

Strategy Formulation Supplement to the Change Integration Methodology

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Overview

Introduction to the Strategy Formulation Supplement

This document presents information supplementary to the Change Integration methodology, the Price Waterhouse approach to planning and implementing significant business transformation and change.

This section outlines the fit of the Strategy Formulation Framework with Change Integration. It provides a high-level overview of Change Integration, including its levers of change, and shows how the Strategy Formulation Framework forms a key aspect of Change Integration.

What Is Integrated Change?

One of the most important challenges in today's business environment is implementing change successfully to enable performance improvement. Performance results from complex interactions between people; these interactions are guided by strategy, affected by culture, and embedded in business processes, organisations, technologies, and infrastructure. To change performance requires changing how people work and interact, using what Price Waterhouse describes as the levers of change:

- The strategic levers: markets/customers and products/services;
- The organisational levers: people/culture and organisation;
- The process or operational levers: processes and information systems/technologies.

The levers of change provide a framework for understanding - and changing - what underlies performance and produces results in today's complex enterprise. While any one of these levers of change can be the driver of a project, any large-scale, transformational change project requires attention be paid to all the levers for change in an integrated manner for implementation to be successful and for performance to improve.



Figure 1: Levers of Change

As a result, the Change Integration methodology is designed to guide an enterprise through the

As a result, the Change Integration methodology is designed to guide an enterprise through the change project tasks and transition management activities needed to successfully implement integrated change, explicitly using all levers:

- **Markets and customers.** The need to undertake a change project frequently begins with the decision to participate in different market segments, or the necessity to respond to changing market requirements and needs in the existing customer base. Change Integration includes a strategic diagnostic and tasks for careful evaluation of market and customer requirements, to assure changes are planned based on the voice of the customer and the overall market dynamics. Changing market requirements and customer needs - once understood - become the driver of change throughout the enterprise, bringing the rest of the levers into play.
- **Products and services.** Both changing external customer requirements and internal capabilities can lead to new or improved products and services. Innovation in product or service design requires equal innovation in the enterprise to develop the capability to deliver on product and service promises. As with markets/customers, changes in products and services inevitably cause a ripple effect across the other levers.
- **People and culture.** The change drivers an enterprise faces may mean the enterprise needs people with different capabilities, and a different culture sending new signals about how work is done and what the enterprise is all about.
- **Organisation.** An organisation restructuring is where many companies start the change process, but too many stop there. Change in the other levers does require the enterprise to change how it organises people to do work, but beyond the organisation chart, attention needs to be paid to other key organisational elements, including roles and responsibilities, performance measures, incentives and rewards, management style, and work group structures.
- **Processes and systems.** Process redesign is another common starting point for large-scale change projects; Change Integration includes a proven, customer-based, results-oriented approach to transformational process change. However, too many redesigned processes never get implemented. Change Integration's focus on integrated change implementation and transition management ensures that processes are redesigned with an eye to implementation and stakeholder involvement and acceptance, thereby enabling better results. Redesigned processes provide an input to organisation restructuring, information system design, even definition of new cultures and capabilities.
- **Technology.** Since many key process flows and operations are embedded in legacy information systems and information technologies, most large-scale transformational change projects involve some degree of IS/IT. Change Integration contains tasks for assessing the need for and defining IS/IT changes, and is linked to Price Waterhouse's proprietary System Development/System Management Methodology (SD/SMM) volumes for system planning, design and implementation for projects where the IS/IT change driver is paramount.

What Is the Focus of the Strategy Formulation Supplement?

A necessary foundation of successful change is the existence of an appropriate and clearly articulated business strategy. Change Integration includes a strategy diagnostic to test the appropriateness of the current business strategy. However, this diagnostic does not validate the strategy or result in changes to that strategy, if required; such changes require a full-scale strategy formulation effort, including situation assessment, strategy development and implementation planning. Thus, a significant review of enterprise strategy, which may be prompted by the results of the strategy diagnostic, encompasses a different aspect of Change Integration and is the focus of this Strategy Formulation Supplement.

The Strategy Formulation Framework outlined in this document addresses in detail the strategy levers of change — defining "where to compete" (specifying which markets and customers), and "how to compete" (specifying what products and services to offer those markets).

Objectives and Flow of a Strategy Formulation Project

A strategy formulation project specifically addresses the following strategic questions:

- Where should the enterprise compete? and
- How should the enterprise compete?

Both internal and external changes can lead an enterprise to revisit the answers to these questions, i.e. to question the current business strategy itself:

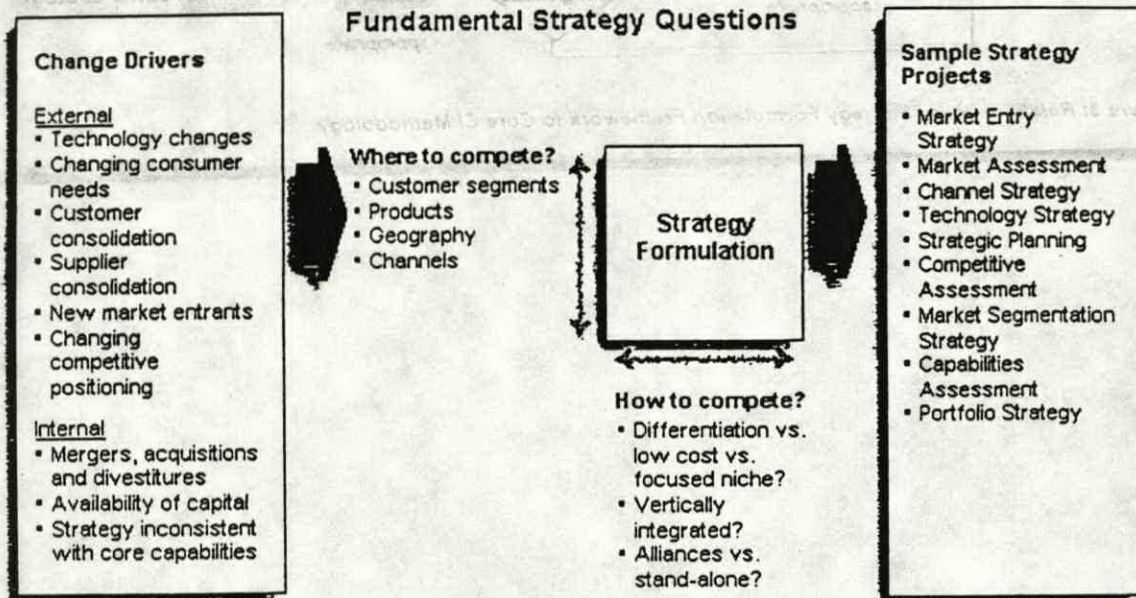


Figure 2: Focus of Strategy Projects

The Strategy Formulation Framework presented in this Strategy Formulation Supplement outlines Price Waterhouse's approach to answering these two strategic questions. The framework presents the overall approach and the key tools that may be used in a Strategy Formulation project. This framework provides the basis for **situation-specific tailoring** of a strategy formulation project to the specific issues facing the enterprise; thus, the approach is customised to each situation. The specific issues faced by the enterprise determine which steps in the approach will be the focus of the project. *This is termed an issues-driven approach.*

This document is defined as a supplement to the Change Integration Methodology because a detailed strategy formulation effort is not needed in every situation; nor must strategy be redefined in every CI project.

As shown in the graphic below, the Strategy Formulation Supplement focuses on the first two Phases in the Strategy Formulation Framework (Situation Assessment and Strategy Formulation) and shows how the transition to other implementation projects takes place.

