business world after World War 2 when Military leaders on both sides of the Atlantic came together to see if some successful elements of waging war could be applied to business" (Norton & Irvin, 1999).

After almost 40 years of development and theory building, the field of strategic management is today more than ever characterised by contrasting and sometimes competing paradigms (Hamel & Heene, 1994 cited in Botten & McManus 1999) .

Mintzberg et al (1998) argue that “the origins of the whole field of strategic management...can be traced back to the 1962 path breaking book by the business historian (Chandler, 1962).

Pearce and Robinson define strategic management as “ the set of decisions and actions resulting in the formulation and implementation of strategies designed to achieve the objectives of an organisation” (Cited in Moore, 1992).

According to Rosen (1995), strategic management draws on and applies a multitude of competencies techniques and knowledge at all levels of the organisation relating to both short-term and long-term issues, but it is particularly, although not exclusively, concerned with the future impact on the organisation of decisions by managers at all levels.

The focus of strategic management is on ‘ What an organisation is trying to achieve in the long run, and when it should be achieved – i.e. the organisations objectives.

Equally important is how they intend to achieve them – i.e. the organisations’ strategy thus suggests a clear distinction between means - the strategy, and ends – the objectives, which does not exist; one may blend into another, and the means often becomes the ends.

Thompson & Strickland (1992) propose five tasks as interrelated components, which together define the term strategic management:

- Developing a concept of the business and forming a vision of where the organisation needs to be headed.
- Converting a mission into specific performance objectives
- Crafting a strategy (to achieve targeted performance)
- Implementing and executing the chosen strategy
- Evaluating performance, reviewing the situation and initiating corrective adjustments.

Whether these be the mission, objectives, strategy or implementation in light of actual experience, changing conditions, new ideas and opportunities.

According to Mintzberg et.al (1998) strategic management has commonly been portrayed as revolving around the discrete phases of formulation, implementation and control carried out in almost cascading steps.

It is argued that no sector within the field of business literature has had more attention in recent times than strategic management, resulting in changes of direction, perspective, emphasis and even name. Numerous schools of thought have emerged over the years in the development of strategic management; various interpretations and definitions of the schools are to be found in the vast strategic management literature. It is proposed by Mintzberg et al (1998), that most of these schools are, or have been, equally evident in practice, both within organisations and from the consulting firms that serve them.

2.6 Strategic models

The strategic management writers and theorists have argued effectiveness of models long and hard. Since 1970's models for formulating and implementing business strategy have grown in type and number to tackle the increasing complexity of the world around us (Norton & Irving 1999).

According to Botten & McManus (1999), in the field of strategic management, both normative and descriptive models are used. Normative models deal with what the firms should do, descriptive models deal with what firms actually do. Literature on strategy is further divided into contributions that focus on process and those that focus on content of strategic management.

Models generate activities that set down a method for examining internal resources and external opportunities or threats in order to make logical proposals for the future. They concentrate heavily on planning processes and require extensive information gathering and manipulation.

Models are designed to provide organisations with methods and systems for gaining advantage over competitors.

Ever since Milton Friedman (1953) and Karl Popper (1959) made positivist methodology explicit and dominant in economic analysis, the concern of economists has been to develop testable hypotheses — statements that yield predictions about observable consequences of specified events. The better theory, on positivist criteria, is the one, which has the greater predictive power. Although predictive power is something of an obsession among economists, it is generally thought to be one of three criteria of the ‘goodness’ of a theory. The other two are generality and simplicity.

2.7 The factors that shape a company’s strategy

Effective strategy making begins with a concept of what the organisation should and should not do and a vision of where the organisation needs to be headed. A company’s business is defined by what needs it is trying to satisfy and by the technologies it will use and the functions it will perform in serving the target market.

2.7.1 Societal, political, regulatory and social considerations

A company is constrained strategy wise by what is legal, by what complies with government policies and regulatory requirements and by what is in accordance with societal expectations and the standards of good community citizenship. Factoring in societal values and priorities, community concerns and the potential for onerous legislation and regulatory requirements is a regular part of external situation analysis. Intense public pressure and adverse media coverage make such a practice prudent. The task of making an organisation’s strategy socially responsible means conducting organisational activities within the bounds of what is considered to be in the general public interest; responding positively to emerging societal priorities and expectations; demonstrating a willingness to take action ahead of regulatory confrontation; balancing shareholder interests against the larger interests of society as a whole; and being a good citizen in the community.

2.7.2 Competitive conditions

A company's strategy has to be tailored to the nature and mix of competitive factors in play – price, product quality, performance features, service, warranties and so on. When competitive conditions intensify significantly, a company must respond with strategic actions to protect its position. Competitive weakness on the part of one or more rivals may signal the need for a strategic offensive. A company's strategy should be tailored to fit industry and competitive conditions.

2.7.3 Market opportunities and external threats

A company's strategy needs to be deliberately aimed at capturing its best growth opportunities, especially the ones that hold the most promise for building sustainable competitive advantage and enhancing profitability. Likewise, strategy should be geared to providing a defence against external threats to the company's well-being and future performance. For strategy to be successful, it has to be well matched to market opportunities and threatening external developments; this usually means crafting offensive moves to capitalise on the company's most promising market opportunities and crafting defensive moves to protect the company's competitive position and long-term profitability.

2.7.4 Company resource strengths, competencies and competitive capabilities

One of the most pivotal strategy-shaping internal considerations is whether a company has or can acquire the resources, competencies and capabilities needed to execute a strategy proficiently. An organisation's resources, competencies and competitive capabilities are important strategy-making considerations because (1) the competitive strengths they provide in capitalising on a particular opportunity, (2) the competitive edge they may give a firm in the market-place, and (3) the potential they have for becoming a cornerstone of strategy. The best path to competitive advantage is found where a firm has competitively valuable resources and competencies, where rivals do not have matching or offsetting resources and competencies and where rivals cannot

develop comparable capabilities except at high cost and/or over an extended period of time. In essence, strategy must be well matched to a company's resources strengths and weaknesses and to its competitive capabilities.

2.7.5 The personal ambitions, business philosophies and ethical beliefs of managers

Managers do not dispassionately assess what strategic course to steer. Their choices are often influenced by their own vision of how to compete and how to position the enterprise and by what image and standing they want the company to have. Both casual observation and formal studies indicate that managers' ambitions, values, business philosophies, attitudes toward risk and ethical beliefs have important influences on strategy.

2.7.6 The influence of shared values and company culture on strategy

An organisation's policies, practices, traditions, philosophical beliefs and ways of doing things combine to create a distinctive culture. Typically, the stronger a company's culture the more that culture is likely to shape the strategic actions it decides to employ, sometimes even dominating the choice of strategic moves. This is because culture-related values and beliefs are so embedded in management's strategic thinking and actions that they condition how the enterprise responds to external events. Such firms have a culture-driven bias about how to handle strategic issues and what kinds of strategic moves it will consider or reject. Strong cultural influences partly account for why companies gain reputations for such strategic traits as leadership in technological advance and product innovation, dedication to superior craftsmanship, a proclivity for financial wheeling and dealing, a desire to grow rapidly by acquiring other companies, having a strong people orientation and being a good company to work for, or unusual emphasis on customer service and total customer satisfaction.

2.7.7 Linking strategy with ethics

Strategy ought to be ethical. It should involve rightful actions, not wrongful ones; otherwise it won't pass the test of moral scrutiny. This means more than conforming to what is legal. Ethics concern s human duty and the principles on which this duty rests. Every business has an ethical duty to each of five constituencies: owners/shareholders, employees, customers, suppliers and the community at large. Each of these constituencies affects the organisation and is affected by it. Each is a stakeholder in the enterprise, with certain expectations as to what the enterprise should do and how it should do it.

Ideally, managers weigh strategic decisions from each constituent's point of view and where conflicts arise, strike a rational, objective and equitable balance among the interests of all five constituencies. If any of the five constituencies conclude that management is not doing its duty, they have their own avenues for recourse. A management that truly cares about business ethics and corporate social responsibility is proactive rather than reactive in linking strategic action and ethics. It steers away from ethically or morally questionable business opportunities.

2.8 Evaluating company resources and competitive capabilities

Analytical techniques such as SWOT analysis, VALUE CHAIN analysis, STRATEGIC COST analysis and COMPETITIVE STRENGTH assessment are basic strategic management tools because they expose the company's resource strengths and deficiencies, its best market opportunities, the outside threats to its future profitability and its competitive standing relative to rivals. Insightful company situation analysis is a precondition for identifying the strategic issues that management needs to address and for tailoring strategy to company resources and competitive capabilities as well as to industry and competitive conditions. A company's value chain shows the linked set of activities and functions it performs internally. The value chain includes a profit margin because a mark-up over the cost of performing the firm's value-creating activities is customarily part of the price (or total cost) borne by buyers – creating value that

exceeds the cost of doing so is a fundamental objective of business. How well a company manages its value chain activities is a key to building valuable competencies and capabilities and leveraging them into sustainable advantage. Systematic assessment of whether a company's overall competitive position is strong or weak relative to close rivals is an essential step in company situation analysis.

2.8.1 SWOT analysis

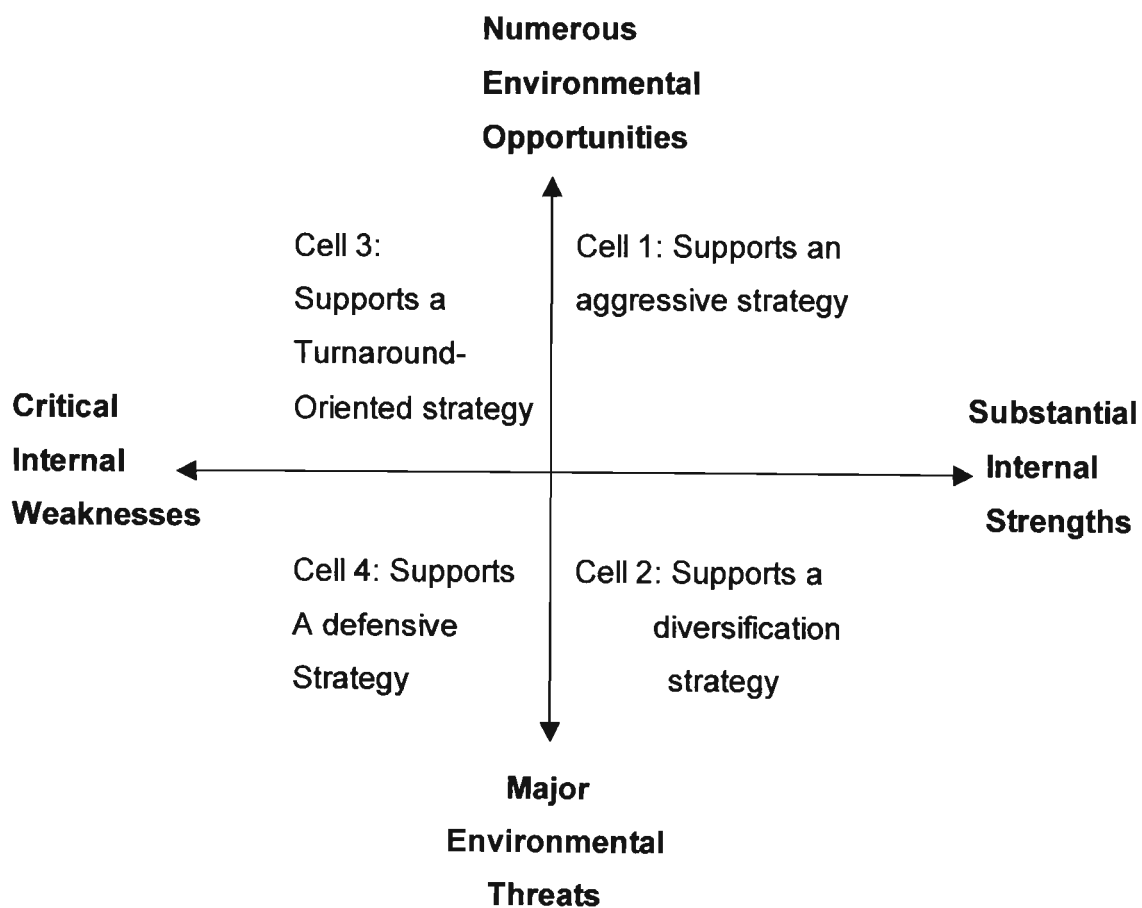


Fig 2.1: SWOT analysis diagram

Source: Thompson and Strickland

SWOT stands for strengths, weaknesses, opportunities and threats. The strengths and weaknesses are statements of the internal capabilities of an organisation. A strength, therefore, would be an internal resource, which would enable an organisation to deal effectively with its business environment, for example, close, and goods links with customers. An internal weakness would leave opportunities poorly accounted for, or not addressed at all. For example, a weak distribution system might hinder sales of a popular and fast-moving product.

Opportunities and threats exist outside of the organisation in many different areas, examples might include competitor moves, government legislation, technological advances and changing customer needs. Typically the environmental opportunities and threats presented in a market are the same for all competitors. The issue that will vary will be their ability to capitalise on them.

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. The exercise, therefore, 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.

SWOT analysis is a popular tool used by managers as an organising framework for intuitive information and as a means of summarising and integrating more formal analyses about the external operating environment and an organisation's current resources and capabilities. However, care has to be taken to avoid several potential pitfalls, some of which can also be applied to other frameworks and tools of analysis.

