Strat. Change **14**: 195–208 (2005)
Published online in Wiley InterScience
(www.interscience.wiley.com). **DOI:** 10.1002/jsc.715

Strategic Change

Business strategy re-engineering and the bid battle for Marks and Spencer

Tony Grundy*
Cranfield School of Management, UK

- *In the late spring of 2004, Philip Green made a £7 billion bid for Marks and Spencer. The company's turnaround over 2001–2003 was slipping badly and its then Chairman and CEO appeared unable to cope with pressure from analysts and shareholders who were becoming highly critical of the Board's performance. Between late May and mid-July, arguably more change was seen in six weeks than perhaps in the previous six years. A new Chairman and CEO, Stuart Rose was appointed, who enacted plans to re-engineer the strategy for the company.*
- *This paper examines how this fascinating case illustrates how business strategy re-engineering, an eclectic approach combining multi-perspectives within strategy, value-based management (VBM) and organizational behaviour, can be a useful concept. Whilst the term 're-engineering' is shared with the concept of 'business process re-engineering', it is more far-reaching and less mechanistic.*
- *Despite the obvious confidentiality and sensitivity of this deal battle, data was collected, analysed and interpreted in real time, all available from the media and thus in the public domain. This research approach is interesting, particularly as it shows how new conceptual frameworks can be developed not only through conventional interviews, observation and questionnaires, but by other methods.*

Introduction

The paper is set out as follows:

- First, a summary of the most relevant literature on key perspectives.
- Second, the case of Marks and Spencer, including:
  — Brief history and background;
  — Unfreezing the past: the anatomy of a deal;
  — Key lessons from the M&S case study.
- Conclusions.

Summary of the most relevant literature

In the early 1990s Hammer and Champy produced the best seller *Re-Engineering the Corporation* (Hammer and Staunton, 1995), which became an instant success for both managers and for management consultants. The business process re-engineering or BPR movement was very successful and at least for

*Correspondence to: Tony Grundy, Cranfield School of Management, Cranfield University, Cranfield, Bedford MK4 3OAL, UK.
E-mail: a.grundy@cranfield.ac.uk

a time encouraged managers to rethink their business. However, unfortunately the *re-engineering* concept tended to be limited to processes, as opposed to the overall business model and the business strategy of the organization, or even the composition of a group. It is argued here that the concept of re-engineering has a very powerful application to strategic management.

The BPR movement was very successful and encouraged business

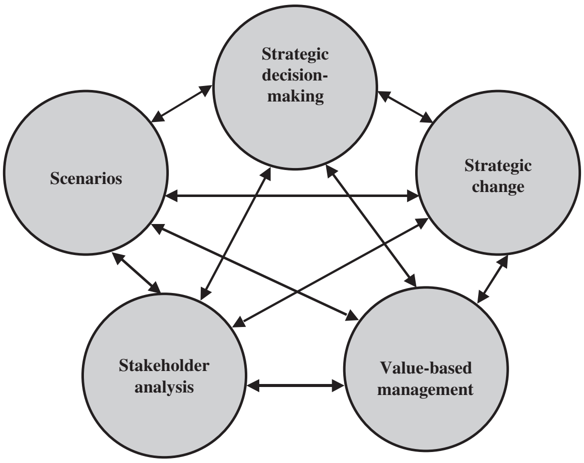

Figure 1. Five perspectives on business strategy re-engineering.

Whilst it appears surprising that no one took this concept further, from the perspective taken here, there appears considerable potential for applying it to business strategy, as in the M&S case, which was highlighted by the bid battle during summer 2004, and in more recent strategies for its turnaround. For like the original BPR concept, which brought together aspects of quality management, work-study, IT planning, etc., 'business strategy engineering' is indeed eclectic. In particular it brings together five interconnected perspectives in a holistic way from:

- Strategic decision-making
- Strategic change
- Value-based management
- Stakeholder analysis
- Scenarios.

See **Figure 1**.

Particularly interesting linkages here are:

- Between scenarios and value-based management: for example, under what scenarios will economic value be optimized?
- Between stakeholder analysis and scenarios: how might stakeholders *create* scenarios and how might they *behave* within them?
- How does value base of management *shape* strategic change and what economic value is in turn *generated* by it?

Note that each one of the *ten* interconnections is interesting, although space precludes discussion of the other seven.

Strategic decision-making: many journal articles cover this extensive literature, so this paper focuses only on the principal themes. Historically, strategy theorists have debated *styles* of decision-making, for example 'deliberate' strategy versus 'emergent' forms (Mintzberg, 1994). Mintzberg *et al*. (1998) make the point that the decision-making process is messy and frequently unstructured (confirmed by Braybrooke and Lindblom, 1963), or appears as 'logical incrementalism' (Quinn, 1980). Whilst there appears to be no 'single right way' of going about decision-making, there do seem to be some perils and drawbacks from primarily emergent and incremental ways of developing strategies, especially:

- They may easily dilute or even destroy shareholder value by not being sufficiently thought through and need to be revisited or adjusted, or even reversed (Grundy, 2002).
- Because they operate with strategy forms which are fluid and implicit, the organization especially at middle levels may become confused, de-energized and demoralized.
- Outside shareholders may not understand the strategy and will lower their valuation and perception of the company.