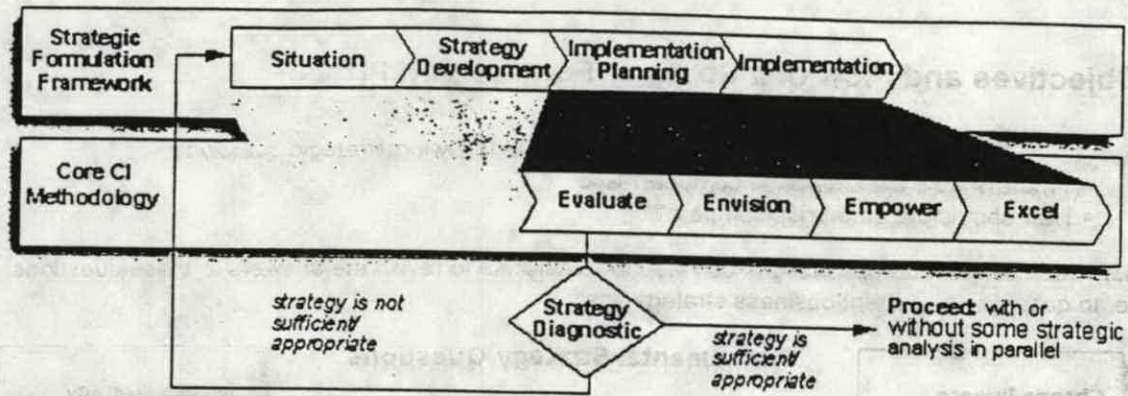


Figure 3: Relationship of Strategy Formulation Framework to Core CI Methodology

Strategy Formulation Supplement Users

The Strategy Formulation Supplement serves two user groups; it provides a uniform framework to professionals specialising in strategy assessment and development, and insight into strategic principles and terminology for core change implementation and business management professionals.

For Strategic Change practitioners, the Strategy Formulation Supplement establishes a basic workflow for Strategy Formulation, focusing on Situation Assessment and Strategy Formulation, including key project steps, and encompassing most activities and analysis types. The Supplement:

- Outlines the purpose, operation and application of key tools;
- Captures a common understanding and the language of strategy work;
- Supports day-to-day practitioner knowledge transfer and training; and
- Provides project planning guidelines and support.

For core Change Integration and business management professionals, the Strategy Formulation Supplement:

- Shows the fit of Strategy Formulation within CI;
- Provides an understanding of
 - Type of work conducted by strategy practitioners,
 - Language used in Strategy Formulation; and
- Supports credentialing of strategy work with internal and external audiences.

Organisation of the Strategy Formulation Supplement

The Strategy Formulation Supplement outlines the framework of key Tasks and activities typically adopted in a strategy formulation project. This supplement is contained in a single document with three sections: Overview, Baseline, and Appendices.

- The **Overview** (this section) provides a high-level guide to the Strategy Formulation Supplement and introduces the key concepts and techniques of the Strategy Formulation Framework.
- The **Baseline** provides a more detailed discussion of the Strategy Formulation Framework and outlines many of the key analyses used in executing a strategy formulation project.
- The **Appendices** include descriptions of the Strategy Analysis Tools, several cases to illustrate key components of strategy formulation, a bibliography and a non-disclosure agreement.

While the Strategy Formulation Framework is not a formal methodology, it uses the organisational hierarchy of activities found in the CI and SMM volume structure to facilitate understanding of the framework by professionals accustomed to the CI and SMM methodologies, as outlined below:

- **Stages:** groupings of related Phases that define the main activities completed in a project;
- **Phases:** groupings of related Tasks that are accomplished to produce a deliverable. Phase deliverables document the work completed and provide the means for quality and schedule monitoring;
- **Tasks:** individual work steps that describe what needs to be done to complete the work outlined in the Phase. Typically, a completed Task results in an interim work product; as a result, it is at the Task level that projects are planned. A combination of work products make up the Phase deliverable; and
- **Steps:** the lowest level in the hierarchy. For each Task, a series of steps is defined. These steps outline how to accomplish the Task.

Strategy Formulation Outputs

Each project Phase produces both interim outputs and deliverables.

- Interim outputs are internal project team documents that support and mark progress toward deliverables. Sometimes interim outputs are shown outside the project team for review by management and others to ensure their accuracy and maximise buy-in.
- Deliverables are provided to the enterprise for approval and buy-in and are the project's formal documents. The major deliverables are:
 - At the end of Phase SF/A - **Situation Assessment**, a formal deliverable providing an overview of the key market segment(s) and their attractiveness (including profiles of target customer characteristics and needs), and assessment of enterprise strengths and weaknesses relative to its competitors (including relative internal competencies and capabilities and financial performance).
 - At the end of Phase SF/B - **Strategy Formulation**, a formal deliverable summarising the strategic options considered, the strategy selected, and the selection rationale, including evaluations of the strategy's potential financial returns, ease of implementation, likelihood of success and risk profile. Ultimately, this Phase delivers a consistent strategy statement, defining where and how the enterprise will compete.
 - At the end of Phase SF/C - **Implementation Planning**, a deliverable summarising the key activities and resources required to implement the strategy, including critical success factors required for execution, the core capability requirements, and a high-level analysis of organisational changes required, including technology, process, competencies, culture and organisational structure changes.

Creation and use of all project outputs and deliverables are highly dependent on enterprise needs and requirements, and hinge on the level of communications required to secure appropriate buy-in.

Critical Success Factors for Strategy Formulation

A strategy formulation project represents a significant opportunity for the enterprise to improve its performance, either by altering its approach to a particular market, entering a new profitable market, or exiting an unprofitable market. To ensure the enterprise makes the most of the opportunities it has for strategic change, strategy formulation project teams must keep the following critical success factors in mind:

- Use appropriately credentialed and experienced strategic change professionals to lead the strategy formulation effort;
- Include appropriately credentialed and experienced industry and/or functional experts on the project team to ensure an understanding of key industry/market and operational issues likely to impact strategy formulation;
- Selectively include other CI professionals on the project team to ensure a holistic approach to change and a smooth transition to subsequent CI projects for implementation;
- Ensure senior management sponsors the project, understanding and supporting the scope and desired outcomes of all project Tasks; and
- Ensure the project team uses fact-based analysis that includes both internal and external research.

Because of the enterprise- and market-specific nature of each strategy formulation project, it is crucial that the project be led by strategic change practitioners experienced in the issues-driven approach and analysis techniques used in assessing the current situation and devising a reasonable and successful strategy. The involvement of industry and functional experts, and other CI practitioners, is also crucial to ensure that industry-specific and operational perspectives are captured in the analysis, and that the project transitions smoothly to other CI projects.

Senior management sponsorship and involvement is also critical to the success of a strategy project. If the strategy implementation is to be successful in altering the approach of the enterprise to its primary market or entering a new market, senior management must be in complete agreement with the results of the strategy formulation project.

Quality Management in Strategy Formulation

The primary goal of quality management is to deliver high quality, high value products and services on time, within budget, that meet or exceed customer expectations. This is achieved through the use of appropriately credentialed and highly trained staff who fully understand the requirements of the enterprise and who use sound working practices that have been proven successful. Quality management must be built into strategy formulation projects through careful planning and ongoing reviews. On all projects, careful consideration should be given to:

- **Project sponsor.** At the outset of each strategy formulation project, a project sponsor should be identified with the authority to agree on project requirements and to approve acceptance of deliverables. Given the considerable impact that a change in strategic direction has on an enterprise, the primary sponsor of a strategy formulation project must be very senior company management and should be heavily involved throughout the project. Senior management should be involved in progress reviews, interviews, presentations, workshops and formal checkpoints to ensure their buy-in to a new strategic direction.
- **Scope control.** Scope definition and control is critical to the success of a strategy formulation project. It is essential to have a clear definition of requirements and an agreed understanding of the responsibilities of enterprise team members, the project team and management. The first Task of Phase A, Hypothesise Key Issues, is designed to ensure that the critical strategic issues facing the enterprise are identified and discussed before the work plan and analysis plan are completed. The project scope and work plan are the primary outcome of this Task. As the focus of the analysis continues to evolve during the course of the project, scope changes should be carefully assessed to determine their impact on timeframes, costs and resource requirements. Formal management approval to proceed with a revised scope must be obtained.
- **Written contract/agreement with enterprise.** In situations where Price Waterhouse provides strategic consulting services, obtaining a written agreement regarding the nature and outcome of the work to be conducted during a strategy formulation project is extremely important. Because a change in strategic direction resulting from such a project can dramatically impact the financial performance of the enterprise, it is critical to get agreement in writing regarding the output of the project, the use of and reliance on project deliverables and management's acceptance of decision-making responsibility after receiving the project team's recommendations. Negotiating a written agreement helps clarify understanding of the project's scope and objectives while protecting Price Waterhouse by allowing risk disclaimers and management. Concerns regarding a written contract/agreement or the issues to be addressed in the contract should be discussed with Price Waterhouse legal counsel prior to submitting a draft contract/agreement to the enterprise.
- **Risk management.** An assessment of the risks associated with undertaking the project should be completed at project funding and/or during completion of the project. The objective of risk management is to identify an acceptable balance between performance, cost and timeframe. Having identified potential threats, contingency plans should be established for risks that cannot be removed or contained. Throughout the assignment, risks should be monitored and regularly reassessed.
- **Third-party contracts.** All projects conducted by a third party organisation should be covered by a formal contract or letter of indemnity. These are required to protect the position of the enterprise and address areas of possible contention (e.g., payment for delays caused by management's actions).
- **Deliverables.** A full list of all deliverables to be produced during and at the end of the assignment should be established, together with any known milestone dates. The proposed