A SWOT analysis can result in long lists of observations, which provide little overall insight or clarity about required action. There are no formal mechanisms to ensure that managers challenge their own frames of reference or their organisation's paradigm; indeed SWOT can be used by managers to 'ride their own hobby-horses'. However, if such a challenge can be achieved, this is where useful analysis rests. A further danger is that managers might conceive of

strengths and weaknesses in terms of the strategy they aim to implement rather than that which currently exists. In this sense it is important that the strengths and weaknesses are considered in terms of current realised strategy rather than just future intended strategy. There is also evidence that there is a tendency for managers to see environmental changes as threats rather than opportunities. Such negative perceptions of change may hinder the identification of opportunities.

Successful businesses *build on their strengths, correct weaknesses and protect against vulnerabilities and threats*. Just as important, they have an eye on their overall business environment and spot new opportunities faster than competitors. To be effective SWOT analysis needs a methodical and objective approach. It is too easy for a company to look at itself - and fail to see any problems, or to see strengths that are not real.

In critiquing the SWOT model, Mintzberg et al (1998) question whether competencies are distinct to an organisation, might they also be distinct to context, time or even application. In other words, can any organisation really be sure of its strengths before it tests them? Every strategic change involves some kind of new experience, a step into the unknown, taking some kind of risk. Therefore how can an organisation ever be sure in advance whether an established competence will prove to be a strength or weakness?

2.8.2 The value chain

Value chain analysis has been widely used as a means for describing the activities within and around an organisation, and relating them to an assessment of the competitive strength of an organisation. Value chain analysis was originally introduced as an analysis tool that was designed to shed light on the “*value added*” of separate steps in complex manufacturing processes, in order to determine where costs improvements could be made and/or value creation improved.

One of the key aspects of value chain analysis is the recognition that organisations are much more than a random collection of machines, money and people. These resources are of no value unless deployed into activities and organised into routines and systems, which ensure that products or services are produced which are valued by the finer customer/user. In other words, it is these competencies to perform particular activities and the ability to manage linkages between activities, which are the source of competitive advantage for organisations.

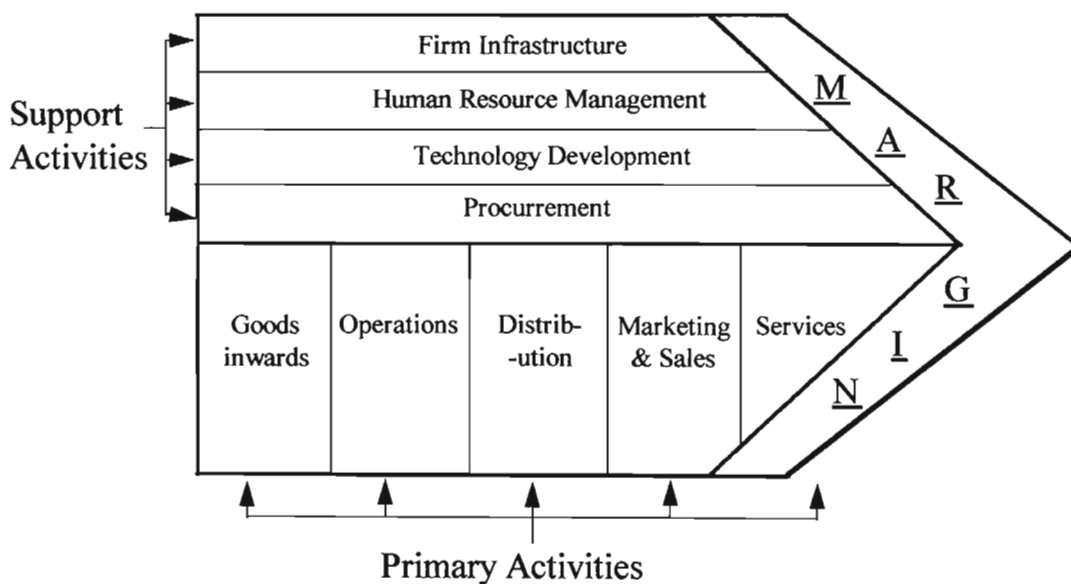


Figure 2.2: The value chain

An understanding of strategic capability must start with an identification of the value activities that an organisation performs. Figure x is a schematic representation of value chain within an organisation. Value chains target competitive advantage. They are a way of modelling the organisation in order to answer question activity by activity. Once an organisation has modelled its value chain it can ask:

- Can we enhance the value added by that activity ?
- Is there an opportunity to reduce the cost of that activity ?
- Is there an opportunity to eliminate that activity ?

- Can we use that activity to differentiate the organisation ?

In order to answer these questions the organisation must study the primary activities that get the product, or service, to the customer and the support activities that facilitate that. In addition, there are linkages between these activity processes. Increasingly it is with improvements to these linkages that information systems can offer the most support and help an organisation achieve a competitive advantage.

The *primary activities* of the organisation are grouped into five main areas: inbound logistics, operations, outbound logistics, marketing and sales, and service. Each of primary activities is linked to *support activities*. The *support activities* can be divided into four areas: Procurement, Technology Development, Human Resource Management, and Infrastructure.

2.8.3 Pest analysis

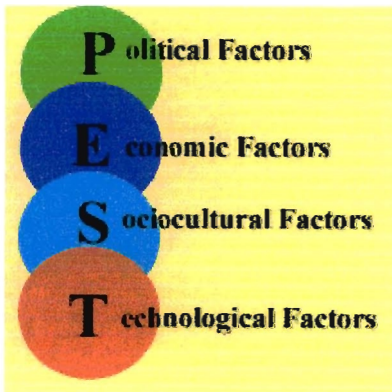


Fig 2.3: Pest analysis

It is very important that an organization considers its environment before beginning the marketing process. In fact, environmental analysis should be continuous and feed all aspects of planning. The organization's marketing environment is made up from:

1. The internal environment e.g. staff (or internal customers), office technology, wages and finance, etc.

2. The microenvironment e.g. external customers, agents and distributors, suppliers, our competitors, etc.

3. The macro-environment e.g. Political (and legal) forces, Economic forces, Sociocultural forces, and Technological forces. These are known as **PEST** factors.

2.8.3.1 Political factors

The political arena has a huge influence upon the regulation of businesses, and the spending power of consumers and other businesses. One has to consider issues such as:

1. How stable is the political environment?
2. Will government policy influence laws that regulate or tax your business?
3. What is the government's position on marketing ethics?
4. What is the government's policy on the economy?
5. Does the government have a view on culture and religion?
6. Is the government involved in trading agreements such as EU, NAFTA, ASEAN, or others?

2.8.3.2 Economic factors

Marketers need to consider the state of a trading economy in the short and long-terms. This is especially true when planning for international marketing. You need to look at:

1. Interest rates
2. The level of inflation Employment level per capita
3. Long-term prospects for the economy Gross Domestic Product (GDP) per capita, and so on.

2.8.3.3 Sociocultural factors

The social and cultural influences on business vary from country to country. It is very important that such factors are considered. Factors include:

1. What is the dominant religion?

2. What are attitudes to foreign products and services?
3. Does language impact upon the diffusion of products onto markets?
4. How much time do consumers have for leisure?
5. What are the roles of men and women within society?
6. How long are the population living? Are the older generations wealthy?
7. Do the population have a strong/weak opinion on green issues?

2.8.3.4 Technological factors

Technology is vital for competitive advantage, and is a major driver of globalisation. Consider the following points:

1. Does technology allow for products and services to be made more cheaply and to a better standard of quality?
2. Do the technologies offer consumers and businesses more innovative products and services such as Internet banking, new generation mobile telephones, etc?
3. How is distribution changed by new technologies e.g. books via the Internet, flight tickets, auctions, etc?
4. Does technology offer companies a new way to communicate with consumers e.g. banners, Customer Relationship Management (CRM), etc?

It is argued that analysis of an organisations circumstances for reviewing strategy should start with the macro-environment as it provides a context for the marketplace, the industry in which the firm operates and then with an understanding of its environment, the firm itself. Recognised as the first step in environmental analysis, the PEST analysis is used to examine the macro-environment, which embraces the organisation, the industry and the marketplace. It provides a framework for understanding the external environment of the organisation, and can present an overall picture of the variety of forces that are at work around an organisation. These forces can and do have an impact on an organisations long-term decisions.

It is important that the PEST analysis is used to look at the future impact of environmental factors, which may be different from their past impact. The inferences drawn from information related to the past and the present are not

automatically valid for the future. The future is not what it used to be (Norton & Irving,1999).

2.8.4 Porter’s five forces model

So far the concern has been with understanding broad aspects of the environment. However, inherent within the notion of strategy is the search for the opportunity to identify bases of advantage. In business, this might be advantage over competitors; in the public sector, it might be advantage in procurement of resources. The aim is to identify if there are factors in the environment, which influence the capability of an organisation to position itself to such advantage. Figure x shows the Porter’s Five Forces Model that have a direct effect upon the functioning of an organisation.

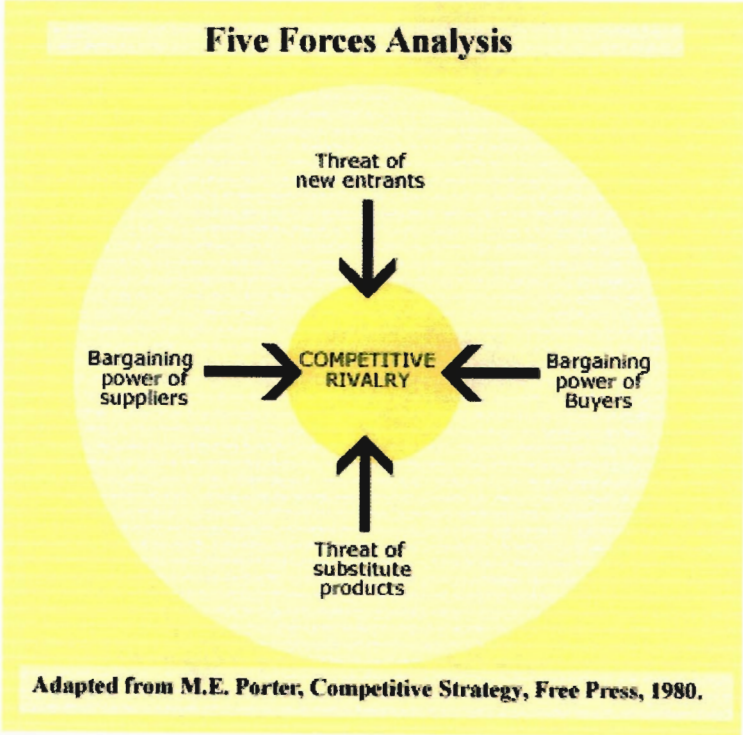


Fig 2.4: Porter’s five forces model

2.8.4.1 Analysing the environment

Five forces analysis helps the marketer to contrast a competitive environment. It has similarities with other tools for environmental audit, such as PEST analysis, but tends to focus on the single, stand alone, business or SBU (Strategic Business Unit) rather than a single product or range of products.

Five forces look at five key areas namely the threat of entry, the power of buyers, the power of suppliers, the threat of substitutes, and competitive rivalry.

2.8.4.2 The threat of entry.

Porter concludes that there are seven major sources of barriers to entry:

Economies of scale e.g. the benefits associated with bulk purchasing.

The high or low cost of entry e.g. how much will it cost for the latest technology?

Ease of access to distribution channels e.g. Do our competitors have the distribution channels sewn up?

Cost advantages not related to the size of the company e.g. personal contacts or knowledge that larger companies do not own or learning curve effects.

Will competitors retaliate?

Government action e.g. will new laws be introduced that will weaken our competitive position?

How important is differentiation? e.g. The Champagne brand cannot be copied. This desensitises the influence of the environment.

2.8.4.3 The power of buyers

Porter identifies those that compete with the industry by forcing down prices, bargaining for higher quality or more services and playing competitors off against each other.

This is high where there are few, large players in a market e.g. the large grocery chains.

Also where there are a large number of undifferentiated, small suppliers e.g. small farming businesses supplying the large grocery chains.

The cost of switching between suppliers is low e.g. from one fleet supplier of trucks to another.

2.8.4.4 The power of suppliers

The power of suppliers tends to be a reversal of the power of buyers:

Where the switching costs are high e.g. switching from one software supplier to another.

Power is high where the brand is powerful e.g. Cadillac, Pizza Hut, Microsoft.

There is a possibility of the supplier integrating forward e.g. Brewers buying bars.

Customers are fragmented (not in clusters) so that they have little bargaining power e.g. Gas/Petrol stations in remote places.

Porter also contends that labour must be considered as a supplier – particularly if it is unionised, or there are skill shortages.

2.8.4.5 The threat of substitutes

Substitute products are those which can perform the same function as the product of the industry either those whose perceived value is tending to improve relative to the industry's product, or those produced by highly profitable industries.

Where there is product-for-product substitution e.g. email for fax.

Where there is substitution of need e.g. better toothpaste reduces the need for dentists.

Where there is generic substitution (competing for the currency in your pocket) e.g. Video suppliers compete with travel companies.

We could always do without e.g. cigarettes.