Strategic change: this perspective links to the concept of incrementalism, which suggests that organizations, especially in marketing, frequently manage change incrementally. This has sometimes been called *strategic drift* (Johnson and Scholes, 1987), where the rate of external change is greater than the rate of internal change and adaptation. Before the case study featured in this paper, the strategic drift of M&S had already been well documented (Beaver, 1999; Bevan, 2001).

Value-based management (VBM): this concept is essentially one which involves seeing a business or a group in the same way as one would an investment project, that is, it is something to evaluate using discounted cash flow techniques to get at its present value. The term economic value added (EVA) was coined to differentiate it, at least for presentation purposes, from net present value (NPV), which is essentially more or less the same concept. Whilst corporate performance had previously primarily been judged either short term or historically, based often on single period results and ones based on accounting accruals, VBM was:

- Forward looking, sometimes 5 to 10 years ahead.
- Based on cash flow estimations.
- In more refined versions on competitive scenarios, there was often a detailed analysis of value and cost drivers.

There is a very extensive literature on VBM, which has accelerated in recent years (for example, Rappaport, 1986; Copeland *et al.*, 1990; Bennett, 1991; McTaggart *et al.*, 1994; Black *et al.*, 1998; Madden, 1999; Young and O'Bryne, 2000; Morin and Jarrell, 2001) but most of the literature, with some notable exceptions (notably see Reimann, 1990; McTaggart *et al.*, 1994; Grundy, 1998, 2002), focuses on technical and financial aspects. This paper focuses on the latter part of the literature, which stresses concepts such as:

- Understanding external and internal value and cost drivers (Grundy, 1998).
- Linking strategic and financial appraisal.
- Managing the value gap, which is essentially the difference between internal EVA estimates and market capitalization, and the gap between current and desired future EVA creation.

Perhaps the nearest concept to strategic engineering was that of Slyvosky (1996), who argued that sometimes, the basis of economic value added has to be fundamentally reappraised.

Stakeholder analysis: again another important theme is incorporated here, in view of the behaviours and agendas of individual service managers, shareholders and other outside parties on business strategy re-engineering. These influences can accelerate, retard or deflect needed re-engineering, as illustrated in the case of M&S. Most relevant literature on this topic includes Piercey (1989), Grundy (1996, 2001, 2002) and Grundy and Brown (2002). In particular, two techniques from the literature, on stakeholder analysis (Piercey, 1989) and dealing with each individual stakeholder preference (Grundy, 2002), are helpful here.

Scenarios: are a very useful strand in strategic thinking and there has been significant literature on the topic (Van de Heijden, 1996; Wack, 1985a; Ringland, 1998). However, scenarios tend to be associated with big picture, external environments, as opposed to the more behavioural aspects of strategy. There are some notable exceptions, for example with team behaviours (Grundy, 1999) and acquisition deals (Grundy, 2003).

In conclusion, these five streams of thinking are both highly complementary and interdependent, and can be used to illuminate the concept of business strategy re-engineering. Having covered the most relevant literature, attention can now be directed to the case of M&S. The key insights can thus be summarized as follows.

Brief history and background

In 1994 Marks and Spencer plc was a very large, successful business with turnover of

£6.5 billion and profits before tax of £851 million. Fourteen million customers then shopped with the company every week. The core business focused traditionally on high street retailing and clothing products for all the family. This general business contributed nearly £3.8 billion of turnover. By 1994 it had also built a very successful food business, which accounted for some £2.6 billion of turnover (40% of the group). During the 1990s the company had successfully diversified into personal financial services, although this business is still relatively small compared with the core portfolio. Growth was primarily of an organic nature and overseas ventures, both acquisitive and organic, had met with variable success.

The main driver of increased profit growth over the period from 1985 to 1994 was the improvement in operating margin, up from 9% of turnover to 13%. This kind of improvement could come in a number of forms, such as higher prices, fewer or lower discounts, or supplier productivity improvements and delaying refurbishments. The success of the company depended upon a philosophy of value for money, quality and service. It had built a strong brand which appealed to a high proportion of the middle market in the UK, who displayed high brand loyalty. The company was very selective in having quality locations and relatively simple product ranges. It was also selective in the things which it did not do, for example, it did not accept credit cards and avoided catering for high fashion. It was also famed for insisting on the absolute best from its suppliers. M&S had thus built a very successful model for creating economic value based on a deliberate strategy which hitherto was not threatened by either external change or stakeholder pressures. In the mid-1980s M&S began to lose ground to new competitors, such as Next and The Gap, which targeted M&S and offered quality clothes with more fashion. This attack was good for the company which, for a period, regained much of the initiative and refashioned its competitive advantage. The company also had some critical areas of competitive disadvantage, which were increasingly as follows:

M&S had thus built a very successful model based on a deliberate strategy

- An over-cautious approach to managing its strategic development.
- Its apparent lack of flexibility, for example in refusing to take non-M&S credit or debit cards.
- Increasingly bureaucracy and rigid procedures, with a resistance to change.

A former manager of M&S, who left in the early 1980s, in an interview stated that: '*M&S was a great place to work; we knew what we were doing and until the early 80's the original family drove the business. But it began then to go downhill when the management became greedy and complacent even before the 1990's*'.