- **Deliverables.** A full list of all deliverables to be produced during and at the end of the assignment should be established, together with any known milestone dates. The proposed contents, production responsibilities, approval levels and review procedures for each deliverable should be identified. This must include nomination of the individual(s) responsible for agreeing all of the deliverables and formal approval points.
- **Staffing.** The selection of team members for a strategy formulation project is important; staff who are trained in and experienced with the issues-driven approach to be used should form the core of the project team and its leadership, while senior management team members should be selected on the basis of their competencies, experience and training and to provide an opportunity for career development. Roles and responsibilities should be clearly defined in appropriate terms of reference.
- **Project management.** A project organisation structure should be established to clarify reporting lines, including any steering committee and team structures. A non-hierarchical, team-oriented structure is most common in strategy formulation projects, with steering and advisory committees providing subject expertise, key project input and advice on recommendations. In addition, a project plan should be developed, based on realistic time estimates to provide a baseline against which progress can be measured. Activities within the plan can be used to assist in costing the project and provide detailed work plans for staff performance.

Procedures should exist to ensure that agreed corrective actions are implemented when progress fails to meet expectations. Progress meeting minutes should include actions allocated to individuals for resolution.

Baseline

The Strategy Formulation Supplement presents the Strategy Formulation Framework as a one-Stage adjunct to the CI methodology, with three major Phases: Situation Assessment, Strategy Formulation, and Implementation Planning. This Baseline section of the Strategy Formulation Supplement describes many of the activities and analyses used in executing a strategy formulation project. However, project teams should realise not all of these activities or analyses are used in every project, and may not be used in the order presented.

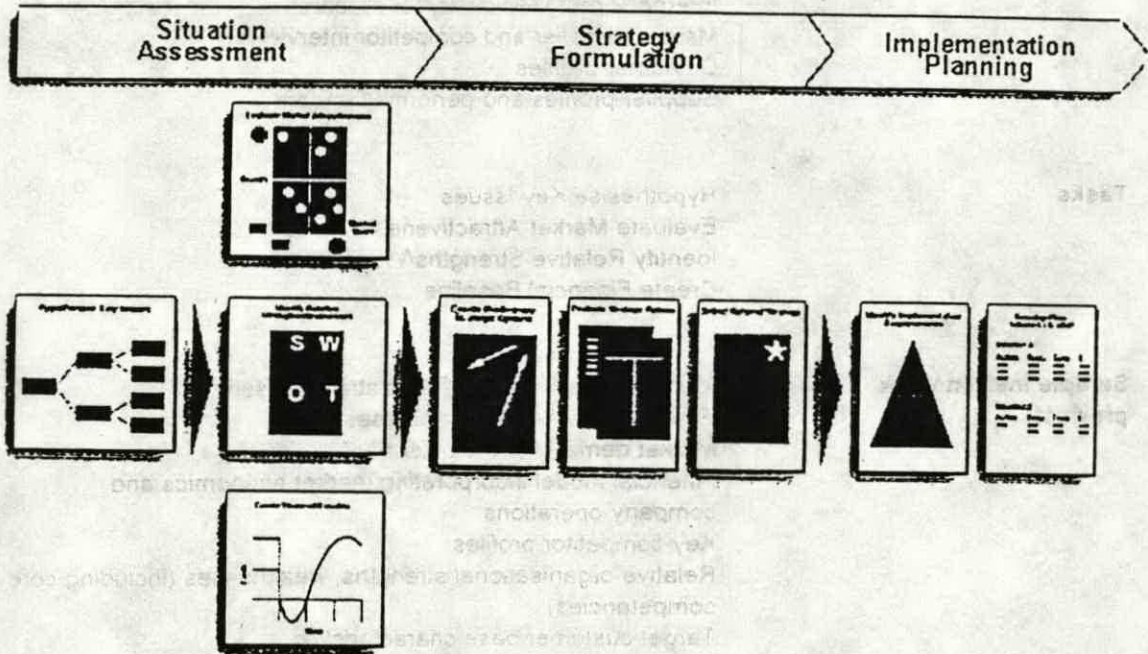


Figure 4: Strategy Formulation Framework

SF/A Situation Assessment - Summary

Sample Inputs

Company mission statement
Strategic plans/business plans
Financial statements/performance data
Market research, data and benchmarks (primary and secondary)
Competitive performance data and financial statements
Internally gathered customer research
Market, supplier and competitor interviews
Customer profiles
Supplier profiles and performance data

Tasks

Hypothesise Key Issues
Evaluate Market Attractiveness
Identify Relative Strengths/Weaknesses
Create Financial Baseline

Sample interim work products

Identification of key business/strategic issues
Preliminary strategic hypotheses
Market demand and profitability forecast
Financial model incorporating market economics and company operations
Key competitor profiles
Relative organisational strengths, weaknesses (including core competencies)
Target customer base characteristics

Phase deliverable

Strategic Situation Assessment

Strategy Analysis Tools

Issue map
Hypotheses/logic trees
Analysis plan
Customer segmentation
Kano model
Primary research
Customer surveys
Focus groups
Conjoint analysis
Market fragmentation/concentration
Porter's five forces
Market profitability modelling
7-S model
Supply/demand curve
Value chain/business system
Core competency analysis
SWOT analysis
Competitive positioning matrix
Scale curve
Experience curve
Regression analysis
Product life cycle analysis
Growth/share matrix
Benchmarking
Shareholder value analysis
Economic value added analysis (EVA)
Sensitivity analysis
Scenario analysis

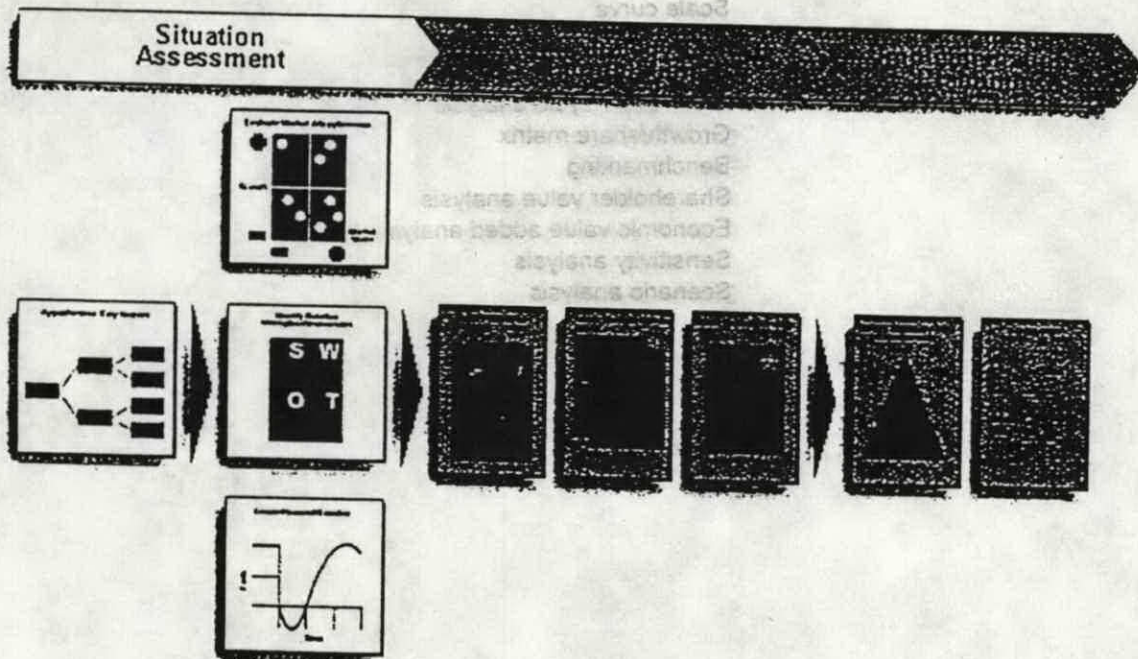
SF/A1 Hypothesize Key Issues

Purpose

To identify and assess the key issues facing the enterprise in its market(s), the attractiveness of the market(s) and relative strengths and weaknesses of the enterprise, including its current financial performance.