2.8.4.6 Competitive rivalry

This is most likely to be high where entry is likely; there is the threat of substitute products, and suppliers and buyers in the market attempt to control. This is why it is always seen in the centre of the diagram. Rivalry among existing firms intensifies when one or more feel pressure (from price cuts, increased advertising, product innovation). Intense rivalry is caused by structural factors such as numerous competitors, slow industry growth, high fixed or storage costs, lack of product differentiation or switching costs, capacity augmented in large increments, high strategic stakes and high exit barriers.

Professor Michael Porter has convincingly demonstrated that the state of competition in an industry is a composite of the above five forces. A company's competitive strategy is increasingly effective the more it provides good defences against the five competitive pressures in the company's favour and helps create sustainable competitive advantage.

Porter says that identifying forces (and their underlying causes) that affect competition in an industry will enable a firm to determine what its comparative strengths and weaknesses are. Strategically crucial are the strengths and weaknesses which emerge from positioning the firm relative to the underlying causes – and therefore an effective strategy takes offensive or defensive action in order to create a defensible position against the five competitive forces.

Porter indicates that 'the intensity of competition in an industry is neither a matter of coincidence or luck. Rather competition in an industry is rooted in its underlying economic structures and goes well beyond the behaviour of the current competitors' (Moore, 1992). Porter's five forces play an important part in the analysis needed to kick start the strategy process. The fundamentals of his five forces model is based on the premise that an organisation has to select an approach towards customers, suppliers, substitutes, competitors and new market entrants depending on the industry conditions at the time. According to Moore (1992) scarcely a modern textbook can be found which does not include his five-box schema.

2.9 The strategic management process

A company's strategy is the 'game plan' management has for positioning the company in its chosen market arena, competing successfully, pleasing customers and achieving good business performance. Good strategy and good strategy execution are the trustworthiest signs of good management. Competent execution of a well-conceived strategy is not only a proven recipe for organisational success, but also the best test of managerial excellence. Good strategy combined with good strategy execution does not guarantee that a company will avoid periods of par or even sub par performance. Sometimes it takes several years for management's strategy-making/strategy-implementing efforts to show good results.

2.9.1 The five tasks of strategic management

1. Forming a strategic vision of what the company's future business makeup will be and where the organisation is headed – so as to provide long-term direction, delineate what kind of enterprise the company is trying to become, and infuse the organisation with a sense of purposeful action.
2. Setting objectives – converting the strategic vision into specific performance outcomes for the company to achieve.
3. Crafting a strategy to achieve the desired outcomes.
4. Implementing and executing the chosen strategy efficiently and effectively.
5. Evaluating performance and initiating corrective adjustments in vision, long-term direction, objectives, strategy or implementation in light of actual experience, changing conditions, new ideas and new opportunities.

An organisation's chief executive officer, as captain of the ship, is the most visible and important strategy manager. The title of CEO carries with it the mantles of chief direction setter, chief objective setter, chief strategy maker and chief strategy implementer for the total enterprise.

Since lead responsibility for crafting and implementing strategy falls to key managers, the chief strategic role of an organisation's board of directors is to exercise oversight and see that the five tasks of strategic management are done

in a manner that benefits shareholders or stakeholders. Board members bear ultimate responsibility for the strategic actions taken.

2.9.2 Deciding on a long-term strategic vision

Requires rational analysis of what the company should be doing to get ready for the changes coming in its present business and to capitalise on newly developing market opportunities. It also requires good instincts, creativity and an intuitive sense of what the company is capable of when pushed and challenged. Management's strategic vision ought to be realistic about the market, competitive, technological, economic, political and social conditions the company is likely to encounter and it ought to be realistic about the company's resources and capabilities. A strategic vision is not supposed to be a pipe dream or a fantasy about the company's future. It has got to be compelling enough to shape the company's actions and energise its strategy.

2.9.3 Establishing objectives

Setting objectives converts the strategic vision and directional course into specific performance targets. Objectives represent a managerial commitment to achieving specific outcomes and results. They are a call for action and results. Unless an organisation's long-term direction and business mission are translated into specific performance targets and managers are pressured to show progress in reaching these targets, vision and mission statements are likely to end up as nice words, window dressing, and unrealised dreams of accomplishment. Companies whose managers set objectives for each key result area and then press forward with actions aimed directly at achieving these performance outcomes typically outperform companies whose managers exhibit good intentions, try hard and hope for the best. Objectives represent a managerial commitment to achieving specific performance targets within a specific time frame.

2.9.4 Crafting strategy

Strategy making is all about *how* – how to achieve performance targets, how to out compete rivals, how to achieve sustainable competitive advantage, how to strengthen the enterprise's long-term business position, how to make management's strategic vision for the company a reality. A strategy is needed for the company as a whole, for each business the company is in and for each functional piece of each business.

2.9.5 Thirteen commandments for crafting successful business strategies

1. Place top priority on crafting and executing strategic moves that enhance the company's competitive position for the long term.
2. Understand that a clear, consistent competitive strategy, when well crafted and well executed, builds reputation and recognisable industry position; a frequently changed strategy aimed at capturing momentary market opportunities yields fleeting benefits.
3. Avoid "stuck in the middle strategies that represent compromises between lower costs and greater differentiation and between broad and narrow market appeal.
4. Invest in creating a sustainable competitive advantage. It is the single most dependable contributor to above-average profitability.
5. Play aggressive offence to build competitive advantage and aggressive defence to protect it.
6. Avoid strategies capable of succeeding only in the most optimistic circumstances. Expect competitors to employ counter measures and expect times of unfavourable market conditions.
7. Be cautious in pursuing a rigid or inflexible strategy that locks the company in for the long term with little room to manoeuvre – inflexible strategies can be made obsolete by changing market conditions.
8. Don't underestimate the reactions and the commitment of rival firms.
9. Avoid attacking capable, resourceful rivals without solid competitive advantage and ample financial strength.

10. Consider that attacking competitive weakness is usually more profitable and less risky than attacking competitive strength.

11. Be judicious in cutting prices without an established cost advantage. Only a low-cost producer can win at price-cutting over the long term.

12. Be aware that aggressive moves to wrest market share away from rivals often provoke retaliation in the form of a marketing “arms race” and/or price wars – to the detriment of everyone’s profits.

13. Strive to open up very meaningful gaps in quality or service or performance features when pursuing a differentiation strategy. Tiny differences between rivals’ product offerings may not be visible or important to buyers.

2.10 TYPES OF STRATEGIES

2.10.1 Unbundling and outsourcing strategies

Outsourcing pieces of the value chain formerly performed in-house makes strategic sense whenever:

An activity can be performed better or more cheaply by outside specialists

The activity is not crucial to the firm’s ability to achieve sustainable competitive advantage and won’t hollow out its core competencies, capabilities or technical know-how

It reduces the company’s risk exposure to changing technology and/or changing buyer preferences.

It streamlines company operations in ways that improve organisational flexibility, cut cycle time, speed decision-making and reduce co-ordination costs

It allows a company to concentrate on its core business

2.10.2 Co-operative strategies and competitive advantages

Alliances and co-operative agreements between companies can lead to competitive advantage in ways that otherwise are beyond a company's reach.

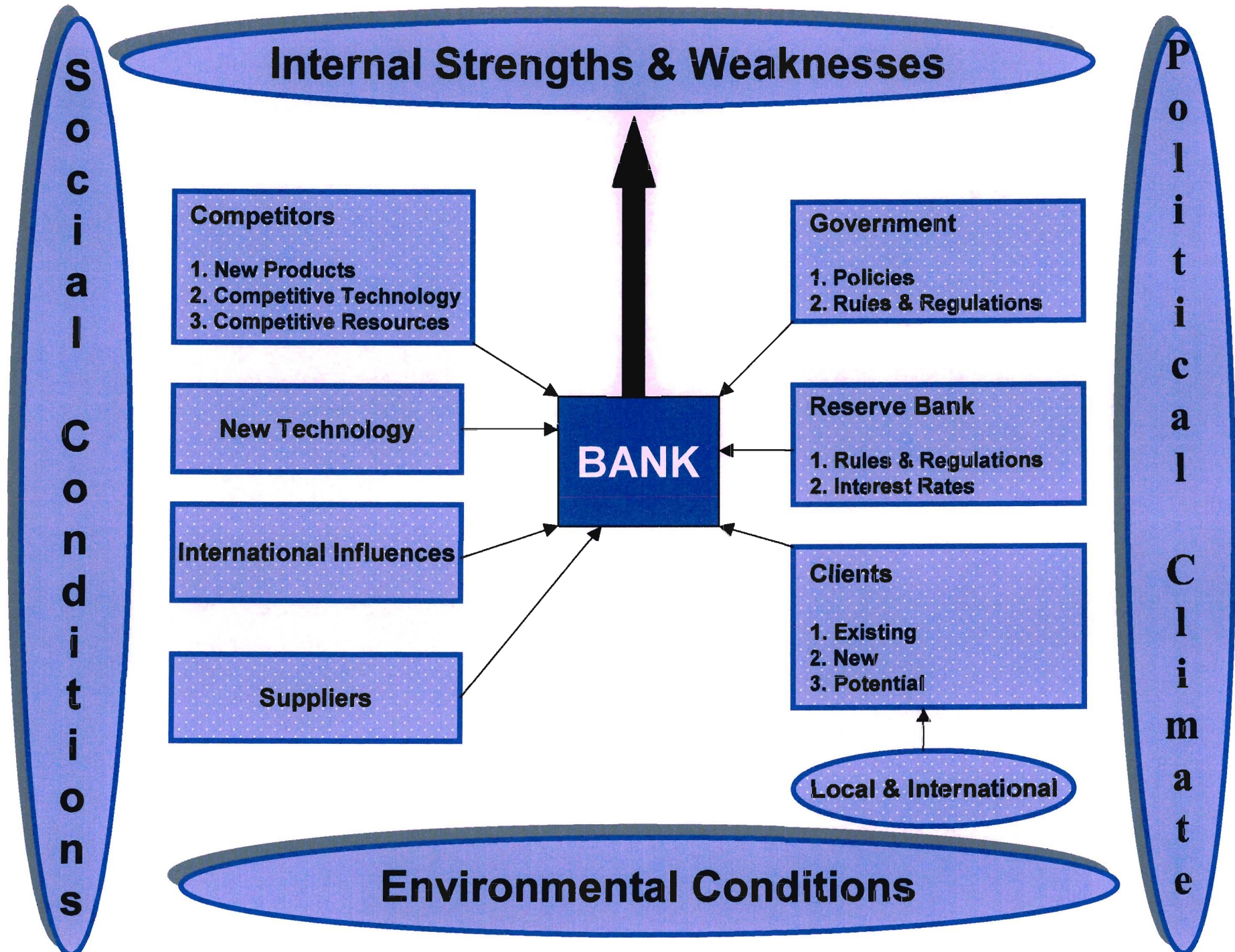
2.10.3 Turnaround strategies for businesses in crisis

Turnaround strategies are needed when a business worth rescuing goes into crisis; the objective is to arrest and reverse the sources of competitive and financial weakness as quickly as possible. Understanding what is wrong with the business and how serious its problems are is essential because different diagnosis lead o different turnaround strategies. Curing problems and turning the firm around can involve any of the following actions:

1. Selling off assets to raise cash to save the remaining part of the business
2. Revising the existing strategy
3. Launching efforts to boost revenues
4. Pursuing cost reduction
5. Using a combination of these efforts.

2.11 Conclusion

The theory of strategy emphasises the importance of strategy for the long term, profitable existence of a company. Irrespective of the industry, the fundamental principles remain the same. All businesses will need to view their current state and decide on a plan on how to use their resources and take advantage of internal and external opportunities to get to their desired state. Chapter 3 looks at mortgage origination in South Africa and abroad and the opportunities that this new concept presented to NBS.



CHAPTER 3 MORTGAGE ORIGINATION

3.1 Introduction

The recent explosion of mortgage broking into the South African property market has resulted in all banks having to make certain strategic decisions. Should they enter proactive operational and/or equity agreements with the pioneers of this concept or should they wait until the impact of these intermediaries on the mortgage loan market is quantifiable. In order to make this decision, the following questions need to be answered:

What are the international trends?

What is the current South African situation?

What are the banks costs of sourcing loans business through the internal sales force as compared to the commission required by brokers?

What are the bank's current positions?

What are the alternative options available?

The financial sector of South Africa is characterised by increasing competition amongst the five major banks for market share. Several new players have entered the sector, as a result of several mergers and acquisitions, the entry of new / niche banks / financial service companies and more recently the advent of securitisation companies. The interest margins and cost ratios of the "big five" are under greater pressure and all are looking for ways to reduce their cost ratios by cutting down on fixed costs. All of the banks are toying in varying degrees with the idea of outsourcing or at the very least incentivising their sales forces. It is off this base that the pioneering mortgage broker companies are trying to sell their services as a way for the banks to outsource their sales forces and thereby reduce fixed costs and minimise wasted costs.

3.2 What is a mortgage originator?

According to the National Association of Mortgage Brokers (NAMB), an American non-profit organisation dedicated to the improvement of the mortgage broking industry with 39 affiliated state associations and over 12,000 members, "*A mortgage broker is an independent real estate financing professional who specializes in the origination of residential and/or commercial mortgages*". An essential element of the above definition, which needs to be emphasised, is the independence of the Mortgage broker. In order for the broker to give the potential buyer the best possible service, with banks competing for the business based on price, product and service, there needs to be transparency and independence. Transparency in the commissions paid by the bank to the mortgage brokers and the independence of the broker from the banks. There cannot be special deals struck with specific banks nor can there be varying commission deals struck with different banks.

