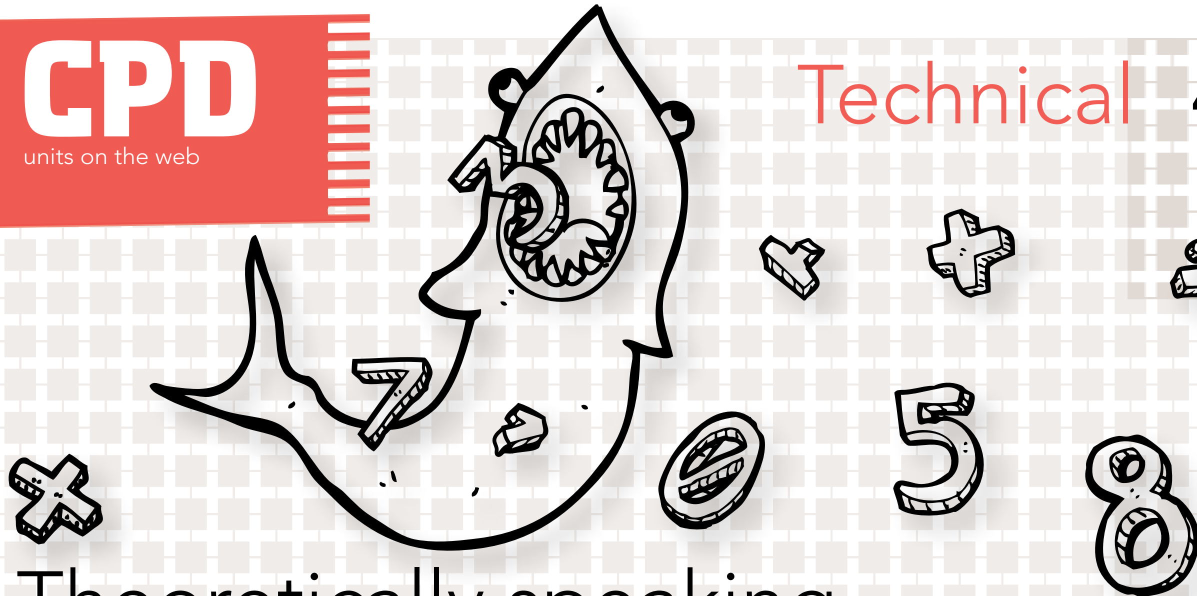


Theoretically speaking

In the first of a series of five articles on management theories, **Dr Tony Grundy** looks at the role these theories play generally, before kicking off with competitive strategy theory

Accounting is merely one strand of the management of any business, and there are many others, including strategy, marketing, economics, operations, technology and organisation. While the training of accountants increasingly looks beyond the narrower borders of accounting, it is still not as broad as, say, an MBA.

Most business issues and problems have many dimensions and can be looked at from a variety of perspectives. Management theories can help us to open up the ways in which we see things: it can thus be both important and useful to draw from such theories to solve problems.

An example of an earlier theory in performance management was financial ratio analysis. In the 1970s, the conglomerate GEC in the UK practised a tight system of financial control based on a hierarchical series of financial ratios that are still a key part of management accounting today. Ratios such as return on capital employed (ROCE) put great emphasis on conserving capital and helped produce efficiencies.

For well over a decade, GEC was very successful financially until its markets and products were in late maturity and in decline, not helped by tight capital constraints that inhibited renewal.

This example is useful because it highlights the need to be eclectic in the use of management theories, and also because a theory may cease to apply as the situation changes.

MOST BUSINESS ISSUES AND PROBLEMS HAVE MANY DIMENSIONS AND CAN BE LOOKED AT FROM A VARIETY OF PERSPECTIVES

The theories

We explore some of the most prevalent and informative theories in this series of five articles. The theories are grouped as follows:

* *strategic* – already partially covered in a five-article series in *Accounting and Business* last year (available at www.accaglobal.com/abcpd) and now developed more here;
* *performance management*, eg the balanced scorecard;
* *knowledge-based*, eg brainstorming, systems thinking;
* *operations management*, eg Six Sigma, lean management;
* *leadership*, eg organisational transformation.