Overview

In Phase SF/A - Situation Assessment, the key issues facing the enterprise are identified and analysed, root cause analysis is performed and preliminary issue/root cause hypotheses are developed and tested for validity. The analyses required to test these hypotheses, identify and test alternative strategies and select an appropriate strategy form the basis of a detailed project workplan, which is developed in this Phase. Phase SF/A typically includes a review of current strategy, an assessment of the attractiveness of the current and related market(s) in which the enterprise competes, analysis of the relative competitive position of the enterprise in these markets, and development of a "base case" financial scenario.



Note: The Steps in each Phase are labelled using the standard CI format to facilitate the understanding of this framework by PW professionals accustomed to the more formal CI methodology. Not all of the Steps discussed below may be appropriate, or sequenced appropriately, for each project. Given the issues-driven approach required to successfully conduct strategy formulation projects, it is important to maintain and promote flexibility in problem resolution and analysis plan design. Ensuring responsiveness to both the uniqueness of issues facing the enterprise, and the uncertain, project-specific nature of each situation is paramount in formulating strategy.

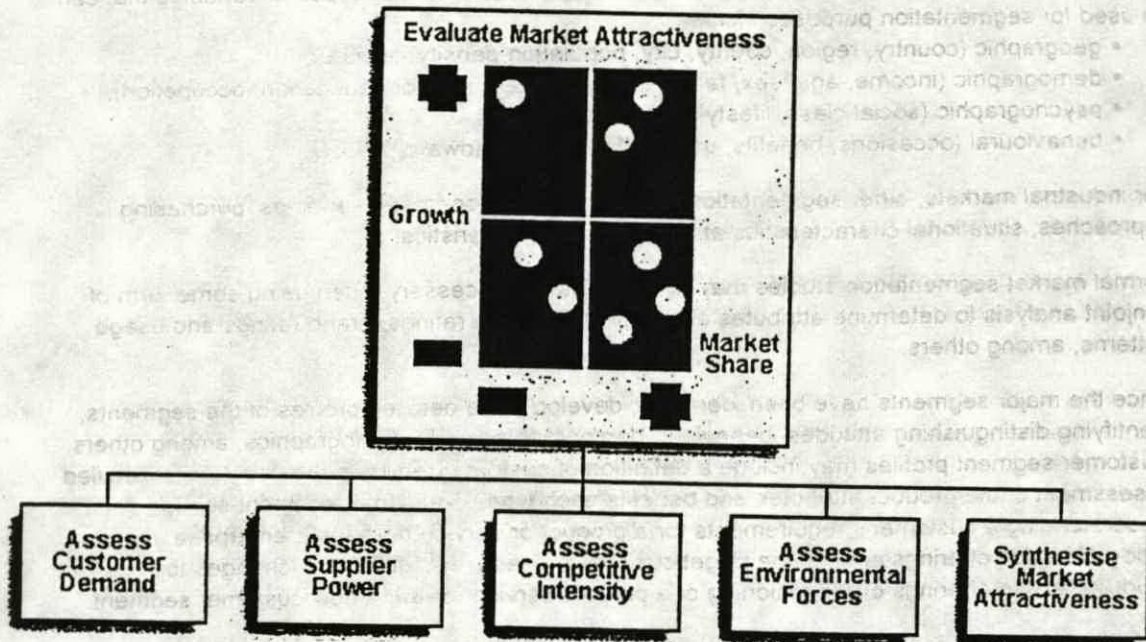
SF/A2 Evaluate Market Attractiveness

Purpose

To determine the overall attractiveness of the most relevant (and high potential) markets or market segments by specifically assessing the long term profit potential of each market or segment.

Overview

In this Task, the team develops an accurate evaluation of the attractiveness of the relevant markets/segments - a key component in answering the question "Where to compete?" The Task is typically accomplished by conducting key analyses: assessing customer demand, supplier power, competitive intensity and environmental forces on the market. The results of these key analyses are synthesised to form a complete picture of the level and degree of competition in a market, and how this impacts the long term profit potential of the market. The Steps in this Task are grouped in categories relating to the different forces impacting a market, as shown in the diagram below:



Assess customer demand

This analysis category focuses on understanding the customer base - the buyers of the products or services of the enterprise. Depending on the market in which the enterprise competes, there can be two broad classes of "customers" - the product/service's end user (the consumer), and the distribution channel through which the product or service is provided to a consumer. For example, in the apparel market, the end users or consumers are the individuals who purchase clothing for personal use, while the distribution channels can include specialty retail stores, department stores, and mass market merchandisers, among others. In some markets, the distribution channels are extremely important and powerful customer groups, whereas in others the end user is the more powerful customer. Assessing customer demand can involve an analysis of the characteristics and demand of both customer groups. Understanding who the more powerful customer is and what the characteristics, needs and requirements of that customer are, is an extremely important aspect of

personal use, while the distribution channels can include specialty retail stores, department stores, and mass market merchandisers, among others. In some markets, the distribution channels are extremely important and powerful customer groups, whereas in others the end user is the more powerful customer. Assessing customer demand can involve an analysis of the characteristics and demand of both customer groups. Understanding who the more powerful customer is and what the characteristics, needs and requirements of that customer are, is an extremely important aspect of forecasting the profit potential of a market.

The power of a customer or buyer group is determined by evaluating the following characteristics:

- degree of buyer concentration/volume of purchases
- buyer profitability
- use of product purchased (e.g. is it a significant component of the buyer's product or service)
- importance of product purchased to quality of buyer's product/service
- extent to which product saves buyer money
- likelihood of backward integration
- degree of influence over end-user (for distribution channels)

SF/A2.1 Segment customers.

To segment customers, identify and profile types of buyers (consumers or channels; although this analysis is more frequently applied to consumers, channels being distinct market segments themselves) who differ in their broad product or service requirements. Types of variables that can be used for segmentation purposes include:

- geographic (country, region, county, city, population density, climate);
- demographic (income, age, sex, family life cycle, race, religion, education, occupation);
- psychographic (social class, lifestyle, personality); and
- behavioural (occasions, benefits, user status, attitude toward product).

For industrial markets, other segmentation variables include operating variables, purchasing approaches, situational characteristics and personal characteristics.

Formal market segmentation studies may be conducted if necessary, often using some form of conjoint analysis to determine attributes and their importance ratings, brand ratings and usage patterns, among others.

Once the major segments have been identified, develop more detailed profiles of the segments, identifying distinguishing attitudes, behaviour, demographics and psychographics, among others. Customer segment profiles may include a definition of customer requirements, such as a detailed assessment of the product attributes and benefits each type of customer segment seeks.

Understanding a customer's requirements for a product or service helps map enterprise product/service offerings against the target customers needs, and determine changes to product/service offerings or repositioning of a product/service toward a new customer segment.

External interviews conducted with market experts (analysts, trade associations) and competitors can supplement customer/consumer research in developing key customer segment profiles.

SF/A2.2 Determine market size and growth, by channel.

Determine market size and growth; this can be done for the total market, for individual market segments, and for the various distribution channels.

Market size is generally defined in terms of unit or dollar sales volume overall, by segment and by channel (e.g., percent of total sold through each channel). Growth rates are usually determined for the total market, market segments and by channel. Historical trends in size are key to forecasting growth; however, other methods must be used to develop an accurate forecast, including researching customer intentions and investigating substitute products.

SF/A2.3 Evaluate market pricing, by channel.

Identifying market pricing trends is critical to estimating future market or segment profitability and

Identifying market pricing trends is critical to estimating future market or segment profitability and demand (based on price elasticity of demand).

Review historical trends to determine market price patterns and develop an indication of the sensitivity to price (elasticity) of various customer segments and how this price elasticity is changing, or may change in the future. Customer groups that are less price sensitive are generally more attractive.

Tools

- Customer segmentation
- Kano model
- Primary research
- Customer surveys
- Focus groups
- Conjoint analysis

Assess supplier power

Understanding the attractiveness of a market also demands a thorough assessment of supplier power and its effect on the profitability of key competitors in the market. Suppliers can affect the profitability of competitors by raising costs and/or lowering the quality of supplied goods. As with customers, distribution channels can be considered suppliers as can those companies that actually produce and sell component parts to competitors in the market. The power of market suppliers is determined by evaluating:

- degree of supplier concentration
- uniqueness or differentiation of supplier product
- number of competing/substitute products to supplier group's products
- likelihood of forward integration
- importance of market to supplier group

SF/A2.4 Identify suppliers and characterise strengths and weaknesses by channel.