Another function of mortgage brokers in the international broking, business model, is to renegotiate with financial institutions on an annual basis, interest rates on behalf of the consumers introduced initially through their agency. An originator merely introduces a prospective client to a financial institution who would then complete all the necessary steps to process the loan. In return for that service, the originator claims a commission. The mortgage broker on the other hand, shops the client's details around in an unbiased and transparent fashion to all financial institutions in order to secure the best deal for the client and then runs with the deal until all the requisite documents are signed and completed

In South Africa, mortgage brokers have not yet started renegotiating rate nor do they handle the complete origination process on behalf of the banks and can thus be defined as a mixture between a mortgage broker and an originator.

3.3 INTERNATIONAL TRENDS

The advent of Mortgage Originators in South Africa is typical of the trends in Australia and USA.

3.3.1 Impact of mortgage originators on the Australian banking market

Mortgage originators have shaken both the foothold and profits of Australian banks in their own home loan market. A new force of competition has emerged and its importance has been recognised.

Mortgage originators are not new, but their impact on the retail banking market began six years ago. Since 1994 their market share has risen sharply from an initial two percent. There had been a significant change in the wholesale lending markets, which gave mortgage originators the opportunity to take a price competitive position – interest margins on variable home loans offered by banks widened to over 400 basis points (4 percent). This opened the door to mortgage originators.

Aussie Home Loans has consistently led a significant pricing differential on interest rates charged for standard variable home loans. Other mortgage originators have followed this pricing differential. Coupled with aggressive marketing strategies (particularly that of Aussie Home Loan), the pricing differential has been the key factors to success. The mortgage origination market is dominated by Aussie Home Loan and to a lesser extent, Registered Australian Mortgages Securities (RAMS). These are the two organizations, which have national brand recognition and have been the key entities in driving competition to the banks. There are however a number of other larger mortgage originators such as FAI, BMC Mortgage Corp, La Trobe Home Loans of Australia and a number of other large institutional mortgage originator groups such as Priori One (owned by AMP) and Member Super Home Loans (owned by National Mutual) that have added to the force of competition. There are also many smaller originators operating in all states of Australia and literally hundreds of professional groups such as solicitors and accountants, real estate agents, financial planners and brokers that originate home loans. There are some

mortgage providers such as Mortgage Choice and Access Home Loans that offer a range of bank home loan products.

There are two types of mortgage originators; those who originate and manage the loan process and those who simply originate and do no more.

Despite the fierce competition between banks and mortgage originators, banks also provide funds for mortgage originators. A number of banks are particularly prominent in the market. These include: Primary Industry Bank of Australia, Adelaide Bank, BankWest, Metway Bank, Bank of New Zealand, Bank of Melbourne, St George and Advance, banks.

3.3.2 Will mortgage originators success continue

Although there are no exact figures to confirm this, it is estimated that mortgage originators may be writing about \$400 million -- \$500 million per month. The larger mortgage originators, the biggest of whom is Aussie Home Loans, which claims to be absorbing over half this amount, dominate a substantial part of the market.

Although mortgage originators have been able to grow their market share over the last five years based on price differential between banks and themselves, price differential has contracted to a point where the banks are offering mortgage rates comparable, if not better, than mortgage originators. The key to the success of the mortgage originators in the past has now been removed as banks cut their net home loan margins further.

Mortgage originators are thus faced with substantial new challenges and potential rationalisation of their industry. It seems clear that with interest rates and margins contracting, many originators may not be able to continue with their businesses as a result of insufficient margins to pay basic costs and overheads. Most have no other source of income or the ability to create other origination forms of business. The immediate casualties may be the latter entrants who saw an opportunity to make a quick buck. Other mortgage originators, who have insufficient volume and can do no more than rely on pricing issues, will be doomed to failure. The banks have already met this first challenge of real

competition in the housing mortgage market and notwithstanding all this, mortgage originators have opened up competition and have challenged the banking industry to cut margins and profits in home lending - all, ultimately, for the benefit of consumers.

3.3.3 Mortgage origination business in America

In 1999 the Mortgage Bankers Association of America sponsored a study of mortgage brokers in America. In their article, Tom Lamalfa, David Olson and Larry Pearl mentioned that to their knowledge this was the most exhaustive study of primary market originators ever undertaken. The research counted 30 000 mortgage brokerages operating in the fourth quarter of 1998. On the lender side, they counted just fewer than 8,500 firms operating in late 1999 to early 2000. Commercial banks made up 50 percent of all lenders. The mortgage broker research indicated that brokers accounted for 70 percent of all residential production in 1998.

Having done three earlier definitive studies of the mortgage brokerage business, broker market share rose from 20 percent nationwide in 1987 to 42 percent in 1991, then 58 percent five years later. Given that growth trend line, and the unusual circumstances of 1998, brokers could have accounted for seven of every 10 originations. Sometime in the first quarter of 1999, the number of mortgage originators probably peaked, with more than 30,000 mortgage brokerages taking applications, processing and closing loans. At the same time, their wholesalers, along with approximately 8,400 other lenders, were simultaneously chasing down customer leads, underwriting files and funding new loans. It is a model of the perfectly competitive market: lots of players, no barriers to entry and little opportunity for any one player to drastically influence the price of mortgages. Despite so many firms soliciting borrowers' business, one of every two mortgages is ultimately produced by one of 28 lenders. Combined, they account for only 0.3 percent of all lenders - but 51 percent of all production. Each produced \$10 billion or more of retail and/or wholesale business in 1999.

This consolidation trend began in the 1980s, accelerated in the 1990s and promises to continue ahead. It is expected that the big lenders will get still bigger in the next several years. The latest acquisition was of Bank United, Houston, by giant Washington Mutual Bank, Seattle. Earlier this year, Wells Fargo Bank, San Francisco, acquired First Security Bank, Salt Lake City, and thereby its subsidiary, CrossLand Mortgage.

Mergers and acquisitions have slowed, but continue nevertheless in spite of the slump in bank stocks. Countrywide Home Loans, Calabasas, California, and PNC Mortgage Corp. of America, Vernon Hills, Illinois, are officially for sale, while First Union, Charlotte, North Carolina, is shrinking its mortgage operation and reinvesting the funds in securities firms, asset-management companies and investment banks. Bank of America, Charlotte, North Carolina, and First Nationwide Mortgage Corporation, Frederick, Maryland, are downsizing their mortgage operations, cutting staff and closing branches. GE Capital Mortgage, Raleigh, North Carolina, shut down its operation and is having its servicing portfolio sub serviced. CitiMortgage, St. Louis, bought Source One Mortgage and shut it down within a year.

Mortgage Brokers 1998 illustrated how increased demand in the primary market was accommodated by the private sector. As demand for refinances grew, more and more individuals sought employment in the origination business. Between 1996 and 1998, approximately 10,000 new brokerages sprung up in response to rising demand from borrowers. This added approximately 50,000 new loan officers.

The low interest rates that stimulated demand ended as quickly as they began. The need for an enlarged supply of originators dissipated. Although hard data is absent, there are at least 10,000 fewer brokerages nationwide, and many fewer employees today.

Mortgage Lenders 1999 provided support for our downsizing estimate: Broker market share collapsed in 1999, at least relative to the prior year. There was a drop in broker business of 47 percent, from 51.2 trillion to \$634 billion one year later.

"Significantly, the advent of the mortgage broker has given wholesalers the means to grow, an opportunity they did not have before there were enough originators seeking to sell loans servicing released." These words followed those of an earlier article in April 1990 that had concluded on this note: "The new economics of mortgage banking are likely to keep this industry segment (wholesaling) thriving into a full and prosperous adulthood."

It is estimated that the market continues to favour brokers. Lender retail costs too much salaries, rent, information technology (IT) and so on, with many more employees and benefits alongside offices, phones, advertising and computers.

Wholesale Access' study of the economics of mortgage brokering, Study of Mortgage Brokerage Industry Costs (1993), indicated that brokers got where they are by being low-cost producers. That appears to remain the case today.

"Online mortgage brokers in the US already do US\$10bn in loans and Goldman Sachs predicts a compound annual growth rate of 97% to 120bn and 22% of the US market by 2003. Mortgages will then be the biggest broking business on the Internet.

3.3.4 Originators deconsolidate

Paul Muolo commented on the deconsolidation of Originators in his Industry Overview report:

The mortgage origination business is deconsolidating and taking a bigger piece of the total market, creating headaches for loan originators who work for big companies.

There is no question among mortgage professionals that the servicing side of the residential finance industry is consolidating. In 1994, for example, the top five residential services in the U.S. (Countrywide, G.E. Mortgage, Fleet, Prudential Home, and Norwest) serviced 12.91% of all outstanding mortgages in America. Six years later, the top five (Wells Fargo, Bank of America, Chase, Washington Mutual, and Countrywide) service 33.01% of all residential loans. Indeed the evidence is overwhelming.

Frank Houttekier, who runs a small mortgage brokerage business in Michigan, believes that deconsolidation is a fact of life and that he and other brokers will thrive.

"I think we are going to see the mid-level players dissolve," he says. "I think we're moving toward an industry where you have lots of small players and very large players. I think we will have an industry that favours the regional and local shops."

Houttekier, who also serves as chairman of media relations for the Michigan Mortgage Brokers Association, notes that three years ago loan officers were quitting their mortgage banking firms to become brokers because they could make a killing during the refinancing boom. Brokers receive a point or more for every loan originated. If you're a super producer, know the local market and can network with Realtors and financial planners, a broker can make six-figures during a hot market.

But today, with production volumes down compared to the peak years of 1998 and 1999, loan officers and underwriters are getting laid off. What's a mortgage professional to do? Go to work at McDonald's or sell shoes? Not likely. They become mortgage brokers either by joining smaller but established brokerage firms or starting their own firm from scratch. But as Houttekier notes, "This time around they're becoming brokers because they have no choice."

3.3.5 Runaway refinancing put banks in race to buy mortgage originators

The boom in mortgage refinancing has sent banks scurrying to buy loan origination units. Large banks active in the field want to bolster their origination capabilities in order to replace loans in their servicing portfolios as consumers refinance, investment bankers and analysts said.

"The demand for mortgage companies, both originators and services, is the highest we've seen in years," said Jeffrey M. Levine, national director of investment banking at BayView Financial Trading Group, Miami.

An explosion in residential refinancing has fuelled the trend. With a strong bond market pushing mortgage rates to unusually low levels, many homeowners are

trading old loans for new ones with lower monthly payments. Experts say the activity is rivalling the historic refinancing boom of the early 1990s.

Some analysts said many small, independent companies would be better off selling, taking advantage of larger banks' interest in production.

Chuck Klein, executive vice president of Charbonneau-Klein Inc., a Houston investment bank and broker specializing in mortgage banking, said banks are "crawling all over themselves to buy production."

Both small and large banks are hungry for production, he said; because they want to increase their customer rosters and thus increase cross-selling opportunities and for smaller banks, increasing the customer base makes them more attractive targets, Mr. Klein noted.

Even larger originators are seen as vulnerable. One company mentioned as a potential target for banks is Resource Bancshares Mortgage Group. The company originated \$10.8 billion in 1997 and has a relatively small servicing portfolio, at \$7.1 billion.

3.4 Key trends and issues

An important trend to emerge is the introduction of new technology in the form of call centres and the Internet. Alongside these recent massive strides in on-line technology has been the increasing awareness and knowledge regarding the financial market place, amongst potential homebuyers. This in turn has led to the banks having to develop new products and add greater value to their current product offerings. Potential buyers demand better service and efficiency and show lesser degrees of loyalty to banks. Banks have to focus their attention on switching clients from other banks and trying to retain their existing clients.

The unpredictable volatility of the South African economy over the last eighteen months has contributed to the constantly changing property market. Traditional estate agencies had to take a long hard look at profitability issues and several have been threaten with economic survival. The above has led to the real estate industry as a whole looking for additional sources of income and the increasing importance of mortgage commission income.

The second key trend to emerge as a direct result of the above is the formation of strategic alliances between real estate groups and related businesses evidenced by the mushrooming of mortgage broking businesses. The objective of these groupings is twofold:

To gain an a greater effective control of the *source* of business; and

To gain a *strategic stronghold* over the financial institutions when negotiating commission structures.

Rightsizing, retrenchment and early retirement have induced many experienced business people to look for new opportunities in recent years, with the real estate and mortgage origination industries being major beneficiaries of the trend. The closure or scaling down of bank branches in recent times has made it difficult for borrowers in many towns to shop around for a home loan, but originators intend to fill that vacuum and to make use of local skills and expertise to do so. At the same time originators believe they can be of enormous assistance to local estate agencies and developers, by helping to secure home finance for their buyers and speeding up their transactions.

3.5 The South African situation

The SA home loan industry is estimated by the Financial Mail to be approximately R15bn/year.

In South Africa, there are several smaller mortgage brokers/originators that have been doing business on a small scale within each of the regions since 1996.

Mortgage broking, as a concept has however not been attempted on a national scale, until very recently. Certain estate agency affiliations have formed effectively two major groupings.