By 1997, the company's business portfolio was of varying competitive strength, for instance, between clothing, food, other items and financial services, both in the UK and internationally. Although it had some impressive product lines, particularly women's lingerie and its successful foods business, this was offset by a number of strategically and financially less interesting business areas, such as men's shoes and home furnishings. During the period 1997–1999 a number of external market shifts, which were effectively external performance brakes, began to crystallize:

- Despite continued economic recovery, consumers became more discerning. Where they were asked to pay a premium price, they appeared to want a strong brand and that brand was, at least in the young and middle-age groups, not M&S.
- Competition for upmarket foods increased significantly, for example, with Tesco's *Finest* lines.

- The company's international expansion faltered, with a U-turn on investment in countries such as Germany.
- New entrants to the UK retail market, such as The Gap and Matalan, began to take more share of the younger market, pushing M&S up the age range where it was under increasing attack from Next and Debenhams.
- The fashion cycle was accelerating so that the two-seasons-a-year merchandizing process at M&S became unwieldy and obsolescent.

Meanwhile, M&S continued to pursue its international expansion plans whilst its UK position came under increasing attack. It then made some major changes to its strategy in the period 1998–2000 as follows:

- It decided to partially abandon its dependency on its traditional brand, St Michael. Ambitious plans to develop more exciting merchandizing ideas came from its *Autograph* range.
- The previous chairman, Sir Richard Greenbury, eventually retired from the board. Sir Richard had overseen the company's success in the early to mid-1990s, but admitted (Money Programme, 2000) that its financial success was at least partially due to cost cutting.

The company's path of strategic change followed very closely the concept of *logical incrementalism* (Quinn, 1980), which involves limited attempts to extend and review the business model, rather than considering whether it needed full-scale strategic and re-engineering. Meanwhile, the core business of both women's clothing and food was in a state of strategic drift (Johnson and Scholes, 1987). M&S then tried to enliven its underwear with joint ventures with Agent Provocateur appearing to push very aggressively into more adventurous and sensual markets. This again proved unsuccessful and was subsequently abandoned.

M&S also recruited George Davies (formerly of Next) to form an alliance to create a new sub-brand, called Per Una. Both centres, given the companies' weakening strategies, drifted, falling into the paradigm of logical incrementalism. In 2000, profits after tax and after exceptional items were down to £258.7 million compared with a £258.6 million dividend, leaving an eventual surplus of just £0.1 million. Whilst M&S still has an enviably well-known brand and a deep customer loyalty in some market segments, there is no question that its brand and corporate reputation had been significantly tarnished (Beaver, 1999). Just before the start of the new millennium the company revealed a number of changes, aimed at influencing its performance:

- *In management*. The long-standing chairman left the board and a number of other top-level management changes were made.
- *In its supplier base*. M&S moved fast to cut the less effective parts of its UK supplier base. Unfortunately, not all of these savings were to help the company's bottom line, as they were needed to substantially reduce prices.
- *In marketing and promotion.* The company began to advertise more aggressively and to introduce more aggressive promotions.
- *In its credit card policy*. M&S decided to allow stores to accept credit cards for the first time in its history.
- *Repositioning of the stores*. By offering better value for money and improved service, and by better display and presentation of merchandise.

By late 2000/early 2001, M&S appeared to be in ever deeper trouble. According to the *Financial Times* (January 24, 2001), Christmas trading had been even worse and in the 16 weeks to January, group sales were down 3.1%, down 5.1% on a comparable store basis. Clothing, footwear and gifts were down 9.3%. On the plus side, there was an improvement of 2.9% in food. However, the 25 new concept stores were only 4% ahead, despite an expenditure of some £60 million in refitting. Luc Vandervelde, the new Executive Chairman, had originally given himself two years to turn the store around, but by early 2001 time appeared to be running out. But still, M&S appeared not to have grasped the full scale of its strategic re-engineering problem.

In March 2001 M&S announced new steps to turn the company around, including:

- Job cuts of 4400.
- Closure of many European stores.
- A share buyback when property sales had gone through; Brooks Brothers in the USA, and Kings Supermarkets (*The Times*, March 30, 2001).

In a television interview Mr Vandervelde said that the company's decline, before his arrival, had occurred over a five-year period and it would take about five years to reverse. The M&S case highlights a number of very major brakes on performance, each of which is ripe for further diagnosis. These include:

- Service standards;
- Dated store formats;
- Lack of appeal to many under 30s;
- Alienation of the traditional customer base, especially women's clothes;
- Limited success of re-launch through designer clothes and store upgrades;
- A slow time to market with new products;
- Aggressive new entrants characterized by low price and reasonable quality;
- Limited innovation in food;
- Lack of critical mass in new product areas, e.g. mobile telephones.

To this list could be added further internal difficulties and thus performance brakes:

- Speed of internal change
- Employee morale
- Cost constraints
- Supplier morale.

The scale of the strategic re-engineering task seems to have been too great for its Chairman and CEO to handle, especially given what appears to be their personal agendas. By spring 2004 trading further deteriorated and now its *Lifestore* concept had proved disappointing. The company's share price began to fall sharply, leaving it potentially exposed to a break-up bid.