Identify key suppliers to the market (both providers of products and services and distribution channels for products) through a review of the components included in the cost of goods sold (COGS).

To evaluate supplier strengths, determine the relative quality of their products, including the unique aspects of their ability to service their customers (the competitors in the industry), unique relationships they may have with competitors, technological advantages one may possess over another and proprietary processes.

The actual factors used in the evaluation of suppliers' relative strengths and weaknesses depend on the market being analysed and are difficult to categorise using a standard method. For example, in markets where the primary supplier products are commodities, supplier strengths and weaknesses may be largely determined by processes or technologies that affect the quality and cost of the commodity; while in markets where supplier goods are themselves differentiated, supplier strengths and weaknesses are more difficult to measure because the products each sells are to some extent unique. Determining the characteristics to be used in evaluating supplier strengths and weaknesses is the first step toward understanding the power of suppliers in a market.

SF/A2.5 Determine supplier share of market.

Determine each supplier's share of market; this is typically measured by the percent of total sales

Determine each supplier's share of market; this is typically measured by the percent of total sales to the market that each supplier captures.

In a highly concentrated market, there are likely to be very few suppliers, each with a large, fairly equal proportion of sales, while in fragmented markets there are often numerous suppliers with no company capturing a significant proportion of sales. A significant share of the supplier market held by one supplier indicates that that supplier has substantial power relative to others, and, if the supplier market is concentrated, indicates a substantial degree of power vis-à-vis the market it supplies to as well.

SF/A2.6 Analyse current supplier relationships.

Determine how important each supplier is to the enterprise. A typical approach is to measure the value of supplier shipments to the enterprise as a percent of the cost of goods sold. In turn, determine how important the enterprise is to each supplier. One method is to calculate what percentage of that supplier's total sales is represented by purchases from the enterprise. These analyses are typically supplemented by interviews with key suppliers, focused on understanding the dynamics of the market, key relationships between suppliers and market competitors, and the suppliers' relative strengths and weaknesses.

Analysing the relationships that the enterprise has with specific suppliers provides important information about the strength of suppliers relative to the enterprise, although less information about the power of suppliers in the market as a whole. The two analyses performed here determine how important a particular supplier is to the enterprise (measured by supplier shipments as a percent of cost of goods sold) and how important the enterprise is to that supplier (purchases as a percent of total supplier sales). For example, if a supplier's shipments account for a significant proportion of the enterprise's COGS, but a small percent of its total sales to the market, that supplier has a substantial degree of power over the enterprise. If both percentages are high, the two companies' future performance is likely to be closely tied together, and the relationship between them is likely to be more cooperative than adversarial.

Combining these two analyses provides a good understanding of the relationship of the competitors in a market to their suppliers and the relative power of each supplier. Very strong supplier power is often an indication of an unattractive market, as suppliers are thus able to limit the profitability of their customers.

Assess competitive intensity

The intensity of competition in an industry is determined by several factors:

- number of competitors and relative size and strength of each
- rate of industry growth
- degree of differentiation in competitors' products and services
- level of fixed costs
- existing capacity and typical size of capacity additions
- level of exit and entry barriers
- likelihood of cooperation among competitors (linked to degree of homogeneity)

SF/A2.7 Develop competitor profiles.

Develop profiles of competitors in the market; this step is a key component of assessing the relative success of each competitor in the market and evaluating their source of competitive advantage. Competitive profiles generally include an analysis of enterprise revenues, costs and profit, market share, brand positioning and image, key product attributes appeal, technological advantages (e.g., patents held) and organisational strengths and weaknesses. As with suppliers, understanding the

Develop profiles of competitors in the market. This step is a key component of assessing the relative success of each competitor in the market and evaluating their source of competitive advantage. Competitive profiles generally include an analysis of enterprise revenues, costs and profit, market share, brand positioning and image, key product attributes appeal, technological advantages (e.g., patents held) and organisational strengths and weaknesses. As with suppliers, understanding the characteristics by which to evaluate competitors is a key step in the process and is largely determined by the market in which they compete. Developing these profiles promotes an assessment of the intensity of competition; markets in which competitors have very different strategies, origins and "personalities" are likely to be intensely competitive. Interviews with key competitors and market experts (e.g. market analysts, trade associations) can be used to provide qualitative and quantitative data required for competitor profiles.

SF/A2.8 Define impediments to entry and exit.

Assess barriers to entry and exit in a market; this is another key component in evaluating the intensity of competition. Entry barriers generally result from the following factors:

- economies of scale
- significant product differentiation
- high capital requirements
- cost disadvantages unrelated to size
- limited access to distribution channels
- government policy (e.g., licenses, regulations)

While high entry barriers can protect existing market competitors from stronger competition, low barriers do not necessarily harm well-established players, particularly if a market is growing extremely rapidly and demand is exceeding supply.

Exit barriers also impact profitability in a market, primarily by forcing competitors to stay in a market even if they are not doing well. If exit costs are very high (e.g. in the form of specialised assets, or unusual management loyalty to a business), companies may continue to compete while earning low or negative returns, putting increased pressure on all competitors in the market as capacity exceeds demand.

Tools

- Market fragmentation/concentration

Assess environmental forces

SF/A2.9 Identify and evaluate external forces on market.

Identify and assess the impact of other forces on the attractiveness of a market; these may include government regulation, technological changes and environmental factors such as social trends or conventions.

As noted above, government regulations can act as barriers to entry to a market, while other types of regulation can influence the attractiveness of a market by imposing costs (as with environmental and safety regulations), offering assistance (in the form of subsidies or tax breaks) or regulating competition (anti-trust regulations).

Changes in technology can also affect market attractiveness by enabling the introduction of new products or services, destabilising the market by generating uncertainty about technological standards or future trends, or changing the balance of competitor strength, if one player acquires or develops a proprietary technology that substantially improves its competitive positioning.

Finally, changing social trends and characteristics influence the attractiveness of a market, and can themselves precipitate government actions that positively or negatively impact the market (e.g., as in the tobacco industry, where strong social condemnation of smoking has led to increasing government regulation and taxation).

External forces are not easily controlled by market competitors, although through government lobbying efforts, marketing and promotions programs and public relations campaigns most competitors try to mitigate their potentially harmful effects.

Synthesise market attractiveness

SF/A2.10 Synthesise market factors and evaluate profitability of key market segments.

Synthesise information from the analyses completed above in this Step to develop a comprehensive view of overall market attractiveness. Much of this analysis involves discussions and assessments with industry experts, who frequently have a more intimate view of a market and its workings than outside research efforts can provide. The importance and strength of different market forces are weighed against each other, with a view toward providing as complete a picture as possible of the market's future profit potential. Market profitability is sometimes estimated by determining each competitor's margin and adding all competitors' margins together. Profitability by channel can also be determined if channel economics are particularly relevant to the overall market analysis.

Developing a clear understanding the basic structural forces at work in the market should also be a focus of this Step. Particular factors which favour one competitor over another (e.g., economies of scale) can be impediments to improving the enterprise's overall competitive positioning, regardless of the market's future profit potential, and should be considered when synthesising the overall market attractiveness.

Tools

- Porter's five forces
- Market profitability modelling
- Supply/demand curve

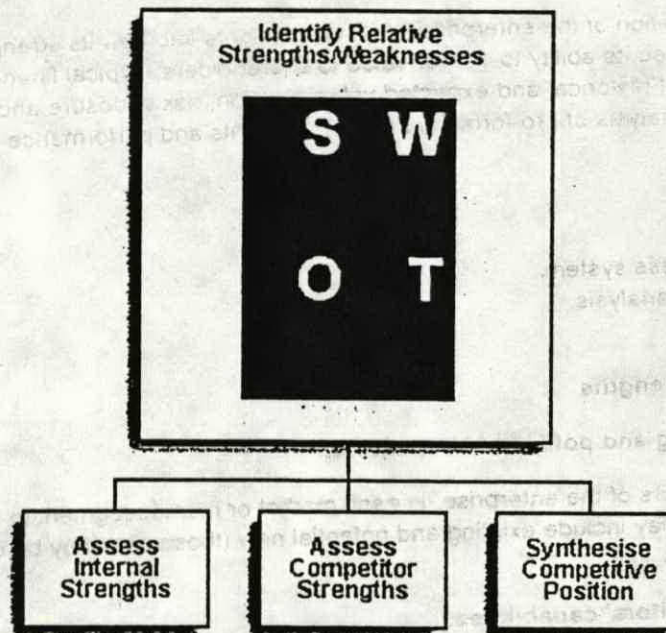
SF/A3 Identify Relative Strengths/Weaknesses

Purpose

To determine the strengths and weaknesses of the enterprise relative to its competitors and synthesise these strengths and weaknesses to determine overall competitive positioning.