3.5.1 MortgageSA.com

Eskel Jawitz Real Estate, Pam Golding Properties, Seeff Mortgage Services, Lew Geffen Estates, Vered Estates and Wakefields have joined financial services divisions to form Mortgage SA.Com - a mortgage origination-outsourcing house.

Mortgage SA.Com will deal with mortgage origination, insurance and conveyancing in association with Standard Bank, Nedcor and FNB Properties, and propose a commission of 2% for the origination of registered mortgages.

MortgageSA.com employs 50 Mortgage Consultants throughout the country to process mortgage applications. The real estate brand names will continue to compete fiercely in the real estate broking market. Nevertheless, they have combined their mortgage distribution channels to form a critical mass of mortgage transactions and a foundation, from which the company will be able to exploit the numerous opportunities available to it in the financial services and outsourcing arena.

A spokesperson for the new company said: "Although we are affiliated to certain banks, we will always strive to meet and beat the best rate offered by any bank". As can be seen from the definition of a mortgage broker, above, this statement is a contradiction, as mortgage brokerages are supposed to shop the potential buyer's details around to several banks in order to ensure that the buyer gets the best rate and that the process is hassle free from the consumers perspective. As MortgageSA.com is not independent, the buyer would have to first find out what is the best rate being offered in the market, before MortgageSA.com will ask one of the affiliated banks to beat the rate. This is obviously not in the interests of the potential buyer, who may as well do his own shopping around for mortgage finance.

The second major grouping is:

3.5.2 Jigsaw Holdings Limited (formerly Aida Holdings Limited)

This is an investment holding and management company currently focussing on real estate and sales franchising (Aida & Era groups), property management and development. Through its recent acquisitions, Jigsaw is today the largest franchiser of real estate services in Southern Africa, with some two hundred offices, managing more than R3.0 billion in property sales and a portfolio of R1.5 billion. ABSA Bank owns Twenty five percent of the Jigsaw group. ABSA's strategic stake in Jigsaw is an attempt to control a portion of the source of their

business through closer links to the ERA and AIDA franchises, together with the prospective business flowing from Machaus. Machaus commenced business in 1995 and focuses on the provision of residential housing priced between R80 000 and R150 000. It conducts its activities primarily in the Rustenburg area in the Northwest Province where it has established itself as a reputable developer of housing units. Machaus is currently in the process of expanding to the other regions of South Africa. The above is more clearly illustrated by the company structure diagram shown below.

The Jigsaw Origination Company has not started operations yet, as it is currently negotiating with financial institutions over commission amounts to be paid.

Jigsaw is proposing a commission for the origination of mortgages of 1.8% on registration. At this stage, it is not clear how many financial institutions Jigsaw will represent. Clearly, ABSA Bank, will be represented in its capacity as one of the major shareholders of Jigsaw

It can therefore be seen that mortgage broking in South Africa does not follow the international example of independence and transparency. What must necessarily occur for the South African business model to approximate the International model is for all of the banks to pay the same commission to all of the mortgage brokers, which will result in the banks competing for business on the basis of price, product and service. In this independent model, brokers give unbiased advice and ultimately the potential buyer would receive the best deal.

Currently, in South Africa, different mortgage brokers are on varying commission structures and are therefore not unbiased and are steering potential buyers to the banks they feel the most comfortable with and that offer them the best commission.

The situation in South Africa is changing rapidly and a degree of transparency and independence is starting to come to the fore, evidenced by a new player in the mortgage broking market called Mortgage.co.za.

3.5.3 Mortgage.co.za

Mortgage.co.za is a representative organisation, started by the owner of Bond One, encompassing all of the smaller currently operating independent mortgage brokers. Mortgage.co.za has entered a number of service agreements with these smaller independent brokerages to create a comprehensive network of mortgage brokers nationwide. The following mortgage brokers have joined mortgage.co.za:

- **Wizard Financial Services:** Wizard is the leading mortgage brokerage in the Western Cape and has 14 consultants. Wizard is the first brokerage company in South Africa to operate on a franchise basis.
- **Homeloan & Investments Company of Southern Africa (Pty) Ltd:** 8 consultants services the entire Pretoria region.
- **Bond One:** Operates a nationwide Internet and call centre mortgage brokerage.
- **Bondsman Financial Services cc:** The Company has six consultants servicing the Johannesburg and East Rand areas. Bondsman has recently expanded its operation into the Eastern Cape.
- **Fame Capital (Pty) Ltd:** Offices in Johannesburg, the West Rand and Johannesburg South.
- **Platinum Property Finance cc:** Operates from Port Elizabeth and services the Eastern Cape Region.

Mortgage.co.za is the closest South African approximation to the international version of the independent mortgage broker. Fourteen financial institutions have representation on this site, which allows the institutions to participate and compete for the business on offer, based on price, product and service.

Mortgage.co.za does not however, renegotiate rate on behalf of the client or complete the origination process as yet.

A fourth currently nameless company, about to be launched in South Africa, is to be formed by the soon to be ex-management of the Saambou mortgage origination division. Their business plan presented to the NBS states that they will remain independent of any financial institution and will charge a flat rate of 1.6% upon registration of mortgage bonds introduced through their agency. To

what extent the formation of this company is a ploy by Saambou to outsource their bond origination division, whilst still retaining a share and/or complete control, is unclear. Added to the Saambou example outlined above another bank starting an in-house mortgage origination company, is ABSA, with ABSA Virtual. This company will originate business for other banks and is supposedly "independent" from its parent ABSA.

Another purely origination company to emerge recently is called Bondnet, representing First National, FBC Fidelity, Saambou and Imperial. Bondnet passes on inquiries to the banks, which have 24 hours in which to bid to the client for the business. The client then deals direct with the chosen lender. Bondnet picks up 0,35% commission for successful online inquiries.

Currently, the three main mortgage broking companies operating or about to operate in South Africa, have colluded unconsciously or otherwise, to demand a commission that is much higher than the current industry norm, evidenced by the investigation into mortgage brokers currently dealing with the NBS (Currently no more than 1% of the business introduced).

3.6 NBS

The hold that mortgage originators, who act as middlemen between home buyers and mortgage lenders, have developed over banks in the past two years apparently contributed to NBS's loss on its home loan book. Bad debts and a considerable number of repossessed properties were among the reasons for NBS's losses. But some analysts reckon NBS's problems also resulted from it having made itself unpopular among mortgage originators without realising how much impact these new players would have on the home loan market. It was no secret that Noel Young, former divisional director of NBS home loans, had little time for mortgage originators. NBS initially refused to pay 'exorbitant' one-off commissions to mortgage originators. Young told Finance Week that banks could not afford the high one-off commissions demanded by most originators. NBS's view was that it would only use mortgage originators who were satisfied with lower commissions or commissions paid over five years.

NBS's policy on commissions was one of the reasons it could offer some of the lowest home loan rates in the market. But it seems that NBS's stance backfired as mortgage originators simply took potential clients to other banks, which were prepared to pay higher commissions.

NBS later changed its view on commissions but then there was a new problem. Its administrative system was inefficient and it apparently took longer than other banks to process mortgage applications. As one mortgage originator put it, this further alienated mortgage originators from NBS, making it difficult for NBS to grow new business.

3.6.1 NBS origination costs

In the process of originating mortgages, approximately fifty percent of all applications submitted are not registered and consequently result in a large portion of wasted costs to the banks. The problem with converting a salaried sales force to a commission only sales force is that without a complete restructure, a HR and Trade Union problem could be created. The new buzz word being bandied about as a means to solve the above problem is the "outsourcing" of the banks sales forces, in order to relieve pressure on rising fixed costs and to minimise wasted costs. The mortgage brokers currently in the market are selling their services as a remedy to effectively outsource the sales force and solve the above problem. What has been omitted is that the NBS and indeed the majority of banks are multi-channelled and cannot immediately divest themselves of the costs associated with running a salaried sales force. What is therefore immediately apparent is that the savings to be had by sourcing mortgage business through brokers is minimal and must in fact be added to the cost of our own, fixed in the short to medium term, infrastructure. This makes the cost of doing business with brokers in the short to medium term prohibitive.

An investigation into the costs associated with mortgage bond origination, has revealed that it costs the NBS on average, across all 19 residential loans sales centres 1.27 % of the value of net granted bonds, to originate mortgage loans. The above cost excludes marketing costs, which is an ongoing operational cost

to the organisation. This cost to the NBS is substantially lower than the lowest of the new mortgage brokers commission proposals. See Table 1 - Expenses per Sales Centre for 5 Months as at the end of February 2000

3.6.2 NBS strategy

The NBS strategy, taken from the ongoing re-inventing mortgage loans for the NBS document, is quite clear on the issue of mortgage broking.

- It is the NBS's strategy to extend its reach into the marketplace, without pushing up cost structures. This means entering the value chain earlier and cutting out as many third parties as possible. Establishing mortgage broking as an alternative channel is part of the strategy. The type of mortgage broking channel envisaged is based on the international example. It was not envisioned that links would be established with the corrupted and lesser form of "hybrid" mortgage broker start-up companies available in the South African market place today. To extend our reach into the market place, without pushing up cost structures, i.e. through alternative, integrated distribution channels
- The second point highlighted in the strategy document is to establish mortgage broking as a channel with a view to this replacing the mobile sales force in the future. After speaking to the parties involved, it is clear that this point referred to the project underway at the time, with the Australian company: Mortgage Choice. The idea was to position the NBS earlier in the value chain by owning a strategic stake in a mortgage broking company. The intention was not however, to subscribe to the exorbitant and unrealistic rates proposed by the newly formed SA mortgage brokers.
- The third highlighted point taken from our mortgage loans strategy document, illustrates the points made above, to namely, Establish mechanisms to get into the property acquisition and mortgage application value chains earlier, with a view to eliminating the influence of the estate agent. This confirms the earlier assertion that the NBS wants to cut as

many middle men/third parties from the mortgage loan transaction as possible.

- The fourth point highlighted on the mortgage loans strategy document further reinforces the fact the NBS is looking for ways to cut out the middlemen/third parties and to incentives the potential buyer to come direct.
- Establish a direct mortgage channel and products to overcome the dependence on estate agents

It is clear from the reinventing mortgage loans strategy document that mortgage broking in its current format, with its onerous remuneration demands, does not fit in with the current strategy of the NBS.

3.6.3 Strategic options for NBS

The following strategic options were discussed by the NBS executive committee for mortgage loans at a meeting in February 2000.

The strategic options available to the NBS are as follows:

- To start our own "independent" origination company in the same vein as Saambou and ABSA
- To, as suggested by Noel Young, as a means to protect the source of our business, start our own in-branch real estate agencies in a mutually beneficial relationship between bank and estate agent, with lower commission rates, in competition to the existing estate agencies.
- To open all channels and to sign deals with all available mortgage brokers, but to regulate and "cherry pick" the business that is attractive to us.
- To back one of the current crop of mortgage brokers and to take an equity investment in that company
- To differentiate ourselves and create a marketing opportunity as the "consumer champion", by not aligning with any mortgage brokers for the short term and giving a portion of the commission that would have been

paid to brokers directly to the consumer and thus bolstering our direct channel, per the loans strategy

- To take an equity stake in an international mortgage broking brand start-up in SA i.e. Mortgage Choice

It was agreed by all members that unless a new mortgage broking company with substantial funds available to invest in establishing its brand in SA and showing a willingness to undercut the main estate agency groupings, the commission demanded by the current brokers will not decrease and may even increase. It is at the stage of aggregation of mortgage broking companies that the commission charged would decrease to lower levels, as the few remaining mortgage broking companies tighten their hold over the market and increase the barriers of entry to new players.

As stated above the South African version of a mortgage broker is a hybrid between the international version of an originator and a mortgage broker.

It is recommended that the NBS adopt a "wait and see" approach before entering the mortgage broking fray. At this juncture, what is important to bear in mind is that these new mortgage broking companies are as yet untested in the market by the consumer and it is not clear how successful they will be. The new SA start-ups are estate agents/banks in disguise and are lacking in independence and transparency.

An opportunity is open to the NBS to bolster its direct mortgage loans strategy, by differentiating itself from competitors and establishing itself as a "champion of the consumer". The average consumer is unaware of the amount of commission paid to mortgage brokers. They are also unaware that in order to cover the costs associated with mortgage brokers, the banks are not offering the lowest interest rate available. The consumer needs to be informed that they are in the final analysis paying for the mortgage broker commission. By subtly educating and offering the consumer a percentage of the money that would have otherwise been paid to a mortgage broker, the NBS will create a competitive differentiation advantage in the short to medium term.

Once mortgage broking in SA approximates the international example, or alternatively, the NBS origination business volumes are affected, links can then be established with local mortgage broking companies. What should be borne in mind is that in order to create the independence necessary for mortgage broking to work successfully in SA, then as many financial institutions as possible must participate. The NBS would therefore be welcomed and not excluded, should it wish to join the mortgage broking industry in the future, as a competing financial institution.

In the long term, per the NBS strategy, it would be prudent to phase the sales force away from being salary earners to commission only earners. This will happen naturally in the medium to long term through natural attrition. Eventually in the long term when a network of mortgage brokers is established nationwide and the NBS cost of originating mortgage bond business is greater than or equal to the commission paid to mortgage brokers, the sales force can be restructured and origination in its entirety can be outsourced to mortgage brokers per the international example.