First let us take a brief look at the role that management theories play in business, and the issue of whether they always add value or not. In my own management career of over 30 years, I have seen the rise, maturity and sometimes the decline of theories such as:

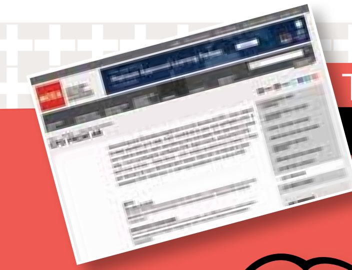
* total quality management (TQM);
* business process re-engineering (BPR).

Many CEOs and management teams believe that theory is a panacea for an organisation's issues and offers quick fixes. They seem to believe that they can be applied like a paint roller and that as long as there is a superficial effect, then that is good enough. But these theories come and go, and we need robust, sustainable management theories instead, which are elusive.

For instance, in my research for these articles I came across a rather interesting paper on management theories, *Bad Management Theories are Destroying Good Management Practices*, by Sumantra Ghoshal, a one-time management guru. Ghoshal suggests that there can be a strong element of faddism in management theory and that this can lead to malpractice. He blames business schools for putting out these management products without sufficient empirical testing to ensure they do what they are supposed to do.

In particular, Ghoshal criticises the naive adoption of theories from the traditional natural sciences which are based on very deductive thinking. For instance, in BPR organisational inflexibility is attributed to business process complexity and is curable with a series of techniques of process-simplification, badged 're-engineering'.

He suggests that such overly



GET VERIFIABLE CPD UNITS
Answer questions about this article online
Studying this article and answering the questions can count towards your verifiable CPD if you are following the unit route and the content is relevant to your development needs.
One hour of learning equates to one unit of CPD

TO GET THE QUESTIONS GO TO
➔ www.accaglobal.com/abcpd

mechanistic theories really do not do justice at all to the fact that any management issue is embedded in a very rich context. Thus, generic treatments alone through a single, set-piece management framework are unlikely to be effective. Indeed, in the wrong hands and with inexperience they could be positively dangerous.

I agree totally with Ghoshal, who sadly is no longer with us. Incidentally, I do remember that about 10 years ago I was doing a strategy lecture on a US company, broadcast live globally by satellite. You couldn't see your audience, but the audience could see you. Ghoshal had done the talk before me. He had arrived to be told that the organisational issues he thought existed didn't really apply: he tore up his talk and spent the entire night redoing it to focus on the real ones; that was a man after my own heart. He did look ragged the next day though!

Strategic thinking

Coming back to our first set of theories, strategic theory, in the series of articles last year we made the general points that:

* strategy is about how you move from where you are now to where you wish to be in the future;
* that move needs to be innovative and something that could be characterised as 'a cunning plan';
* to develop an effective strategy, one needs to know where one is now (strategic positioning) and also to develop some key strategic options to get there;
* this should not be arrived at just by brainstorming, but by a more systematic look at the different 'degrees of freedom' or 'lines of enquiry' in order to open up many more strategic options;
* these options should be evaluated systematically using clear and predefined decision criteria (eg the Strategic Option Grid).

AS SOMEONE SAID OF SCENARIO STORYTELLING: 'WHY THINK ABOUT THE FUTURE? BECAUSE WE ARE GOING TO SPEND THE REST OF OUR LIVES IN IT'

Three kinds of strategy theory

The rest of this article will now look at:

* competitive strategy theory;
* blue and red ocean theory;
* scenario theory and game theory.

Competitive strategy is a term first coined in 2008 by Harvard professor Michael Porter, who was an economist. In his work *Competitive Strategy*, Porter looked at a number of different industries and their structures and found that some were inherently more profitable (and thus attractive) to be in than others. He identified five 'forces' that were the key indicators of superior performance:

* the bargaining power of the buyers, ie customers;
* entry barriers;
* competitive rivalry;
* substitutes (products or services);
* supplier power.