Overview

In the Identify Relative Strengths/Weaknesses Task, the team works with senior management to understand the core competencies and organisational capabilities the enterprise can use to defend its competitive position.



Assess internal strengths

SF/A3.1 Assess existing capabilities.

Evaluate qualitative and quantitative aspects of performance to determine the internal strengths and weaknesses of the enterprise (which can then be compared to those of its competitors).

The more qualitative aspects involve enterprise capabilities and competencies, which determine how effective a player it is in the market in which it competes. The quantitative aspects of the performance are in a sense the result or outcome of the competitor's ability to use its competencies and capabilities to create financial returns for its shareholders.

In assessing existing capabilities, determine the key elements of the enterprise value chain or business system — the basic processes the enterprise executes to create its products or services and deliver them to its customers. This approach defines the key areas in which to evaluate the competencies and capabilities of the enterprise.

Determine critical success factors (CSFs being those aspects of performance where excellence is

Determine critical success factors (CSFs being those aspects of performance where excellence is critical to achieving competitive success) for each value chain/business system segment, and assess the ability of the enterprise to execute against those success factors. This type of analysis will reveal the overall strengths and weaknesses of the enterprise in performing the key business activities required to deliver value to the customer, indicating where the enterprise has strong competencies and capabilities and where there are gaps between the required capabilities and the actual competency levels of the enterprise.

Assess strengths and weaknesses across key organisational elements, including strategy, overall critical success factors, core capabilities, decision processes and systems, staff, style and culture and organisational structure. This analysis identifies other areas that enhance or detract from the ability of the enterprise to compete successfully in the market.

SF/A3.2 Assess financial position.

Assess the financial position of the enterprise to provide insights into how its strengths and weaknesses have affected its ability to deliver value to shareholders. Typical financial analysis includes an evaluation of historical and expected value creation, risk exposure and capital allocation, through an analysis of pro-forma financial statements and performance indicators (such as financial ratios).

Tools

- 7-S model
- Value chain/business system
- Core competency analysis
- SWOT analysis

Assess Competitive Strengths

SF/A3.3 Identify existing and potential competitors.

Identify the key competitors of the enterprise, in each market or market segment in which it competes. Competitors may include existing and potential new (those who may be considering market entry) competitors.

SF/A3.4 Assess competitors' capabilities.

Assess competitors' strengths using the same Steps and analysis techniques used to evaluate the strengths and weaknesses of the enterprise.

Once key competitors are identified, assess their strengths and weaknesses against both key elements of the value chain and the main organisational dimensions (see SF/A3.1). Special attention should be given to understanding the competitors' core competencies relative to the core competencies of the enterprise. These competencies indicate where each competitor is best positioned to compete in the market.

Another element in understanding competitive strengths and weaknesses is assessing where competitors' products are in their life cycle. Product life cycle positioning (indicated by a product's level and growth rate of sales, characterised as introduction, early/late growth, maturity, decline or renewal) provides insight to a competitor's strategic actions (e.g., is the competitor milking the product or seeking to grow it?) and indicates competitor vulnerabilities or strengths in product positioning.

SF/A3.5 Assess competitors' relative financial position.

Assess competitors' financial position using analysis techniques similar to those used in assessing the financial position of the enterprise (see SF/A3.2). Understanding each competitor's revenue and cost structure, and ability to create shareholder value (including historical trends in value creation and likely future performance) is critical to completing the picture of its overall position in the market.

Tools

- Competitive positioning matrix
- SWOT analysis
- Scale curve
- Experience curve
- Core competency analysis
- Regression analysis
- Product life cycle analysis

Synthesise Competitive Position

SF/A3.6 Summarise relative positions of competitors.

Synthesise the analyses performed above to produce an overall profile of the relative positioning of the enterprise and each competitor in the market. Focus on determining what customer base each competitor targets and appeals to, how their products are differentiated from one another, what their relative cost positions are and how this impacts their ability to compete. Use this synthesis of competitive positioning to indicate where there are potential opportunities for the enterprise to improve its positioning and thus financial performance.

Tools

- Growth/share matrix
- SWOT analysis
- Benchmarking

SF/A4 Create Financial Baseline

Purpose

To identify high-impact management levers, and provide a financial reference point for the evaluation of the potential economic return of each strategic option.

Overview

In this Task, the team works with senior management to develop an understanding of current and expected financial performance given existing strategies. The team also uses information gathered in previous Tasks to identify the factors to which future financial performance may be most sensitive.

SF/A4.1 Review strategic plans to characterise expected decisions and actions.

Gather and review existing strategic and business plans to determine the current strategic outlook, potential decisions regarding product positioning, pricing and development. Prepare for an analysis that measures the impact of new strategies on the current financial performance. This review characterises management decisions without a change in strategic direction or repositioning of the product in the market.

SF/A4.2 Synthesise completed analyses to forecast future performance.

Synthesise the results of previous internal and external analyses to provide insight into likely competitor actions in response to management's current strategy.

SF/A4.3 Develop economic model.

Develop an economic model based on the team's understanding of these expected enterprise and competitor actions. This model typically comprises a custom-built income statement, cash flow and balance sheet, characterising likely future performance.

Create sensitivity analyses by developing alternative economic scenarios based on modified key revenue and cost variables. These analyses and the baseline economic model generate a likely picture of the financial performance with no alteration in strategic direction. This model is typically used to test alternative strategic options in Phase SF/B - Strategy Formulation.

SF/A4.4 Develop Strategic Situation Assessment.

At the end of this Phase, synthesise data gathered and analyses previously conducted to produce a detailed summary of the market environment, including the nature of customer demand, the competitive outlook, profiles of competitors and an assessment of enterprise position and organisational strengths and weaknesses that will impact its ability to compete in the future.

Tools

- Shareholder value analysis
- Economic value added analysis (EVA)
- Sensitivity analysis
- Scenario analysis

SF/B Strategy Formulation

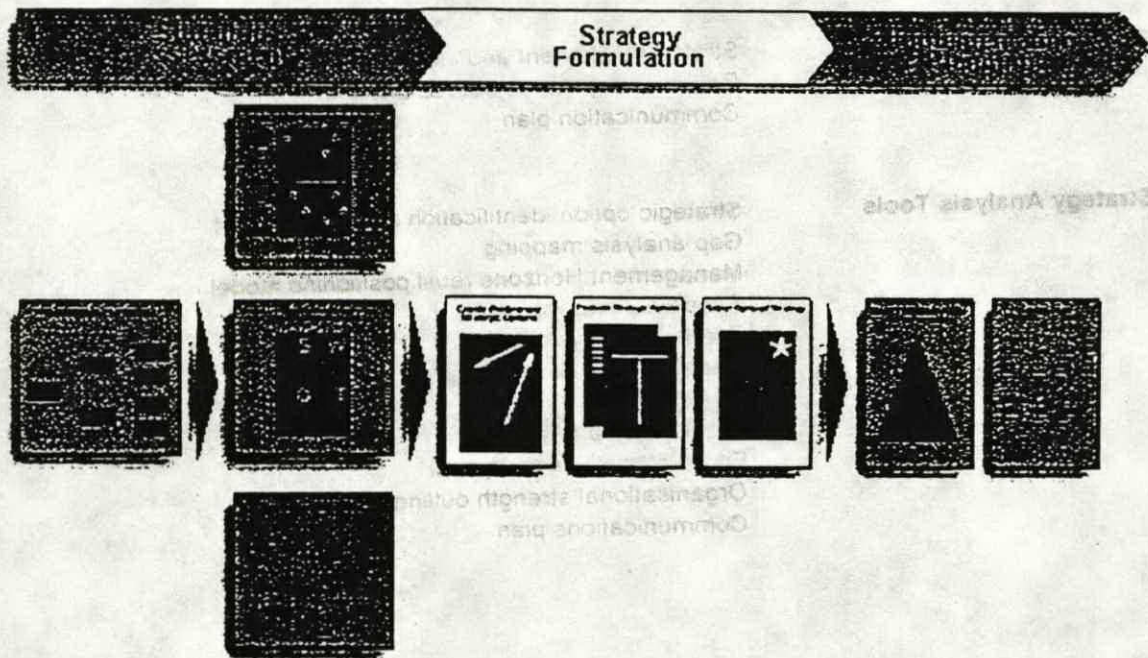
Purpose

To define the optimal strategy for the enterprise.