In summary, by May 2004:

- M&S new innovations were only a patchy success and were incremental with new projects being costly and risky. They were insufficient to fill any value-gap.
- The company's appeal to its core women's wear markets was fragile.
- Its stores were often old-fashioned, lacked appeal and were increasingly hard for many customers to understand, further increasing its strategic drift.
- There were considerable gaps in its management skills, leaving M&S vulnerable to competition from top quality retailing skills from elsewhere, and its direction was still heavily influenced by more narrow personal agendas.
- Its financial recovery was fragile and the fall in its share price clearly left it exposed to a takeover bid. Its shares had recovered to around 420 pence in late 2001 but declined later to around 270 pence. (In 1997 they had been worth a staggering 650 pence.)

This economic value destruction was now such that continuance of the existing business model without more fundamental re-engineering was probably unsustainable.

Unfreezing the past: the anatomy of a deal

By April 2004, M&S was again in the press for having lost its way (*Observer*, 18 April, 2004). At the time, it was rumoured that its high-profile Chairman, Luc Vandervelde was planning his exit. Also, Vittorio Radice (Head of Design) had recently been appointed as head of clothing and challenged with the mission of transforming the company's entire look. The food business was now being run by the former head of menswear, who had no proven track record of selling food. According to many sources the company's new ranges designed by Yasmin Yusuf were getting lost amidst the dull layouts. To compound uncertainty, it was alleged that George Davies, the designer of its Per Una range, was due to leave at the end of June. Many media sources compared M&S unfavourably with a number of other stores like Zara and Top Shop. The very existence of these stores made the company's ageing format even more dull. M&S was reaching the limits of its capabilities on strategic change, value-based management and stakeholder agenda grants (see Figure 1).

On Friday May 28, 2004, Philip Green launched a bid worth around £8 billion to buy the company. According to the *Daily Express* (May 28, 2004), Green said that he had been watching M&S for years and that now was the right time to make a bid. Green's personal wealth was then estimated (*Guardian*, May 28, 2004) at £3.6 billion, so he was well placed to make a credible bid for the company. He also had what M&S then lacked — retail flair. As of May 2004, M&S awaited the arrival of Kate Bostock from Asda, who was not able to take up position until the autumn. In contrast, Green could apply his incisive skills very quickly and in addition was a proven and skilled cost-cutter.

Even before details of a bid emerged, analysts were saying that a 400 pence price might be justified if the financial services business and properties could be sold for £3 billion. If M&S had around £685 million of after-tax profits and operating profits were increased to the level of Next (per square foot) by 50% (a considerable stretch), then this would produce a 10% after-tax return. From an external perspective, it appeared easy to identify business strategy re-engineering opportunities, but internal stakeholder interests had inhibited this realization previously. After the bid by Green, the M&S Board moved fast, beginning the first stage of its real strategy re-engineering programme. They removed both its Chairman and CEO and appointed Stuart Rose on Sunday May 30, 2004. The *Financial Times* outlined Rose's imminent moves as:

- A management shake-up.
- Sorting out the company's core women's wear ranges.
- Cost-cutting of head office staff.
- Review of the property portfolio to release its full shareholder value.
- The likely sale of M&S Money for around £1 billion to another financial services group.

Discounting the possibility of an even higher bid, M&S shares leapt from around 290 pence to 360 pence, suggesting that previously its shares had been undervalued by at least 24%, albeit against an optimistic and high economic value-added re-engineering scenario. At the time Green headed the biggest private retail group, with 12% of the UK retail clothing landscape. In 2003 his stores generated £3 billion in sales and £252 million in profits. His aggressive, commercial attitude was summed up by *The Times* (June 3, 2004) as:

> '*I was in an M&S store last month. I thought I have got to buy this*'.

Putting a value on the re-engineering bid

Green's bid involved offering both cash and a stake in the residual company majority owned by him. The offer was in many respects unusual in so far as it was a complex package which was hard to put a value on. The *Daily Mail* (June 5, 2004) valued his offer at £8.3 billion, or approximately 350 pence a share. The complex bid structure made it very easy for the M&S Board, now with Stuart Rose in charge, to reject this bid as a significant undervaluation and to influence other stakeholders in that direction. It seemed strange at the time that Green did not appear to have examined this from the perspective of the other stakeholders in a potential corporate break-up. If he had, surely he would have realized that besides this bid not being successful, the market might raise its expectations of what Green would eventually have to pay. Now that Rose was in place as well, the new M&S Board had a much better chance of releasing shareholder value through the new top management who were also now in place. Taking a value-based management perspective, arguably, when a business is acquired, these savings should accrue to the bidder, as it is they who have to carry them out. But where a vendor of a business has relatively strong bargaining power, then they seek to capture a share of that value. The argument, were one to be needed, for this share being accrued by existing shareholders, would be that 'we can effect this turnaround ourselves, anyway'. These discussions highlight the need to consider, in the M&S case, the context of re-engineering via acquisition:

- How much value is being created by any re-engineering (after transaction costs), both at the time of the deal and afterwards?
- Who, in effect, is creating that value?
- What are the respective bargaining positions of the various parties?
- What deal strategies and tactics will be advantageous to relevant parties?
- How can speed/surprise be used to advantage?
- Who are the key stakeholders, what is on their agendas and how can they be best influenced?
- What scenarios can be envisaged about how the bid might evolve?

