

Practical Dimensions of the Debate Strategy VS Structure of Trace Group Hold AD

Nikolay Mihaylov

University of Architecture, Civil Engineering and Geodesy – Sofia,
Bulgaria, Sofia 1408 "Lozenets", residential group "South Park", 12
"Nikola Obrazopisov" St.

Telephone: +359 882 949 469

Email Address: mihaylov@tracebg.com

Reviewers:

Daniela-Tatiana AGHEORGHIESEI (CORODEANU), Alexandru Ioan Cuza
University of Iasi, Romania;

Jari Roy Lee KAIVO-OJA, University of Turku, Finland;

Spartak KEREMIDCHIEV, Economic Research Institute at Bulgarian Academy of
Sciences, Bulgaria;

Eduard MARINOV, Economic Research Institute at the Bulgarian Academy of
Sciences, Bulgaria;

Gerasimos SOLDATOS, American University of Athens, Greece.

Abstract

This article represents a continuation of the debate over the interaction between strategy and structure. The research is based on the evolution of the Bulgarian construction holding company Trace Group Hold AD. It outlines the development of the holding company throughout its three stages characterized by the employment of different strategies and structures. The summarized analysis of the path traversed by Trace Group Hold AD points to the thesis that strategy determines structure. Another important conclusion is that the interaction between strategy and structure should be viewed as a dynamic development cycle rather than as a flat correlation between the two categories.

Keywords: strategy, structure, interaction cycle

JEL codes: M15

Overview of the issue

Strategy and structure are two fundamental notions for each undertaking.

Strategy is the direction and scope of an organization over the long-term which achieves advantage for the organization through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations (Johnson et al. 2008). Strategy refers to the determination of long-term goals and objectives, the adoption of courses of action and allocation of resources required to achieve goals.

Structure is a fundamental, tangible or intangible notion referring to the recognition, observation, nature, and permanence of patterns and relationships of entities (Mintzberg, 1987). Structure, whether formally or informally defined, has two aspects. It includes, first, the lines of authority and communication between different administrative offices and officers and second, the information and data that flows through the lines of communication and authority (Chandler, 1962).

From study of the four American companies - DuPont, General Motors, Standard Oil of New Jersey, and Sears, Chandler found that (i) analysis of the creation of the new administrative structure required knowledge of the firm's entire administrative former history; (ii) changes in organization were related to the way the firm expanded; (iii) the patterns of growth reflect changes in the overall economy, and (iv) reorganizations were affected by the state of administrative science at the time. In brief, his solution of the debate is that structure follows strategy (Chandler, 1962).

Other researchers inverted Chandler's thesis, suggesting that strategy follows structure (Hall and Saias, 1980; Kavale, 2012). For example, they point out that a multidivisional structure biases a firm towards a conglomerate strategy. Henry Mintzberg offered a balanced view, arguing that the relationship between strategy and structure is reciprocal. "Structure follows strategy ... as the left foot follows the right." (Mintzberg, 1990).

The way in which the debate has developed so far is very much like the philosophical question of which came first, the chicken or the egg. The logic starts with the premise that structure is the function of a pre-defined strategy and it is as true as the reversed assertion that as strategy is developed by people coming from a certain structure, it is structure that determines strategy (Figure 1).

Fig. 1.
Conventional
perception of
the interaction
strategy vs
structure



Breaking this vicious circle calls for a fresh perspective on the debate. This is precisely what this paper suggests, building on the experience of a large Bulgarian construction holding company, namely Trace Group Hold AD.

The path of Trace Group Hold AD and the debate strategy vs structure

Trace Group Hold AD is the company with the fourth largest turnover and the only listed public company in Bulgaria's construction sector. The holding company is listed on the Bulgarian Stock Exchange and it applies the principles set out in the National Corporate Governance Code, including the principles of accountability and transparency of operations (National Corporate Governance Committee, 2012, in Bulgarian) Therefore it is a particularly felicitous choice for research of this scientific issue.

Trace Group Hold AD was established as a private equity company in 2004. Three stages of development can be discerned in the history of the holding company, each characterized by a different strategy, structure and object of activity.

During the first stage, the holding company was established and its initial structure and business took shape. That stage covered the period from 2004 to 2006. The initial structuring followed the strategy of acquisition of local monopolies in the road maintenance sector. In the course of a series of acquisitions and mergers, resulting from the redistribution of ownership in the privatization process in this country,

the holding company became the majority owner of 14 subsidiaries in south Bulgaria. Most subsidiaries were involved in the maintenance of roads in the relevant regions of the country and also in the production of building and inert materials and products thereof. Those undertakings constituted the backbone of the holding structure.