Overview

In this Phase, the team works with senior management to develop hypothetical strategy options based on the analysis completed in the Situation Assessment. These potential strategies are validated through external analysis, then developed in more detail as potential strategic options for the enterprise. The options should be mapped against internal capabilities to identify potential gaps.

Strategic options are evaluated against both quantitative and qualitative criteria, including their potential economic return (measured against the financial baseline created in Phase SF/A), ease of implementation, probability of success and level of risk, leading to selection of an optimal strategy.



Note: The Steps in each Phase are labelled using the standard CI format to facilitate the understanding of this framework by PW professionals accustomed to the more formal CI methodology. Not all of the Steps discussed below may be appropriate, or sequenced appropriately, for each project. Given the issues-driven approach required to successfully conduct strategy formulation projects, it is important to maintain and promote flexibility in problem resolution and analysis plan design. Ensuring responsiveness to both the uniqueness of issues facing the enterprise, and the uncertain, project-specific nature of each situation is paramount in formulating strategy.

SF/B Strategy Formulation - Summary

Sample Inputs

Phase A analyses and work products
Market, supplier and competitor interviews

Tasks

Create Preliminary Strategic Options
Evaluate Strategic Options
Select Optimal Strategy

Sample interim work products

Interview notes and information
Strategic option implementation requirements and financial analysis
Gap analysis
Strategic option fit vs. attractiveness analysis

Phase deliverable

Strategy statement and implementation requirements
Revised mission, objectives and goals
Communication plan

Strategy Analysis Tools

Strategic option identification and assessment
Gap analysis mapping
Management Horizons retail positioning model
Sensitivity analysis
Scenario analysis
Shareholder value analysis
EVA analysis
Growth/share analysis
Fit vs. attractiveness model
Organisational strength outline
Communications plan

SF/B1 Create Preliminary Strategic Options

Purpose

To define hypothetical strategic options, and map the options to internal capabilities.

Overview

In this Task, the knowledge gained in the Situation Assessment is considered to draft several (two to eight) hypothetical strategy options. Market and competitor information is synthesised to assess the implications for each of the strategy options.

Gaps between current capabilities and those required to implement each strategy option are identified and must be considered in this analysis.

Steps

SF/B1.1 Draft hypothetical strategic options.

Identify hypothetical strategic options based on the analyses of market and competitor information gathered in Phase SF/A, and through additional information and data gathered subsequently in this and other Steps.

These options specify where and how the enterprise could compete and may reposition the enterprise through changes in customer focus, developing new products designed to pursue new markets or particular niches, and/or extending brand(s) into new businesses.

Typically, a series of interviews are conducted with market experts, suppliers and competitors to assess the implications these new strategic options would have for the enterprise, its relationships with suppliers and the market as a whole, and to evaluate the likely reaction of competitors to the new strategic direction.

SF/B1.2 Develop strategic options in detail.

Using the information gathered in the interviews conducted above, develop more detailed explanations of each potential strategic option. These detailed plans include a

- statement of the customer group(s) targeted by the strategy;
- the core competencies that the strategy leverages;
- the competitors and potential competitive responses;
- a high level assessment of the capabilities required to execute the strategy; and
- potential entry methods (e.g. build vs. acquire).

SF/B1.3 Map options to internal capabilities and identify capability gaps.

Map the high-level capabilities required to execute each option against the internal capabilities analysed in Phase SF/A to determine what gaps exist between the competencies required and those possessed by the enterprise. These gaps may be related to new product/ service development, sales or marketing competencies, customer service and brand management.

Tools

- Strategic option identification and assessment
- Gap analysis mapping
- Management Horizons retail positioning model
- Sensitivity analysis

SF/B2 Evaluate Strategic Options

Purpose

To evaluate the strategic options against a variety of quantitative and qualitative factors to assess their potential to maximise business performance for the enterprise.

Overview

In this Task, the implementation requirements and potential return associated with strategy options are identified and tested against the current business capabilities and baseline economics. This analysis provides an assessment of the overall fit of the strategy with the enterprise and the attractiveness of the strategy option.

Steps

SF/B2.1 Outline each option's key implementation requirements.

Identify the key implementation requirements for each strategic option. These implementation requirements are not the detailed steps needed to roll-out the new strategy to the entire enterprise, but simply an overview of the key organisational processes, procedures, communication/documentation flows and roles and responsibilities that enable decision-making and prepare for full scale implementation.

SF/B2.2 Forecast each option's economics.

Model the economic impact of each strategic option on the enterprise; this involves determining the key revenue and cost variables for each option, projecting total revenues, costs, profit and cash flows for each option in a variety of scenarios (base case, optimistic, pessimistic scenarios) and testing sensitivity of the financial results to changes in the key variables.

Use this financial analysis to assess each option's impact on total returns to shareholders.

SF/B2.3 Evaluate each option against baseline performance.

Compare the financial results derived from the option modelling to the baseline economic scenario determined in Phase SF/A. As a result of this analysis, the potential impact of each strategic option on shareholder value can be compared to the modelled scenario of likely financial results given the existing strategy, to determine which options offer the most favourable improvement over the baseline case.

SF/B2.4 Evaluate options for potential returns, ease of implementation, probability of success, and risk taken.

Combining the analysis of implementation requirements with financial results, evaluate each strategic option against multiple factors to determine which option(s) offer the highest potential return and probability of success with ease of implementation and minimised risk.

These evaluation criteria depend on the specific situation, but might include

- strategic fit;
- fit with enterprise core competencies;
- capital investment required;
- potential return; and/or
- degree of management control maintained, among others.

SF/B3 Select Optimal Strategy

Purpose

To define the optimal strategy (the option offering the highest financial returns and potential for success), and develop a plan to communicate the new strategic direction throughout the enterprise.

Overview

In this Task, the team uses the option evaluation analyses to define the strategy for the enterprise. This is likely to include a revised mission statement and corporate goals to be consistent with the new strategy. The team also creates a communications plan to disseminate the new strategy throughout the enterprise to ensure buy-in and successful implementation.

Steps

SF/B3.1 Identify option(s) with highest potential for enterprise to define strategy.

Identify the options with the highest potential for the enterprise by synthesising the results of the evaluation of each strategic option against the qualitative and quantitative criteria established by the team. These criteria include potential financial returns of the option, ease of implementation (given the overall capabilities of the enterprise and those required for successful implementation), probability of success (in implementation), and overall level of risk taken.

Options with the highest potential are those that offer the best overall combination of high financial return, high ease of implementation, high probability of success and low level of risk. Most options are likely to have a combination of traits requiring the project team to work closely with the senior executives to determine the best option(s) for the enterprise to pursue in defining a new strategy.

SF/B3.2 Update mission, objectives, and goals to fit strategy.

Once the new strategy has been defined, establish the mission, objectives and high-level corporate goals required to fit the new strategy. This generally involves revising the corporate mission statement, issuing new objectives and goals that support the execution of the new strategy and outlining how this strategy will necessitate changes in organisation, staff and competencies.

SF/B3.3 Develop communication program to maximise buy-in.

Develop a communications plan that defines the key messages that need to be communicated and describes how this communication will happen. Key messages include why the new strategy is needed, what new capabilities the strategy requires and how they will be developed or acquired and how the strategy will impact the organisational structure, processes, staff and systems. The actual detail of the message will vary substantially by project and will depend significantly on the extent to which the new strategy differs from the old (e.g., a new strategy that requires the enterprise to exit a particular market it currently serves will require much greater communications planning than one which simply modifies current positioning).