Again, a carve-up of the value of M&S seems to be down to the relative merits of the alternative management teams poised to run the company and their subjective appeal to stakeholders, highlighting the importance of this stakeholder dimension. Also, whilst Green had made considerable cost savings in the past, for example at BHS, he had apparently not been able to significantly improve its market share. Again, in a bid-war-turned-hostile, the advisers to M&S could easily seek to discredit Green's retailing pedigree.

By June 6, 2004, Stuart Rose had already made his mark at M&S. The *Financial Mail* (June 6, 2004) highlighted that by 'junking' both Vandervelde and Holmes and by bringing in Rose and his assistant Charles Wilson, described as one of 'the most ruthless cost cutters in the business', M&S now looked a plausible, potential strategy re-engineering story. Not only this, but Philip Green might now struggle to finance a full, or near-full offer, as by increasing debt further the company's credit rating might plunge to junk level, alienating many stakeholders. Green obviously had the option to undertake a hostile bid, but with real downsides in damaging the morale of M&S staff. Only weeks later did the press highlight the fact that Green clearly did not want to go hostile due to the cost and risk of this option, limiting his overall options and flexibility, implying that he had become the victim of his own stakeholder agendas.

On the other hand, even with dramatic top management changes, Rose inherited the M&S bureaucracy which might prove slow to cut through. But he made a quick start by axing Vittorio Radice (June 19, 2004), with the marketing director also resigning. By this stage the company's 'Simply Food' project, involving small, decentralized food-only stores at railway stations and motorway service centres, came under the press spotlight. The *Daily Mail* (June 16, 2004) highlighted that Simply Food often cannibalized food stores in other M&S locations, sometimes by 10%, suggesting that value-based management was not a company philosophy. By June 13, 2004, Green had also leaked his intentions not to make a £9 billion bid, equivalent to 400 pence a share. Major investors had felt this was the minimum that they would need in order to sell to Green, but clearly he was anxious to dampen their expectations (*Financial Mail*, June 13, 2004).

Green also began to send mixed messages, deliberately no doubt, to the investor community that he was prepared to try a second time with an all-cash deal. Meanwhile, Lloyds TSB were also now mooted as a potential contender to buy M&S Money for around £900 million. Lloyds had recently bought the credit card company Goldfish and by buying M&S Money they would acquire 2.1 million extra credit card owners. Again, however, strategy re-engineering had a limited scope, with the same argument of 'release potential economic value' not being applied to foods, which might well have released value through flotation. By June 16, 2004, Rose gave himself a month to organize the defence of M&S, namely, 12 July, as the date when he would set out steps to improve current operating performance.

To summarize:

- Green was now becoming more and more on the defensive, now Rose had quickly assumed power and was projecting it back at Green in a focused and very grounded way.
- Green seemed to believe that his financial bait to the M&S shareholders (over Rose's head) would be sufficient to woo over sufficient support to make the M&S Board capitulate.

On June 17, 2004, Green tabled his second bid for £8.4 billion. This valued M&S at 370 pence per share but the M&S Board again suggested that the bid was unacceptable as it significantly under-valued the business. M&S shares now rose to 363 pence. According to *The Times* (June 17, 2004), Green now had three options:

1. To raise his bid to reach the 400 pence psychological price which many shareholders appeared to be looking for.
2. To go hostile: Green would approach M&S shareholders without the M&S Board approval, which would be more expensive to fight.
3. To walk away: in this case under Takeover Panel rules, Green would not then be able to make another bid for six months.

Could it be that Green had not really thought through the deal-making scenario he now found himself in? Perhaps he never banked on Rose's appointment when he made his earlier plans, but both bids were made after he became aware of Rose's presence. This again implies inflexibility and perhaps even naivety, and that Green was primarily driven by his own personal agenda, that shareholders would be persuaded by a new price much higher than the pre-bid value, even though they now had Rose in the driving seat. By raising his bid from £7.3 billion to £8.4 billion Green must now have been quite close to his 'walk-away-from' price. He would now appear to have got himself into a tight corner, and with the M&S Board well ensconced to make a powerful case in July to prevent Green from taking over. With the time ticking by, Green must have been torn between his personal ambitions and agendas and his considerable financial instincts to take a profit and exit.