The exception to that pattern was the main company in the holding structure, Patstroyinzhenering AD, Stara Zagora, which had experience and capabilities to implement nationwide road reconstruction and rehabilitation projects. That was another venue of the holding development strategy. The pooling of many road maintenance companies together boosted the potential for participating in procurement procedures to build new roads. At that time, it was only an anticipation against the backdrop of the forthcoming accession of Bulgaria to the EU and the opportunities for building and extending the national road infrastructure with European development funds.

Such opportunities existed during the pre-accession period, too, but on a much smaller scale. For the purpose of their successful use, the holding setup included design, investment, engineering and marketing units at the central level. That was the way in which the holding structure took shape, as presented in Figure 2. It was fully subordinated to the strategy of structuring and initial development of the holding company. Since the main activity during the first stage was focused on road maintenance, the holding strategy could be defined as a focus strategy for the implementation of those activities (Porter, 1980).

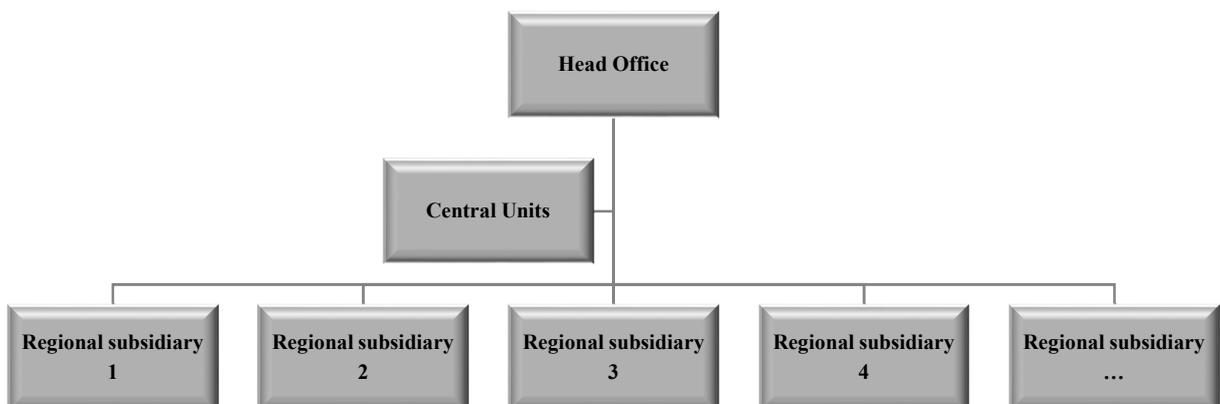


Fig. 2. Structure of the holding company during the first stage of its development

The second stage of the corporate development took place in the 2007–2011 period. It coincided in time with the initial years of Bulgaria's membership of the EU. During the second stage, the development of the holding structure was targeted to the creation of a potential to implement large-scale infrastructure works contracts. The landmark event was the reorganization of Trace Group Hold AD into a public company, which took place at the end of 2007. For that purpose, the capital of the holding company was increased three times, including an increase through an initial public offering. The equity of the company grew from BGN 150 thousand to BGN 24.2 million at the end of that stage, which was an increase of more than 160 times. The leverage was used to purchase building equipment and thus create production capacity at a sufficiently high level to be awarded large-scale public procurement contracts and to implement big technical infrastructure projects.

The other effects linked to the capital increase were the ownership consolidation, the attainment of a public status and the introduction of corporate governance practices in the holding company. It was at that stage when the acquisition and establishment of foreign subsidiaries began and the holding company built its capacity to engage in international activities and enter foreign markets.

The novelty in the structure of the holding company was the setting up and strengthening of units for the vertical integration of the construction process (Figure 3). Those units deal with investments, transport, foreign trade, logistics, design and project management. They were needed because they were used to create a comprehensive product covering all stages of the process from the design to the implementation. Furthermore, they facilitated construction works, shortened implementation time limits and guaranteed the quality of the works. All those parameters were of special importance in applying for public procurement contracts.

Thus the objects of activity of the holding company expanded to cover the following: construction development, general entrepreneurship in civil works, sewerage installations, installation and maintenance of sewerage pipes and pipelines, electrical wiring, building of tunnels, construction of bridges and dams, road construction, railway and underground metro construction.