The recommended way forward is to adopt a conservative approach to mortgage broking. The NBS should not fall for the mortgage broker start-up companies scare tactics, which imply that the source of our business will be threatened if we do not immediately form proactive links with them. In addition, threats of being cut out of the loop in the future are groundless. By not affiliating itself, the NBS can become the "consumers champion" and capitalise upon the marketing differentiation opportunity presented.

In addition, we need to keep watch over developments in this part of our supply chain, as this will without doubt be the future of mortgage origination in South Africa.

We need to choose our future mortgage broking company partners very carefully and wait for the moment that it is prudent, based upon costs, to open formally this additional channel.

Finally, it is necessary to point out that the ideal situation for the NBS, would be to have a strategic equity stake in a mortgage broking company that is either a

subsidiary of an international mortgage broking company or is a local start-up company that adopts the international criteria of independence and transparency i.e. Mortgage Choice.

3.7 Conclusion

This chapter commenced with the definition of mortgage originators and thereafter reviewed the mortgage origination industry in Australia and USA. The proliferation of originators in South Africa is typical of the trends overseas. NBS, being one of the smaller players in the mortgage loan market in South Africa, is deeply affected by the advent of mortgage originators. The rapidly changing external environment is forcing banks to adapt and review their strategies. NBS's senior management are in constant meetings analysing the impact of originators. Chapter 4 reviews both the theory of strategy and the current homeloan industry in South Africa. A gap analysis at this juncture is appropriate.

Table 1

| CURRENTLY UTILISED MORTGAGE BROKERS | | | | | | | | | | | | | | | | | | | |
|--|---------------------------------|------------------------------|--|-----------------------|---------------------|-----------------------|------------------|--------------------------|--|----------------------|-----------------------|------------------|--|-------------------------------------|---|----------------------|--------------------------------------|----------------------------|---------------------|
| LOANS SALES CENTRES | SOUTHERN SUBURBS (TOKAI) | KZN SOUTH (WESTVILLE) | EASTERN CAPE | BROOKLYN | KZN MIDLANDS | SOMERSET WEST | CENTURION | RANDBURG (CRESTA) | TABLE VIEW | VAAL TRIANGLE | ALBERTON | KZN NORTH | TYGER - VALLEY | GAUTENG N SUBURBS (ROSEBANK) | PRETORIA NORTH | MPUMA - LANGA | DOWER GLEN | WESTRAND (WESTGATE) | BLOEMFONTEIN |
| 1. Name of Firm | Powerhouse Financial Services | Kashmir Financial Services | Platinum Property Finance | No Response to e-mail | Nil / N/A | No response to e-mail | Nil / N/A | Nil / N/A | Financial Workshop | Nil / N/A | Fame Capital | Nil / N/A | Probond / Wizard | Bond One | Amanada Wasserman | Nil / N/A | Mr Bond | Nil / N/A | Nil / N/A |
| Area of Operation | Cape Peninsula | Greater Durban | P.E. & Surrounds | | | | | | Tableview & Cape Town Area | | JHB South & East Rand | | Northern Suburbs & Tableview | Sandton + JHB | | | JHB | | |
| Commission Structure | Flat Rate of 1% | Normal Agents Commission | 0-R5 Mil 0.3%; 5-R7 Mil 0.6%; 7-R10 Mil 0.7%; >R10 1%. 0.5% will be paid up to 30/04 | | | | | | <=R5 Mil 0.7%. r5 - R8 Mil 0.8%. R8 - R10 Mil 0.9% & over R10 Mil 1% | | Flat Rate of 1% | | <=R5 Mil 0.7%. r5 - R8 Mil 0.8%. R8 - R10 Mil 0.9% & over R10 Mil 1% | Flat Rate of 0.75 % | Organised by Brooklyn SLC Details to be Forwarded | | 0.8% up to R2 Mil & 1% above 2% p.m. | | |
| NBS - Contract Expiry Date | N/A | N/A | 30/04/00 | | | | | | N/A | | 30/06/00 | | Reviewed every 3 Months | 30/06/00 | | | 31/03/00 | | |
| Estate Agents Represented | Various | N/A | Various | | | | | | Various | | 60 | | 7 Localised Agencies | Various | | | | | |
| Total Consultants Employed | 3 | 1 | 2 | | | | | | 8 | | 9 | | 8 | 1 | | | | | |
| 2. Name of Firm | | Moody's Strategic Services | | | | | | | Sapphire Finance | | | | P F C Group | | | | | | |
| Area of Operation | | Greater Durban Area | | | | | | | Central Cape Town Area | | | | Northern & Southern Suburbs | | | | | | |
| Commission Structure | | Normal Agents Commission | | | | | | | <=R5 Mil 0.7%. r5 - R8 Mil 0.8%. R8 - R10 Mil 0.9% & over R10 Mil 1% | | | | <=R5 Mil 0.7%. r5 - R8 Mil 0.8%. R8 - R10 Mil 0.9% & over R10 Mil 1% | | | | | | |
| NBS Contract Expiry | | N/A | | | | | | | N/A | | | | Reviewed 3 Months | | | | | | |
| Estate Agents Represented | | N/A | | | | | | | Various | | | | 6 Localised Agents | | | | | | |
| Total Consultants | | 1 | | | | | | | 3 | | | | 5 | | | | | | |
| Additional Broking CO's | | 6 More Brokers | | | | | | | | | | | 1 More Broker | | | | | | |

Table 2

| EXPENSES PER SALES CENTRE FOR 5 MONTHS AS AT THE END OF FEBRUARY 2000 | | | | | | | | | | | | | | | | | | | | |
|--|--------------------------|-----------------------|--------------|--------------|--------------|---------------|--------------|-------------------|--------------|----------------|--------------|--------------|----------------|------------------------------|----------------|---------------|--------------|---------------------|--------------|-------------|
| LOANS SALES CENTRES | SOUTHERN SUBURBS (TOKAI) | KZN SOUTH (WESTVILLE) | EASTERN CAPE | BROOKLYN | KZN MIDLANDS | SOMERSET WEST | CENTURION | RANDBURG (CRESTA) | TABLE VIEW | VAAAL TRIANGLE | ALBERTON | KZN NORTH | TYGER - VALLEY | GAUTENG N SUBURBS (ROSEBANK) | PRETORIA NORTH | MPUMA - LANGA | DOWER GLEN | WESTRAND (WESTGATE) | BLOEMFONTEIN | TOTALS |
| Expense Description | | | | | | | | | | | | | | | | | | | | |
| Depreciation | 20,833 | 48,611 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 48,611 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 20,833 | 451 |
| Marketing Expenses | 0 | 9,881 | 0 | 89 | 0 | 0 | 56,362 | 0 | 0 | 0 | 0 | 0 | 0 | 500 | 1,050 | 4 | 0 | 0 | 0 | 87 |
| Operating Taxes | 1,591 | 2,951 | 2,093 | 5,546 | 1,395 | 1,508 | 424 | 3,365 | 830 | 811 | 1,839 | 1,735 | 1,625 | 1,897 | 1,179 | 1,041 | 1,808 | 1,322 | 1,022 | 33 |
| Other Expenses | 546,540 | 247,037 | 347,134 | 190,561 | 160,566 | 109,036 | 126,156 | 156,116 | 154,157 | 59,208 | 214,829 | 156,290 | 315,001 | 135,955 | 94,858 | 80,637 | 163,266 | 208,660 | 42,888 | 3,510 |
| Monthly Rental (Ex VAT) | 122,300 | 126,375 | 110,000 | 70,885 | 60,000 | 16,260 | 54,575 | 66,235 | 53,750 | 28,500 | 41,850 | 83,545 | 104,285 | 91,000 | 48,140 | 30,000 | 81,470 | 95,000 | 47,500 | 1,311 |
| Printing/Stationery | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 5,000 | 85 |
| Telephone @ +R500 ppm | 25,000 | 35,000 | 35,000 | 25,000 | 17,500 | 12,500 | 17,500 | 20,000 | 20,000 | 15,000 | 25,000 | 27,500 | 30,000 | 25,000 | 17,500 | 15,000 | 25,000 | 30,000 | 12,500 | 430 |
| Staff Expenses | 507,704 | 828,507 | 794,877 | 599,384 | 645,239 | 476,676 | 395,046 | 773,948 | 358,117 | 393,678 | 380,623 | 486,365 | 472,757 | 419,131 | 313,378 | 248,687 | 683,245 | 520,675 | 289,137 | 9,537 |
| Operating Expenses | 1,228,968 | 1,303,162 | 1,314,938 | 907,259 | 910,553 | 641,804 | 675,897 | 1,045,517 | 612,687 | 623,030 | 669,774 | 783,268 | 977,279 | 869,266 | 501,739 | 401,202 | 940,642 | 881,890 | 398,678 | 15,437 |
| Average YTD Monthly | | | | | | | | | | | | | | | | | | | | |
| Ops Expenses per LSC | 245,794 | 260,632 | 262,988 | 181,452 | 182,111 | 128,361 | 135,178 | 209,103 | 122,537 | 104,606 | 137,955 | 156,654 | 80,240 | 139,857 | 100,348 | 80,240 | 188,128 | 176,378 | 79,778 | 156438 |
| YTD Net Granted Bonds | 117,555,036 | 147,791,376 | 109,188,687 | 74,980,764 | 64,208,330 | 58,257,563 | 48,993,706 | 61,666,507 | 76,975,476 | 37,480,827 | 78,245,256 | 83,878,170 | 95,510,207 | 71,783,287 | 35,877,371 | 43,577,715 | 41,676,827 | 44,380,460 | 17,410,023 | 1,399,767 |
| Average p.m. Net Granted | 23,511,007 | 29,558,275 | 21,837,377 | 14,996,153 | 12,841,666 | 11,651,513 | 9,798,742 | 12,333,301 | 15,395,095 | 7,496,125 | 15,649,051 | 16,775,834 | 19,102,041 | 14,356,853 | 7,195,474 | 8,715,543 | 8,375,325 | 8,878,098 | 3,482,005 | 261,951 |
| Average Monthly Ops Expense as a % of Average Monthly Net Granted Bonds per LSC | 1.05% | 0.88% | 1.20% | 1.21% | 1.42% | 1.10% | 1.38% | 1.70% | 0.80% | 1.40% | 0.88% | 0.93% | 0.42% | 0.97% | 1.39% | 0.92% | 2.25% | 1.99% | 2.29% | 1.27 |

CHAPTER 4 EVALUATION OF THE SITUATION

4.1 Introduction

In the previous two chapters we examined the theory of strategy and viewed the current state of the mortgage origination industry in Australia, USA and South Africa with particular emphasis on NBS bank. In this chapter we review both the preceding chapters. Company situation analysis prepares the groundwork for matching the company's strategy both to its external market circumstances and to its internal resources and competitive capabilities. Organisations that understand their strengths are better able to compete successfully in a rapidly expanding and competitive world economy. Core competence analysis will help them do this by enabling them to see beyond their end products and served markets to their core technologies and sources of competitive advantage. Gap analysis can help managers better understand the dynamics of the competitive environment. It can be used to reveal where an organisation has weaknesses and where it has strengths, in relation to its competitors. Such an analysis helps the manager develop strategies to catch market leaders or strategies to stay ahead of the chasing pack.

4.2 Gap analysis

The simplest useful form of gap analysis merely involves a search for gaps in the market. An alternative is to look at the differences between competitors. Gap analysis is less concerned with the fact that there is a gap between things, than with how to close the gap. Recognition of the fact that a gap exists is only one stage in the process. Having recognised that there is a gap, companies need to develop strategies that will close the gap, manage the process of change and finally monitor the process to ensure that the same gap does not reappear and, if possible, to open a favourable gap with the competition.