We introduced these in the article *Unpeel your competitive onion* last year, but now develop further.

Where these forces are favourable, it generally increases operating profit margin, ROCE and economic value added (see last year's articles on strategy for more on EVA). So in determining strategy it is crucial to look at the five forces past, present, and future. Other things being equal, one should migrate out of markets or areas of a market that do not look attractive or which are worsening, vis-à-vis Porter's five indicators.

Multicoloured oceans

In 1985 Porter's second major work (both of which still rank as classics) was *Competitive Advantage*. Here he addresses the issue that 'other things are not equal', especially companies' competitive positions. Porter's two books thus highlight two key variables that determine strategic position (past, present, and future):

A 'inherent market attractiveness' – mainly the five forces;
B relative competitive position.

Roughly speaking, strategic attractiveness = A plus B, or the sum of these two variables.

This is interesting to accountants because strategic attractiveness is a strong indicator of ROCE longer term. HMV would be a graphic case of a business failure waiting to happen on account of these two factors becoming seriously adverse.

Later theorists have tried to surpass Porter's forces by suggesting that the best strategy should be to bypass competitive intensity altogether through identifying market opportunity where there is uncontested space. Quite simply, these are markets where either 'no one is doing it' or 'no one is doing it well', often in an emergent state. Craftily, these are called 'blue oceans' to suggest clear space, in contrast to 'red oceans' (*Blue Ocean Strategy*, Kim and Mauborgne), which are mature markets with lots of sharks and blood. This simplicity appeals to many managers.

This colour analogy may seem catchy and appealing, but where exactly is this new space to be found? Maybe 5–10% of the economy at best is of that nature, so for the majority of us that isn't very helpful. And isn't much of that idea already wrapped up in the notion of the 'cunning plan' that I emphasised last year,– for example, through finding new and clever ways to compete?

Having just two market states also seems a rather crude division. Indeed, in my book, *Demystifying Strategy*, I suggested three other oceans: green, brown and black:

* green: new markets, old forms of competing;
* brown: mature markets, aggressive players, profitable;
* black: perfect competition in contracting market conditions (HMV-land!).

So what kind of market is your business in: blue, green, brown, red or black – and does your strategy deal with it well?

Again, it is necessary to be watchful of oversimplifications of reality in management theory.

Scenarios and game theory

The final branches of strategy theory are scenarios and game theory.

Scenarios are simply self-consistent storylines of the future. They are not projections, but focus on market dynamics, such as new entrants, changes in regulations, product maturity, and shifting methods of competition and distribution.

Scenarios are useful for planning over the horizon; for instance, to help support cashflow projections for long-term business valuations (eg for terminal value). Without them, there should be real concerns around sustainable shareholder value creation.

Scenarios are constructed around:

* assumptions about the future, particularly those that are very uncertain or of high importance and thus unstable;
* particular events that take you from one state of the world to another – the transitional events;
* storylines with a chain of events and a cause-and-effect process;
* role-playing.

In the case of role-playing, this brings in game theory, which combines economics and maths through probabilities and payoffs. For example, one might well need to imagine oneself as a new entrant to the market, or the regulator, or maybe as a key customer, and one by one, the key competitors in the market. Here one has to imagine actually being those competitors.

Without going overboard on the maths, one can actually get some very interesting insights from scenarios – especially ones informed with very simple role-playing from game theory.

If you want to learn more, see my *Demystifying Strategy*, particularly on the scenario dealing with the next London riots – suitably updated for new organisational strategies and tactics by the rioters! I did take the precaution of sending this to the Met police.

As someone once said of scenario storytelling: 'Why think about the future? Because we are going to spend the rest of our lives in it.'

So maybe we should account for that management theory at the very least.

Dr Tony Grundy is an independent consultant and trainer, and lectures at Henley Business School
www.tonygrundy.com