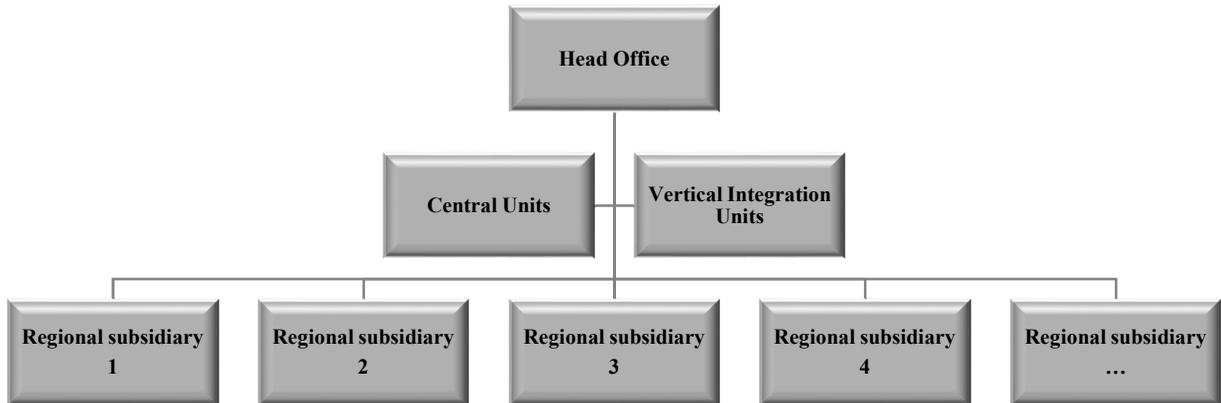


Fig. 3. Structure of the holding company during the second stage of its development

The strategy at that stage of development could be defined as a diversification strategy (Porter, 1980). The management of the holding company saw the opportunities for diversification of its products and began preparations for that process. The opportunities went beyond the scope of its traditional activities and emerged in other segments of the infrastructure construction, such as the water infrastructure, the underground and railway infrastructure. During the second stage, it was again the strategy of the holding company that dominated and defined its structure.

The third stage of development of Trace Group Hold AD since 2012 (Figure 4) has been a time for market expansion of the holding company on the Bulgarian market and for launching the internationalization of its activities.

The market expansion was linked mainly with the implementation of large-scale infrastructure projects financed from EU funds and the national budget. The biggest ones among them are the construction of sections of Trakia motorway (Sofia – Burgas), the construction of the underground metro in Sofia and the rehabilitation of the Sofia – Plovdiv railway. Those projects made it possible for the holding company to quadruple its turnover from 2008 to 2011, reaching some BGN 160 million over the 2011 – 2014 period.

The experience gained and the well-developed competitive advantages of the holding company oriented its development strategy

towards entry into neighbouring countries like Serbia and Macedonia and also the Czech Republic. The management of the holding company also took interest in some Middle East markets, such as Qatar and the Sultanate of Oman. In 2013, a special vehicle, Trace International EOOD, was established to coordinate the international operations of the holding company. It deals with the acquisition and establishment of foreign subsidiaries. It has been instrumental in establishing foreign subsidiaries in these target countries. There are two fundamental principles underlying the establishment or acquisition of these companies. The first one is the existence of a project awarded in the relevant country. The second one is the prospect of participating on the construction market in the target country.

Examples of the use of the first principle are the projects implemented in Serbia. They are four projects at a total value of EUR 95 million. Two infrastructure projects are underway in the Czech Republic. The second principle underpins the establishment of joint ventures in Qatar and the Sultanate of Oman.

The successful market expansion and the internationalization of the activity of the holding company have led to an increased group of companies. Currently, it incorporates 24 companies and 56 special vehicles for the implementation of infrastructure projects in Bulgaria and abroad.

Logically, in view of the strategy of market expansion and internationalization at this stage of development, the holding structure has added new foreign companies which are coordinated by a special structure (Figure 4). The number of *ad hoc* companies established to implement specific projects with the participation of other companies has also grown. The other structural components of the holding company have been further strengthened to maintain the turnover levels achieved in the holding company.

The objects of activity of Trace Group Hold AD have acquired new dimensions in the current stage. They relate to its development into new avenues of vertical integration aimed at a comprehensive package, such as consultancy, engineering, rehabilitation of buildings and energy efficiency, maintenance of completed infrastructure facilities, finishing works, greenery. The other direction in which the objects of activity develop is determined by the challenges of the new projects and international operations. In this way, the objects of activity of the holding company are also broadened horizontally with the involvement of

electricity transmission and distribution networks, district heating, gas supplies, water supply and sewerage and the related facilities, hydro technical facilities, hydro power plants and irrigation equipment and systems, waste treatment facilities, waste disposal facilities and installations, building and decommissioning of landfills for solid municipal waste, supply and assembly of machines, equipment and installations, electrical, electronic and telecommunication networks, restoration of cultural artefacts.

Nevertheless, the leading strategy of the holding company in this period can be defined as price leadership (Porter, 1980). The comprehensive nature of the product and the large scale of the production resources enable the holding company to offer exceptionally favourable prices, while observing the requirements for high quality on both the domestic and foreign markets. During the third stage of development, strategy again determines the structure of the holding.