Before discussing how the company's future was resolved at the time of writing, it is as well to summarize the key issues arising from the case study:

- Business strategy re-engineering clearly requires skills, particularly in anticipating the actions of other players and simulating competition for a deal. Rose appeared to show a keen appetite for such a management style, whereas the previous management of M&S appeared far less radical in thinking.
- From VBM theory, different valuation strategies exist, highlighting that economic value added could be separately diagnosed for a) existing performance, b) new strategic development and c) disposal strategies. Deal outcomes are likely to be driven by the vendor's desire, acquisitions, vendor's options, acquirer's options and the time pressure to do a deal (see **Figure 2**). Green's

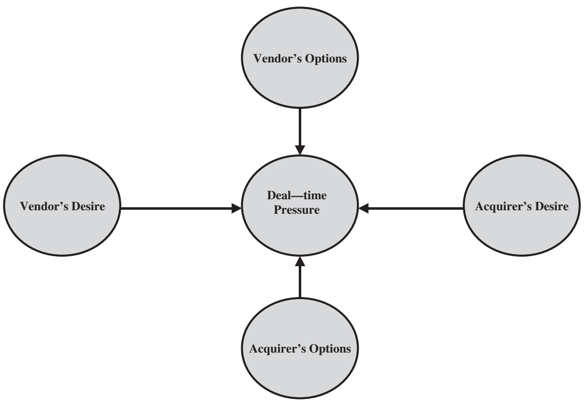

Figure 2. Factors influencing value sharing — in an acquisition.
Source: Grundy (2003).

only other option was perhaps to try to acquire Sainsbury (not his core area of skill), whilst the vendor, the M&S shareholders and Board, now appeared under a lot less pressure to sell.

- A brand such as M&S clearly has considerable economic value, and an extension of the brand might generate considerable cash flows and net present value. In the media commentary on the bid there had been little discussion of the M&S brand value, which, following a successful repositioning, could be significant. Surely this was an area for Rose to emphasize, together with his longer-term plans to exploit it? Curiously, this did not appear to happen.
- In a deal of this nature clearly some assessment of the *value gap* (between present value of the existing strategies' cash flows and the market capitalization) is crucial. It seems surprising that M&S under-performed for so long before Philip Green's bid pointed to its under-valuation relative to its potential. Also stakeholder agenda analysis and deal scenario story-telling might have been useful and to greater advantage to gain a deal edge in this particular context.

At this point, the company's future seemed critical. Green had, through his bid, through his critique of M&S and with his offer 50% above the company's previous share price, clearly made it impossible for M&S to remain the same ever again. However, the argument was still very much open as to who might give the company's shareholders maximum economic value.

On July 7, 2004, some increasing difficulties began to be encountered by the Green faction. Green had asked M&S a number of questions which they had refused to answer. In particular, there were concerns about its potentially under-funded pension scheme. According to the *Financial Times* (July 5, 2004), the impact on the M&S share price could potentially be 30 pence a share, or under-funding of £670 million (*Daily Mail*, July 4, 2004), a potential deal-breaker if Green was expected to bid at the more psychologically acceptable level of 400 pence a share. Months earlier, Permira's bid for W.H. Smith was withdrawn for the same reason, so it should have been possible to work this into some scenario story-telling. Meanwhile, the M&S pension fund was being unsurprisingly resistant in giving Green any information at all. This was unsurprising as its Board was clearly very much on the M&S Board side, with both organizations sharing the same finance director. The pension fund appeared to dislike Green also, as his future capital structure would be leveraged and risky, making the funding ability of the M&S pensions fund more uncertain (*The Times*, July 8, 2004). On July 6 Green acted for the third and potentially final time. Green now offered either:

- 400 pence a share in cash, or
- 330 pence plus a 30% share in Green's acquisition vehicle and revival, offering a potential capital gain upside.

Whilst, from a deal perspective, this was excellent timing, according to *The Times* (July 8, 2004), the takeover panel forced Green to show his cards. This offer was worth £9.1 billion and involved Green putting up another £400 million, taking his stake to £1.5 billion, or half of his personal fortune (*The Times*, July 8, 2004). The 400 pence offer was very well received by most institutional investors (*The Times*, July 8, 2004), and it looked, at least on an economic basis, that the M&S Board would have a very tough job defending it. Analysts were now expecting the share price to drop by 70 pence to 330 pence, were Green to retract his offer. As put succinctly by *The Times* (July 7, 2004), this put a £1.75 billion price on Mr Rose's head. Rose was expected to unveil a business strategy re-engineering package that consisted of:

- £80 million cost reductions annually.
- £100 million savings by squeezing suppliers.
- Scrutinizing the property portfolio and raising money for a share buy-back (unquantified at this point).

- Sale of peripheral assets and sale, or refinancing, of the M&S finance division.

This re-engineering package still seems incomplete. Interestingly, during all of this action and commentary, no one had identified the foods business as potentially one of unlocked value. Furthermore, Green's expertise was not in food, but in clothing. It could be that Green had been considering the flotation of the foods business, a possibility identified as early as late 2001 (Grundy, 2002). On July 7, 2004, the under-funded pension scheme surfaced again. Taking the M&S perspective, this was a wonderful form of defence against Green. With its Chairman, David Norgrove being a former M&S director, it was hardly surprising that the fund would take such a stance, perhaps exaggerating the potential cost and with the M&S Board still refusing to reveal their true financial position to Green, the predator would find himself unable to quantify the downside and less inclined to push the deal forward.

The newly constituted M&S Board were thus able to manipulate stakeholder agendas to limit the scope of strategic engineering to that which delivered economic value less than that perceived by Green. On Wednesday July 7 Green then made what would have to be — at least for six months — his final move, which might have been his ultimate mistake, or not. He decided that he would not be able to offer more than 400 pence a share, the magic number which had been thought to be the minimum necessary price to win control. Initially press and television commentary suggested this could be a knock-out tactic, especially as on July 8 M&S won the backing of the US investment fund Brandes, with the condition that the M&S Board now agreed to a bid.