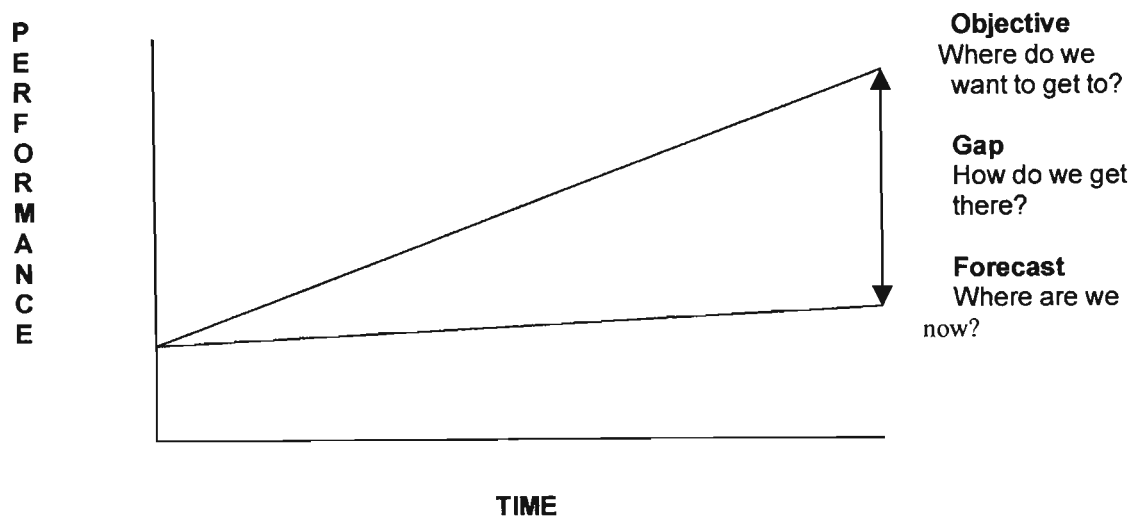


Figure 4.1: Performance of Gap Analysis

4.2.1 Competitive gaps

A company's strategy has to be tailored to the nature and mix of competitive factors in play – price, product quality, performance features, service, warranties and so on. When competitive conditions intensify significantly, a company must respond with strategic actions to protect its position. Competitive weakness on the part of one or more rivals may signal the need for a strategic offensive. A company's strategy should be tailored to fit industry and competitive conditions. The Mortgage Origination industry is providing the banking sector with a valuable opportunity to replace fixed costs with reduced variable costs whilst growing their mortgage books. Full service mortgage originators allow banks to significantly reduce infrastructure and salary costs, replace the need to maintain expensive distribution channels, as well as reduce variable costs as commission paid to originators are typically less than combined internal lead commissions and sales costs. Since the mortgage originator's core business is just that – originating mortgages – they are better equipped to generate higher business volumes as well as reduce the time it takes to place a new mortgage on the books, all of which directly benefits the bank and allows it to focus on improving its product offerings and service levels. The key to this win-win situation is the strong

partnership between the bank and the mortgage originator. While it has taken time for the banks to place the requisite degree of trust and reliance on mortgage originators, the four leading banks in South Africa have reaped the benefits of their partnerships with the mortgage originators. However, to achieve the optimum benefits from the outsourcing relationship, banks need to place an even greater degree of reliance on the originator so that duplication of functions can be completely removed from the process resulting in further cost savings and efficiencies. The focus placed on fast approvals by mortgage originators has also required banks to consider their own service levels and has challenged their thinking on process improvement, resulting in enhanced service levels both to their customers and mortgage originators. The inherent risk in this symbiotic relationship is the bank that makes use of the services of a mortgage originator but also continues to maintain its own costly infrastructure and distribution channels – effectively duplicating its costs. By paying commission to a mortgage originator, the bank should be able to significantly reduce the fixed cost component while increasing the variable cost component. By reducing infrastructure, banks are to some degree handing over their mortgage origination capabilities to the originator.

4.2.2 Usage gap

A company's strategy needs to be deliberately aimed at capturing its best growth opportunities, especially the ones that hold the most promise for building sustainable competitive advantage and enhancing profitability. Likewise, strategy should be geared to providing a defence against external threats to the company's well being and future performance. For strategy to be successful, it has to be well matched to market opportunities and threatening external developments; this usually means crafting offensive moves to capitalise on the company's most promising market opportunities and crafting defensive moves to protect the company's competitive position and long-term profitability. An important trend to emerge is the introduction of new technology in the form of call centres and the Internet. Alongside these recent massive strides in on-line

technology has been the increasing awareness and knowledge regarding the financial market place, amongst potential homebuyers. This in turn has led to the banks having to develop new products and add greater value to their current product offerings. Potential buyers demand better service and efficiency and show lesser degrees of loyalty to banks. Banks have to focus their attention on switching clients from other banks and trying to retain their existing clients.

The concept of mortgage broking is in its infancy in South Africa and a greater proliferation of broking companies will emerge in the market place, as the concept moves from its introductory phase through acceptance by the consumer and past its growth phase to maturity. Once the concept is established and has been accepted by the consumer in South Africa, we will see an aggregation of the proliferation of mortgage broking companies, through mergers and acquisitions into a few of the strongest companies.

While many competitors may see this as a threat, mortgage originators may be an opportunity for a bank to leapfrog the others and grab a greater share of the homeloan market.

Rightsizing, retrenchment and early retirement have induced many experienced business people to look for new opportunities in recent years, with the real estate and mortgage origination industries being major beneficiaries of the trend. The closure or scaling down of bank branches in recent times has made it difficult for borrowers in many towns to shop around for a home loan, but originators intend to fill that vacuum and to make use of local skills and expertise to do so. At the same time originators believe they can be of enormous assistance to local estate agencies and developers, by helping to secure home finance for their buyers and speeding up their transactions.

In America the boom in mortgage refinancing has sent banks scurrying to buy loan origination units. Large banks active in the field want to bolster their origination capabilities in order to replace loans in their servicing portfolios as consumers refinance, investment bankers and analysts said.

"The demand for mortgage companies, both originators and services, is the highest we've seen in years," said Jeffrey M. Levine, national director of investment banking at BayView Financial Trading Group, Miami.

An explosion in residential refinancing has fuelled the trend. With a strong bond market pushing mortgage rates to unusually low levels, many homeowners are trading old loans for new ones with lower monthly payments. Experts say the activity is rivalling the historic refinancing boom of the early 1990s. Some analysts said many small, independent companies would be better off selling, taking advantage of larger banks' interest in production. Both small and large banks are hungry for production because they want to increase their customer rosters and thus increase cross-selling opportunities and for smaller banks, increasing the customer base makes them more attractive targets. Even larger originators are seen as vulnerable

4.2.3 Sales gap

JA Weber (1977: 34-46) focuses on the gap between an organisation's sales potential and its actual performance. By forming an understanding of the current position and the potential of the market, the manager is in a position to analyse the gap between the two.

South Africans are not spoilt for choice when it comes to home loans. With all recent mergers and acquisitions, 90% of the country's R200 billion home loan market is now controlled by just four major commercial banks. NBS, which is estimated at being the sixth largest bank in the country behind Investec, has approximately 6% of the homeloan market. NBS market share has been declining in the last few years. NBS's view was that it would only use mortgage originators who were satisfied with lower commissions or commissions paid over five years. NBS's policy on commissions was one of the reasons it could offer some of the lowest home loan rates in the market. But it seems that NBS's stance backfired as mortgage originators simply took potential clients to other banks, which were prepared to pay higher commissions.

In Australia, although mortgage originators have been able to grow their market share over the last five years based on price differential between banks and themselves, price differential has contracted to a point where the banks are offering mortgage rates comparable, if not better, than mortgage originators. The key to the success of the mortgage originators in the past has now been removed as banks cut their net home loan margins further. Mortgage originators are thus faced with substantial new challenges and potential rationalisation of their industry.

4.2.4 External situation analysis

A company is constrained strategy wise by what is legal, by what complies with government policies and regulatory requirements and by what is in accordance with societal expectations and the standards of good community citizenship. Factoring in societal values and priorities, community concerns and the potential for onerous legislation and regulatory requirements is a regular part of external situation analysis. Intense public pressure and adverse media coverage make such a practice prudent. The task of making an organisation's strategy socially responsible means conducting organisational activities within the bounds of what is considered to be in the general public interest; responding positively to emerging societal priorities and expectations; demonstrating a willingness to take action ahead of regulatory confrontation; balancing shareholder interests against the larger interests of society as a whole; and being a good citizen in the community.

One of the best things about the advent of mortgage origination in South Africa is the boost it has given consumerism in the form of a greater awareness of how home loans are approved, granted and should be managed. Bond origination is well established in international markets, with roughly 80 per cent of people in the USA, Britain and Australia securing their bonds through mortgage originators. It's been around in South Africa for the past four years and is rapidly becoming the preferred option for many homebuyers. Bond originators are essentially the middlemen between the homebuyer and the banks. Prior to mortgage originators,

prospective homebuyers had to shop around for competitive transactions themselves, dealing with reticent consultants who represented the banks and thus had their interests skewed in favour of the lenders. In addition, consultants had limited power to negotiate, being restricted in the managers they could approach on the customers' behalf. This problem, combined with the sometimes-woeful service from many banks, created a gap in the market that bond originators fill. Mortgage originators obtain the client's financial information and then approach the banks to provide the client with a bond. Each bank has certain criteria that must be met to qualify for a bond, and even further criteria that could qualify the client for a discount on the interest rate. Deposits, client status and even educational background can all play a role and an originator's business is dependent on knowing which criteria are important to which banks. Unlike the average consumer, they can then negotiate the most competitive package from an informed position. It's important to note that originators do not play one bank off against another, forcing them to compete against each other only in terms of product, service and rate. The originator's role is to use its negotiating power, skills and knowledge of bank products and credit criteria to obtain the best deal for each individual client. Because originators operate independently of – and yet in tandem with – the banks, they can advise the client which of the available home loan products suit the clients needs. They handle all the administration, some even to the point of registering the bond, which makes the consumer's life easier. Originators are paid a commission from the bank that offers the client a home loan, in much the same way that banks have financial commitments to their own in-house consultants. The amount of commission varies, depending on the originator and the bank. As for the banks, originators offer them an additional, outsourced sales force that generate increased turnover. Commission costs are reduced, not only because banks are able to negotiate what they will pay, but also because there is a centralized invoicing process for commission that cuts administration costs. Service levels are higher because bond application forms are captured at source and then interfaced directly with the banks' credit scoring system. All of which means that the client scores.

An additional international trend to emerge is that of Government regulation. In the US, TEN federal laws, FIVE federal enforcement agencies, and over FORTY-FIVE State laws or licensing boards regulate mortgage brokers. Additionally, brokers typically have some type of Quality Control requirements and NAMB members adhere to a strict Code of Ethics.

4.3 Strategy and creative thinking in business

'Know yourself and conquer' is an old Chinese proverb. Creative thinking is vital if a business is to achieve surprise, gain a significant advantage or dominate a market. In an age where information flows more freely, the old maxim of 'Information is power' begins to look like a recipe for drowning in data. All the research in the world will not produce a successful strategy if it lacks the power to surprise. In today's information-rich society, when most competitors have access to key data, it requires ingenuity and creativity to deliver a 'break out' conferring strategic advantage.

Managers do not dispassionately assess what strategic course to steer. Their choices are often influenced by their own vision of how to compete and how to position the enterprise and by what image and standing they want the company to have. Both casual observation and formal studies indicate that managers' ambitions, values, business philosophies, attitudes toward risk and ethical beliefs have important influences on strategy.

The hold that mortgage originators, who act as middlemen between home buyers and mortgage lenders, have developed over banks in the past two years apparently contributed to NBS's loss on its home loan book. Bad debts and a considerable number of repossessed properties were among the reasons for NBS's losses. But some analysts reckon NBS's problems also resulted from it having made it unpopular among mortgage originators without realising how much impact these new players would have on the home loan market. It was no secret that Noel Young, former divisional director of NBS home loans, had little time for mortgage originators. NBS initially refused to pay 'exorbitant' one-off commissions to mortgage originators. Young told Finance Week that banks could

not afford the high one-off commissions demanded by most originators. NBS's view was that it would only use mortgage originators who were satisfied with lower commissions or commissions paid over five years. But it seems that NBS's stance backfired as mortgage originators simply took potential clients to other banks, which were prepared to pay higher commissions.

4.4 Conclusion

A company's strategy is the 'game plan' management has for positioning the company in its chosen market arena, competing successfully, pleasing customers and achieving good business performance. Good strategy and good strategy execution are the trustworthiest signs of good management. Competent execution of a well-conceived strategy is not only a proven recipe for organisational success, but also the best test of managerial excellence. Good strategy combined with good strategy execution does not guarantee that a company will avoid periods of par or even sub par performance. Sometimes it takes several years for management's strategy-making/strategy-implementing efforts to show good results.

To succeed in building a competitive advantage, a company's strategy must aim at providing buyers with what they perceive as superior value – a good product at a lower price or a better product that is worth paying more for. This translates into performing value chain activities differently than rivals and building competencies and resource capabilities that are not readily matched.

Investing aggressively in creating sustainable competitive advantage is a company's single most dependable contributor to above-average profitability.

"If we can know where we are and something about how we got there, we might see where we are trending – and if the outcomes which lie naturally in our course are unacceptable, to make timely change." Abraham Lincoln

CHAPTER 5 RECOMMENDATIONS AND CONCLUSION

5.1 Introduction

Porter argues that strategy is about doing things differently or doing different things from those which rivals do and being able to sustain that difference. From this viewpoint I will recommend the way forward for NBS by focusing on Porter's systematic search for relationships between an organizations external conditions and its internal strategies. Strategy involves making choices and is a conscious decision to be different. Industrial efficacy is a self-explanatory concept. It concerns what each business should in any event be doing. Porter says it's incredibly arrogant of a company to think it can deliver the same sort of product as its competitors and do better than them for long. That's especially true today, with the lightning speed of information and capital flows. It's particularly dangerous to depend on the incompetence of rivals, but that's exactly what you do if you concentrate only on industrial efficacy.