Tools

- Communications plan

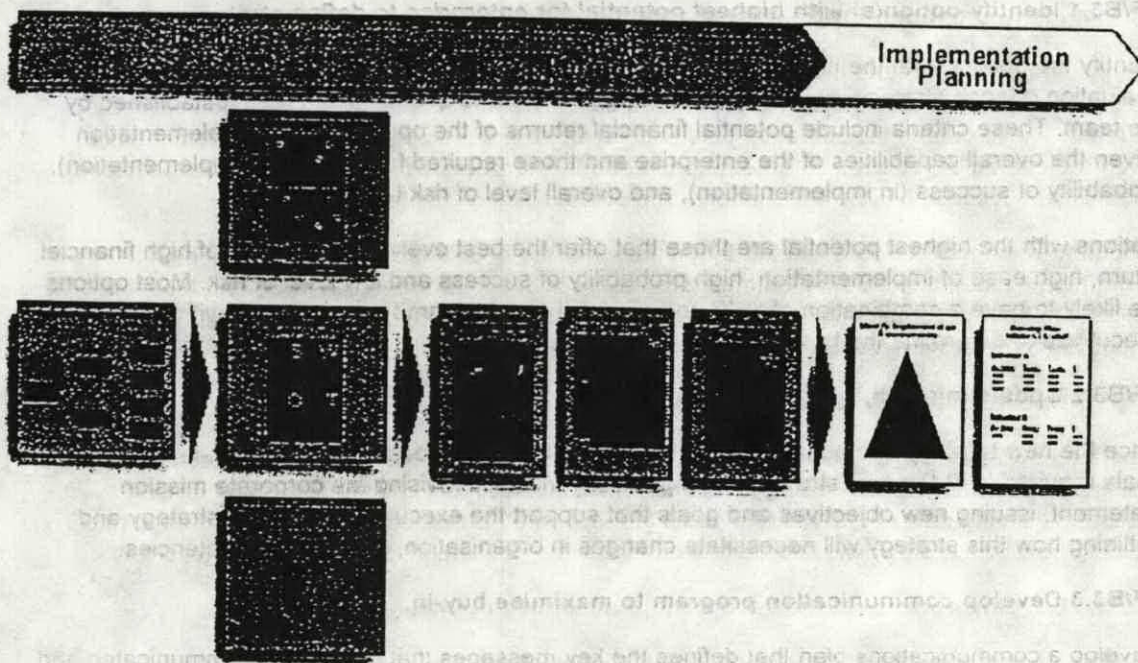
SF/C Implementation Planning

Purpose

To determine the critical success factors for implementing the new strategy and plan for the implementation of the strategy within the enterprise.

Overview

In this Phase, the team identifies the key success factors for successfully executing the new strategy in the enterprise, and determines how the enterprise can acquire or develop the capabilities needed for successful implementation. The team then prepares a work plan detailing how the implementation will progress, including key activities, timelines and roles/responsibilities. The implementation plan also includes the initiation of process redesign, organisation or systems projects (including CI or SISP projects), should any be required.



Note: The Steps in each Phase are labelled using the standard CI format to facilitate the understanding of this framework by PW professionals accustomed to the more formal CI methodology. Not all of the Steps discussed below may be appropriate, or sequenced appropriately, for each project. Given the issues-driven approach required to successfully conduct strategy formulation projects, it is important to maintain and promote flexibility in problem resolution and analysis plan design. Ensuring responsiveness to both the uniqueness of issues facing the enterprise, and the uncertain, project-specific nature of each situation is paramount in formulating strategy.

SF/C Implementation Planning - Summary

Sample Inputs	Phase SF/A and SF/B work products and deliverables Process/organisation/systems and/or CI/SISP outputs
Tasks	Identify Implementation Requirements Develop Plan/Initiate CI and SISP
Sample interim work products	Core capability definition Changes to organisational dimensions required
Phase deliverable	Detailed implementation requirements CI and or SISP work plans
Strategy Analysis Tools	7-S model

SF/C1 Identify Implementation Requirements

Purpose

To identify the key success factors for executing the new strategy and outline the required changes to the enterprise.

Overview

In this Task the team identifies the key requirements for successfully implementing the new strategy. These requirements include the key success factors for implementation (those dimensions of the enterprise where excellence is necessary for competitive success), core capabilities, and infrastructural changes necessary to support strategy execution.

Note: This Task correlates with the CI Tasks in Phase D — Design Target Environment and Phase E — Develop Change Plan. At this point in the project, the team may wish to begin using the Change Integration methodology.

Steps

SF/C1.1 Identify critical success factors for new strategy execution.

Identify CSFs for executing the new strategy; CSFs are those dimensions of the enterprise (e.g., parts of the marketing mix, manufacturing, management) where excellence is crucial for competitive success. CSFs are often those business elements that are important to customers or are determinants of profitability.

In determining CSFs, distinguish between factors where competence is necessary but excellence is not. CSFs are closely linked to enterprise strategy, and therefore must be reevaluated when strategic direction changes.

SF/C1.2 Define core capability requirements.

Determine the core capability requirements for successful strategy execution. These core capabilities will derive from the CSFs and are those organisational competencies that the enterprise must have to support the critical success factors and execute the strategy.

SF/C1.3 Summarise change lever activities.

Summarise change actions that will facilitate strategy execution. Identify the changes to operational and decision-making processes, technology, systems, staff competencies, culture, organisational structure and performance measurement and incentive systems to support the strategy. Changes to processes and systems can ensure that the enterprise is operating efficiently and effectively in strategy execution, and that the right information is available on a timely basis to management for decision-making.

Changes to staff competencies may be required to ensure that the management and employees of the enterprise have the right capabilities for managing and operating the enterprise on a daily basis. Cultural changes could involve a change to leadership attitudes or the emphasis placed on the values of the enterprise. Structural changes may be needed in order to realign operational or functional units to better leverage synergies or organisational capabilities.

Finally, design changes to realign performance measurement and incentive systems. This ensures that the new strategy is translated into activities and results that can be monitored by management.

Finally, design changes to realign performance measurement and incentive systems. This ensures that the new strategy is translated into activities and results that can be monitored by management, to ensure the entire enterprise is supporting the new strategy.

Tools

- 7-S model

8F02 Develop Plan/Initiate CI and SISP

Purpose:
To identify the details work steps required to initiate a CI and SISP project, and to be appropriate.

Overview:
During this task, the team develops a work plan for the initiation of CI and SISP projects as appropriate.

Steps:

8F02.1 Develop change plan
Develop a plan to coordinate and manage the new strategy.
In the case of most SISP projects, the assessment and analysis conducted during Strategy Formulation provides the majority of information required to move through target environment design and begin development of a detailed change plan, although additional work may be required, such as analysis of detailed process flows.

The Strategy Formulation project will also provide the enterprise with a new business environment analysis needed in a SISP to identify areas of the IS environment where further analysis is required to identify opportunities for enterprise-wide systems improvement.

8F02.2 Prepare work plan for initiation of CI and/or SISP projects
Identify the staffing level required to complete specific activities for a CI and/or SISP project, the budget needed and the timeframe required to complete the activities. In the case of most CI projects, the assessment and analysis conducted during Strategy Formulation provides the majority of information required to move through target environment design and begin development of a detailed change plan, although additional work may be required, such as analysis of detailed process flows.

8F02.3 Complete any tasks necessary to formally close the project
Complete any tasks necessary to formally close the project, such as:
• Finalize any contractual issues
• Assess and bring documents to be maintained and complete any remaining duties
• Discuss any final steps involving the project, such as:
• Determine the need and agree on data and reports that are required in subsequent post-implementation performance review.

SF/C2 Develop Plan/Initiate CI and SISP

Purpose

To identify the detailed work steps required to initiate a CI or SISP project, should one be appropriate.

Overview

During this Task, the team develops a work plan for the initiation of CI and/or SISP projects as appropriate.

Steps

SF/C2.1 Develop change plan.

Develop a plan to implement the changes driven by the new strategy.

In the case of most CI projects, the research and analysis conducted during Strategy Formulation provides the majority of information required to move through target environment design and begin development of a detailed change plan, although additional work may be required, such as analysis of detailed process flows.

The Strategy Formulation project will also provide the enterprise overview and business environment analysis needed in a SISP to identify areas of the IS environment where further analysis is required to clearly identify opportunities for enterprise-wide systems improvement.

SF/C2.2 Prepare workplan for initiation of CI and/or SISP projects.

Identify the staffing levels required to complete specific activities for a CI and/or SISP project, the budget needed and the timeframe required to complete the activities. In the case of most CI projects, the research and analysis conducted during Strategy Formulation provides the majority of information required to move through target environment design and begin development of a detailed change plan, although additional work may be required, such as analysis of detailed process flows.

SF/C2.3 Complete any tasks necessary to formally close the project.

Complete any tasks necessary to formally close the project, such as:

- Finalise any contractual issues;
- Assemble working documents to be maintained, and complete any remaining quality management tasks;
- Discuss any next steps involving the project team; and
- Determine the need for and agree on date and scope of and participants in subsequent post-implementation performance reviews.

*****FORMAL APPROVAL POINT*****