Green had made the offer 'final', thus preventing him, under Takeover Panel rules, from making a fresh and higher bid for six months unless another party were to bid for the company. He had also ruled out a hostile bid (*Financial Times*, July 8, 2004), thus reducing his options and reducing his negotiating power (see Figure 2). By July 9 the pressure was mounting even more on M&S. Many major shareholders were expressing their disappointment at the M&S Board's rejection (*Financial Times*, July 9, 2004). The expectations of shareholders were increasing, with the *Financial Times* suggesting that Rose must be able to tease shareholders with a possible value of 450 pence a share, or otherwise they would find 400 pence easily irresistible.

It was only at this stage of the bid that analysts started to discuss the more detailed composition of the shareholders. By July 11, 2004 (*Sunday Times*) some 30% of M&S shares were in the hands of mainly US hedge funds, financed by borrowings which did not have voting rights, clouding the picture. These shareholders were in for a quick profit and this was their sole agenda. The *Sunday Times* estimated that 45% of shares were held by investors who would like to exit at 400 pence but maybe not enough to achieve a final blow, but only 25% of shares were now held by smaller investors and these might have fragmented influence. On 12 July, Rose announced his re-engineering strategy. This involved the following:

- A return of £2.3 billion cash to the shareholders (or £1 a share).
- To raise £762 million from the sale of its financial services shares to HSBC (but returning half of future post-tax profits).
- To buy the Per Una brand for £125 million (with profits of £17 million).
- To revalue the property portfolio by £1.4 billion to £3.6 billion.
- Cost savings of £250 million for 2005–6 and £320 million by 2006–7 (including 650 job cuts).
- The closure of some Simply Food stores and Lifestores.
- In 2005–6: '*To improve products and services*' but without the disclosure of details of how this was to be achieved.
- In 2006–7: '*To broaden M&S appeal to a broader customer base*' but how this was to be implemented remained an issue.

As was discovered in the early 1990s, when the de-merger of ICI generated £5 billion of shareholder value following the hostile bid of Hanson, considerable shareholder value can be released on a radical de-merger as part of business strategy re-engineering. M&S foods were in much better shape than its clothing and probably had been held back by the distractions elsewhere. Oddly, the foods business, which accounted for almost 40% of M&S turnover, was hardly discussed at all by the media for this period, which appears to be a remarkable omission. With a more aggressive and innovative foods strategy, M&S could have yielded a very large market capitalization through disposal or de-merger of its foods business, which could have been used to reduce Green's high gearing. Interestingly, in none of the commentary seen to date was this particular option even hinted at. The *Financial Times* then summarized the key differences between the two plans as:

Rose	Green
£320 cost savings by 2006–7	Higher than £320 million
Achieve this more slowly	Achieve this more quickly
Low/medium risk	Very high risk
Higher capital investment	Probably tighter control of investment

By July 13, 2004, the outcome appeared to be still on a knife-edge, with a rational investor maybe preferring to take his 400 pence now, rather than to see his shares probably slide if Green walked away. They were currently trading at 368 pence, suggesting that a fall would be likely if Green did exit. In the event Green now decided to make M&S an ultimate ultimatum — '*Back me or I back off*' (*Daily Mail*, July 13, 2004). On the same day Standard Life signalled that it was backing Rose, which was a crucial transitional event in scenario theory. With its 2.07% share, this was sufficient to shift the balance of the battle against Green, indicating just how marginal its outcome had become. On Wednesday July 14 Green finally backed off. He had no more room to manoeuvre and had been spending £5 million a day on this battle (M&S fees had amounted to £40 million). However, he had, according to the *Financial Times*, been a major catalyst for monumental change at M&S, increasing its share price significantly. The bid for M&S was unique both in its scale and in the extent of personal involvement and investment by Philip Green, together with its media exposure. Only the disposal of Rover by BMW in 2000 succeeded in obtaining greater media coverage in recent times. From an analysis of M&S history and its position in early 2004, it would therefore appear that the company required fundamental business strategy re-engineering, including a change in its leadership. Green's third and final bid was at a price 50% greater than that pre-bid, showing the scale of the value gap between its previous 270 pence valuation and what it now appeared to be, 360 pence, plus with some new, if relatively obvious strategies, highlighting just how overdue strategy re-engineering had become.

Clearly there was still therefore a considerable value gap between the M&S potential restructured value and its then market capitalization. Whilst its previous leadership were probably not unaware of this, their combined incremental strategies leading up to May 2004, to roll out Simply Foods, Per Una and Lifestore and its extension into sub-brands, were not working, and unlikely to work or be sufficient to fill the value-gap, suggesting that strategic change was not being managed appropriately and in the right direction.

Conclusions

In summary, the M&S case study illuminates the following key points on business strategy re-engineering:

- Managers often believe they have a resilient strategy when (a) they manage their core businesses in an incremental way without radical re-thinking and (b) as long as they are engaging in incremental and deliberate strategies which on the surface appear necessary but in reality are not sufficient to deal with the problem.