5.2 Competitors

Rivalry among existing firms intensifies when one or more feel pressure. Mortgage originators have increased the pressure on all the banks in South Africa. It is the adaptation to this pressure that will differentiate the competitors. Mortgage originators have provided NBS the opportunity to increase their volume of business it requires to compete with the other major players in the market. NBS has a reputation for being strong administratively and the proliferation of mortgage brokers provides the opportunity to source a large portion of the mortgage originators' business. It is in the preferential position of having a relatively small sales and administrative workforce which makes it capable of adapting easier than any of the other major banks in South Africa. Mortgage Originators provide banks access to a large volume of business, but the pre-requisites are streamlining of administration and downsizing of the sales force. Both pre-requisites pose cost-reducing benefits to the bank, which should be an

ongoing initiative of profit seeking companies. Mortgage originators allow banks the opportunity to outsource the entire sales function of mortgage loans. This, together with a technologically advanced and streamlined administration department, will result in higher profit margins in the long term even though mortgage originators are regarded as an expensive source of business. It is presently regarded as expensive because most, if not all, banks are maintaining their current cost structures and also want to source business from mortgage originators. This results in duplication of functions and costs. Forming solid business relationships with the pioneers in mortgage origination industry gives NBS the competitive edge over its competitors who are still investigating and procrastinating over the long-term existence of these companies. This similar trend occurred in Australia and the USA where originators now have between 50% and 70% of the residential market. Whilst the other banks in South Africa contemplate forming business relationships with mortgage originators, NBS is capable of redesigning its entire mortgage loans division to suit the needs of mortgage originators in anticipation of South Africa following the trend of Australia and USA. This may be risky, but it is a calculated risk. This should also fit in with the NBS strategy of being innovative.

What is not good news, in the short to medium term, from the financial institutions viewpoint is that mortgage broking is here to stay. In addition, logic dictates that from the consumer's perspective, in its international form, mortgage broking would play a significant role in the mortgage lending process and the overall economy by increasing competition, service levels and driving down costs.

The good news in the long term for the financial institutions in SA is that once an expansive mortgage broker network has been established, this would allow banks of all sizes to gain a national presence without incurring the great expense of national advertising and maintenance of branch offices, which would lead to consequent reductions in fixed and wasted costs. In addition, they would, be able through outsourcing their mortgage origination business, to concentrate on their

core business and benefit from an efficient administration service with regards to mortgage origination.

5.3 Social conditions

What an organisation can and cannot do strategy wise is always constrained by what is legal, by what complies with government policies and regulatory requirements and by what is in accord with societal expectations and the standards of good community citizenship. Factoring in societal values and priorities, community concerns and the potential for onerous legislation and regulatory requirements is a regular part of external situation analysis. Intense public pressure and adverse media coverage make such a practice prudent. The task of making an organisation's strategy socially responsible means (1) conducting organisational activities within the bounds of what is considered to be in the general public interest; (2) responding positively to emerging societal priorities and expectations; (3) demonstrating a willingness to take action ahead of regulatory confrontation; (4) balancing stockholder interests against the larger interests of society as a whole; and (5) being a good citizen in the community. Mortgage originators are seen as the people's champion. They are exploiting the concept that they are able to negotiate with the different banks and provide their clients with the best deal. By not embracing the originators, the banks are alienating themselves with companies that seem to be working in the best interests of the community.

Bond originators are essentially the middlemen between the homebuyer and the banks. Prior to mortgage originators, prospective homebuyers had to shop around for competitive transactions themselves, dealing with reticent consultants who represented the banks and thus had their interests skewed in favour of the lenders. In addition, consultants had limited power to negotiate, being restricted in the managers they could approach on the customers' behalf. This problem, combined with the sometimes-woeful service from many banks, created a gap in the market that bond originators fill. Mortgage originators obtain the client's financial information and then approach the banks to provide the client with a

bond. Each bank has certain criteria that must be met to qualify for a bond, and even further criteria that could qualify the client for a discount on the interest rate. Deposits, client status and even educational background can all play a role and an originator's business is dependent on knowing which criteria are important to which banks. Unlike the average consumer, they can then negotiate the most competitive package from an informed position. It's important to note that originator's do not play one bank off against another, forcing them to compete against each other only in terms of product, service and rate. The originator's role is to use its negotiating power, skills and knowledge of bank products and credit criteria to obtain the best deal for each individual client.

NBS may prove their social responsibility by embracing the originators by and acknowledging their role of serving the community. The bank could focus on their core function of processing bond applications and providing innovative products and services. Time and money that was spent in the past on the sales function can be re-directed towards mortgage originators in order to receive the bulk of their business. NBS may then be viewed in the community of being a partner to companies that are looking after the interests of the consumer.

5.4 Technology

Advances in technology can dramatically alter an industry's landscape, making it possible to produce new and/or better products at lower cost and opening up whole industry frontiers. Technological developments can also produce significant changes in capital requirements, minimum efficient plant sizes, vertical integration benefits and learning or experience curve effects.

Different businesses have technology fit when there is potential for sharing common technology, exploiting the full range of business opportunities associated with a particular technology or transferring technological know-how from one business to another. Businesses with technology-sharing benefits can perform better together than apart because of potential cost-savings in technology development and new product R & D because of shorter times in getting new products to the market, important complementarities or

interdependence between the resulting products that leads to increased sales of both and the technology transfer potential between businesses allows more effective or efficient performance of technology-related activities.

NBS recently spent R35 million on new technology to process bond applications. This investment allows the entire sales and administration functions to be streamlined and efficient. However this was designed to cater for the current structure and sales force. The mortgage origination companies are investing huge sums of money on new technology to assist in electronic submission of bond applications to the banks. NBS is in a favourable position to share common technology with the originators, thereby exploiting the full range of business opportunities associated with this technology. It would be the first bank to form this type of relationship and would therefore become a trendsetter, forcing other banks to invest in technology and follow their example. Comcorp, an IT service provider, is currently developing IT software to allow originators to interact with the banks. NBS would be the first bank to use this software because all the other major banks have recently expressed their desire to upgrade their current systems to cater for electronic applications. NBS already has this capability.

Whilst the other banks restructure and start building relationships with originators, NBS may be at an advanced stage where technological synergies may distinguish them from others. Being a market leader at this stage may give NBS the edge over a long period as banks and originators will continuously look at improving their existing relationships. There could be joint ventures in the introduction of technology. This may further alienate banks that are slow to build relationships with the major players in the mortgage origination industry.

"Online mortgage brokers in the US already do US\$10bn in loans and Goldman Sachs predicts a compound annual growth rate of 97% to 120bn and 22% of the US market by 2003. Mortgages will then be the biggest broking business on the Internet.

SA start-ups are hoping to get the same results. In a growing housing market, 22% could be as much as R5bn in SA Web business in just a few years from now. "

Source: Financial Mail - 03 September 1999

On the assumption that SA will follow international trends, what is clear from the above statistics is that mortgage broking will in the future become part of the SA mortgage loan landscape. The mortgage loan industry will eventually become disintermediated, much in the same vein as the insurance industry, where the insurance underwriters deal with their clients through insurance brokers.

5.5 Political climate

Currently there are no rules and regulations governing mortgage originators. Meetings are planned for the new, large origination companies to form a governing body called the National Association of Mortgage Originators (NAMO). This provides further evidence of mortgage originators following the trend of the international markets..

In the US, ten federal laws, five federal enforcement agencies, and over forty-five State laws or licensing boards regulate mortgage brokers. Additionally, brokers typically have some type of Quality Control requirements and NAMB members adhere to a strict Code of Ethics.

It is clear that in SA, the Government will at some stage in the future eventually step in and regulate the mortgage loan industry in order to protect the homebuyer from unscrupulous operators.

The South African Reserve Bank is also playing its part in the industry by regulating the repo rate which impacts on the rate that the banks borrow money from the Reserve Bank and lend money to their clients. The high interest rates stifle demand for home loans while low interest rates increases the demand. A stable repo rate creates certainty in the market and people are therefore not reluctant to purchase home and take mortgage bonds. A booming market allows the proliferation of mortgage originators. The Reserve Bank also set rules and regulations regarding the amount of risk a bank is allowed to take. A risk weighting principle is applied if a bank grants loan to individuals who have little or no deposit.

5.6 Suppliers

From the banks perspective, mortgage originators are regarded as suppliers. The suppliers to a group of rival companies are a strong competitive force whenever they have sufficient bargaining power to put certain rivals at a competitive disadvantage based on the prices they can command, the quality and performance of the items they supply or the reliability of their deliveries. Suppliers are also more powerful when they can supply a component more cheaply than industry members can make it themselves. The bargaining position of suppliers is strong until the volume of parts a user needs becomes large enough for the user to justify backward integration into self-manufacture of the component. The more credible the threat of backward integration into the suppliers' business becomes, the more leverage users have in negotiating favourable terms with suppliers. There are other instances in which the relationship between industry members and suppliers is a competitive force. One is when suppliers, for one reason or another, cannot provide items of high or consistent quality. A second is when one or more industry members form close working relationships with key suppliers in an attempt to secure to secure lower prices, better quality or more innovative components, just-in-time deliveries and reduced inventory and logistics costs. Such benefits can translate into competitive advantage for industry members who do the best job of managing their relationships with key suppliers.

Currently, in South Africa, different mortgage brokers are on varying commission structures and are therefore not unbiased and are steering potential buyers to the banks they feel the most comfortable with and that offer them the best commission. The originators also claim to steer clients to the bank that offer the best service. As this is a commission driven industry, the originators are likely to supply most of their business to institutions that are capable of registering their bonds in the quickest possible time thereby enabling them to receive their commission as soon as possible. Forming excellent working relationships with these suppliers of business results in a win-win situation for both players. The key is to manage the relationship well. NBS has the technology, procedures,

human and other resources to build and maintain the relationship with the originators. Backward integration should not be ruled out either. With over 100 knowledgeable and trained loans consultants it would not be difficult to form a mortgage origination company with the current sales staff who would then supply all their business to NBS. According to an approach made by Saambou representatives to NBS, this was a strategy being contemplated already by other banks.

A recent independent report by international investment bank, JP Morgan, suggests that full service mortgage originators allow banks to significantly reduce infrastructure and salary costs, replace the need to maintain expensive distribution channels, as well as reduce variable costs as commissions paid to originators are typically less than combined internal lead commissions and sales costs. In addition the report suggests that since the mortgage originator's core business is just that – originating mortgages – they are better equipped to generate higher business volumes as well as reduce the time it takes to place a new mortgage on the books, all of which directly benefits the bank and allows it to focus on improving its product offerings and service levels. The key to this win-win situation is the strong partnership between the bank and the mortgage originator.

“The focus placed on fast approvals by MortgageSA.Com has required Standard Bank to consider their own service levels and has challenged their thinking on process improvement, resulting in enhanced service levels both to their customers and to MortgageSA,” said Tony Ketcher, the general manager of home loans at Standard Bank.

Further research needs to be conducted.

5.7 Conclusion

“On the one hand, strategic intent envisions a desired leadership position and establishes the criterion the organisation will use to chart its progress. The concept also encompasses an active management process that includes focusing the organisations attention on the essence of winning; motivating people by communicating the value of the target; leaving room for individual and team contributions; sustaining enthusiasm by providing new operational definitions as circumstances change and using intent to consistently guide resource allocations (Hamel and Prahalad 1989:64 as cited in Mintzberg et al (1998).

According to Mintzberg et al (1998) stretch is defined by Hamel and Prahalad as “ a misfit between (a firms) resources and (its’) aspirations”. Some organisations have ample resources but lack aspirations, on the other hand there are organisations that are driven by high aspiration but have meagre resource bases. Hamel and Prahalad propose that leveraging a limited resource base can be done in various ways; by concentrating resources more effectively around a strategic focal point, by accumulating resources efficiently, complementing one resource with another, conserving resources wherever possible and recovering resources from the marketplace in the shortest possible time.

In Hamels’ recent writings, he has argued for “strategy as revolution” According to Norton & Irving (1999), Hamel believes that to be successful in the modern organisational environment, strategy must not only be different from what has gone before but also be revolutionary.

Hamel, like Mintzberg, argues that strategic process has become too ritualistic, based on rules, and driven by the calendar.

“Opportunities for innovative strategy don’t emerge from sterile analysis and number crunching – they emerge from novel experiences that can create opportunities for novel insights” (Hamel, 1997,32 cited in Mintzberg et al, 1998).

For strategy to be revolutionary it must:

- Be subversive by ignoring industry conventions and aiming to be unique
- Actively promote change, not simply be carried along with it

- Let everyone have a voice, so that the new and young as well as the tried and tested are part of the process.
- Take risks because we cannot predict the future with any certainty.

Hamel argues that it is usually senior managers who are the staunchest defenders of the status quo although they have the greatest experience they have the greatest investment in the past.

He defines a new role for senior management, which should:

- Sponsor thinking about change and discontinuities
- Consider all new ideas openly and honestly
- Get involved in the learning process by casting off the mantle of omniscience
- Foster entrepreneurship and participate in creative process as team members, not just team leaders.

Hamel's "myths" of conventional wisdom appeared in a cover story June 23, 1997 edition of Fortune magazine.

Industry analysis is the key to strategy – The rule breakers know that it is increasingly difficult to define precisely where an industry begins and ends. "What industry are you in?" is becoming harder and harder to answer.

You should focus on your direct competitors. The rule breakers know that rivalry is not as simple as it used to be. For many companies today it is harder to distinguish competitors from collaborators from suppliers from buyers.

In Strategy it is you against the world. Today's smart leaders understand that it's difficult to know where the boundaries of the firm begin and end – temporary workers, outsourcing and long term supply relationships are now the norm. The radical strategy that leads to true innovation becomes substantially more complex in a world where the firms don't directly control the assets critical to its success (Richard Pascale cited in Mintzberg et al, 1998).

Pascale proposes that in order to be successful, organisations must undergo perpetual and radical change. His belief is that companies should not merely seek improvement but that those that do not seek to reinvent themselves will be overtaken by those that have.

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