- Where internal stakeholders are driven by substantial personal agendas, then through their political skills they can still hang onto power. The BBC Money Programme documentary in October 2004, which was extensively researched with analysts and other industry experts, reaches the conclusion that Green had the more appropriate management skill following the challenge than Rose.
- Value-based management approaches can potentially help give a real impetus to strategy engineering and help to cut through the resistance of stakeholders.
- Scenarios can play a most useful role in helping to anticipate the outcome of different re-engineering scenarios.

More generally, a very influential strand in strategic management theory over the last decade has been that of incrementalism and emergence, with the design school of strategy being sidelined. But as this paper has shown, there is a very strong argument for the design school of strategy, especially if strengthened by an enlightened, value-based management perspective. Where this is softened by both scenario story-telling and through explicit use of stakeholder analysis, then this can offer both some very useful explanatory frameworks and practical techniques for managers.

By integrating this approach under the banner of business strategy re-engineering, it is possible to encourage managers to engage in more strategic thinking in both a structured and fluid way using scenarios, and to avoid strategic drift and to focus on value creation and with the explicit discussion of stakeholders and their agendas. The M&S case study graphically highlights the utility of these explanatory and diagnostic frameworks. Had the M&S Board thought more along these lines prior to May 2004, then maybe the Green versus Rose battle might never have occurred. Alternatively, perhaps if Stuart Rose were to adopt these ideas explicitly then his journey towards restoring the M&S brand, reputation and its shareholder value might be eased.

Biographical note

Tony Grundy is a Senior Lecturer in Strategic Management at Cranfield University School of Management and an active independent management consultant. Tony is the author of 17 books, including *Be Your Own Strategy Consultant*, published by Thomson Learning. Before joining Cranfield, his previous career spanned Ernst and Young, BP, ICI and KPMG. Tony is on the editorial board of *Strategic Change*.

References

Beaver G. 1999. Competitive advantage and corporate governance: shop soiled and needing attention, the case of Marks and Spencer plc. *Strategic Change* **8**(7): 325–334.

Bennett SE. 1991. *The Quest for Value*. Harper Collins: New York.

Bevan J. 2001. *The Rise and Fall of Marks and Spencer*. Profile Books: London.

Black A, Wight P, Bachman JE. 1998. *In Search of Shareholder Value*. Financial Times Management Leader: London.

Braybrooke D, Lindblom CE. 1963. *A Strategy of Decision*. The Free Press/Macmillan: New York.

Copeland T, Koller T, Murman M. 1990. *Valuation: Measuring and Managing the Value of Companies*. John Wiley & Sons: New York.

Grundy AN. 1996. Accelerating strategic change: the internal shareholder agenda. *Strategic Change* **5**: 1–8.

Grundy AN. 1998. *Exploring Strategic Financial Management*. Prentice Hall: Hemel Hempstead.

Grundy AN. 1999. Strategic behaviour — the driving force in strategic management. *European Management Journal* **17**(3): 326–335.

Grundy AN. 2001. Strategic change, competitive strategy and strategic agendas. *Strategic Change* **10**(5): 247–258.

Grundy AN. 2002. *Shareholder Value*. Capstone: Oxford.

Grundy AN. 2003. *Mergers and Acquisitions*. Capstone: Oxford.

Grundy AN, Brown L. 2002. *Be Your Own Strategy Consultant*. Thomson Learning: London.

Hammer M, Staunton S. 1995. *The Re-engineering Revolution*. Harper Business: New York.

Johnson G, Scholes K. 1987. *Exploring Corporate Strategy*. Prentice Hall: Hemel Hempstead.

Madden BJ. 1999. *Cash Flow Return on Investment*. Butterworth Heinemann: Oxford.

McTaggart JM, Kontes PW, Mankins MC. 1994. *The Value Imperative*. The Free Press/Macmillan: New York.

Mintzberg H. 1994. *The Rise and Fall of Strategic Planning*. Prentice Hall: Hemel Hempstead.

Morin RA, Jarrell SL. 2001. *Driving Shareholder Value*. McGraw-Hill: New York.

Mintzberg H, Ahlstrand B, Lampel J. 1998. *Strategy Safari*. The Free Press: New York.

Piercey N. 1989. Diagnosing and solving implementation problems in strategic planning. *Journal of General Management* **15**(1): 19–38.

Quinn JB. 1980. *Logical Incrementalism — Strategies for Change*. Richard D. Irwin: Illinois.

Rappaport A. 1986. *Creating Shareholder Value*. The Free Press: New York.

Reimann B. 1990. *Managing for Value: A Guide to Value-Based Management*. Basil Blackwell: Oxford.

Ringland E. 1998. *Scenario Planning*. John Wiley & Sons: Chichester, UK.

Slyvosky J. 1996. *Value Migration*. Harvard Business School Press: Boston, MH.

Van de Heijden P. 1996. *Scenarios — the Art of Conversation*. John Wiley & Sons: Chichester, UK.

Wack P. 1985a. Scenarios: uncharted waters ahead. *Harvard Business Review* **Sep/Oct**: 73–89.

Wack P. 1985b. Scenarios: shooting the rapids. *Harvard Business Review* **Nov/Dec**: 139–150.

Young SD, O'Bryne SF. 2000. *EVA — and Value-Based Management*. McGraw-Hill: New York.