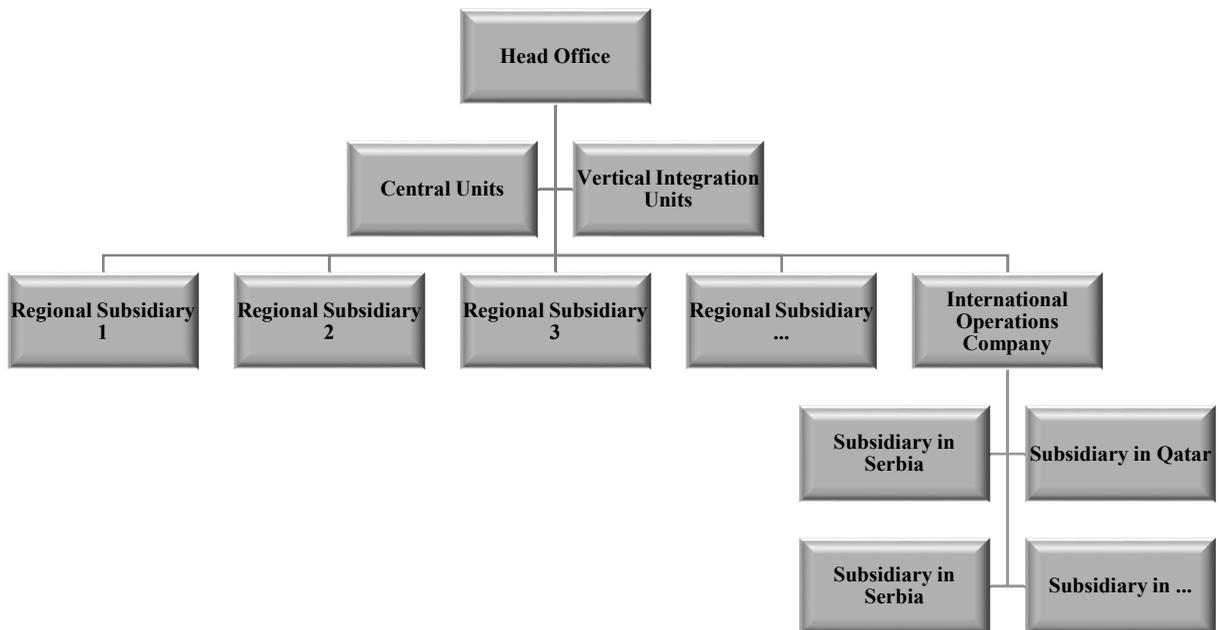
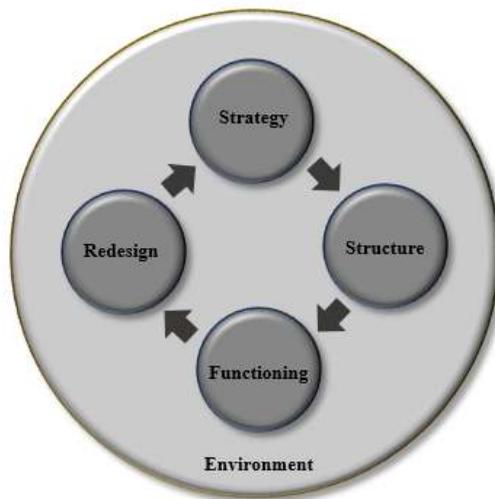


Fig. 4. Structure of the holding company during the third stage of its development

The experience of Trace Group Hold AD reveals that the interaction between strategy and structure is not linear, but cyclic (Figure 5).

Fig. 5.
Strategy and
structure
interaction
cycle



Changes in strategy followed by changes in structure occur after the structure developed to implement the strategy is already functioning and when the signals coming from the environment are taken into account, the preparations for further change of strategy begin.

Conclusions

The stages identified in the development of Trace Group Hold AD are characterized by the three types of strategy. They determine the changes and the development of new units in the structure of the holding company.

The successful development of Trace Group Hold AD results from the smooth implementation of the strategies and the relevant structure. This leads to a very straightforward answer to the issue on the basis of this case study. Strategy determines structure and structure is the function of the pre-defined strategy.

The case of Trace Group Hold AD proves that the interaction between strategy and structure is cyclic, not linear. Hence the solution of the issue strategy vs structure can be found in the dynamic development cycle, rather than in a flat correlation between the two categories.

References

- Chandler, Al. (1962). *Strategy and Structure: Chapters in the History of Industrial Enterprise*, Doubleday, New York.
- Hall, D. J. and Saias, M. A. (1980). Strategy Follows Structure! *Strategic Management Journal*, **1(2)** (April-June 1980), 149-163.
- Johnson, G., Scholes, K, & Whittington, R., (2008). *Exploring Corporate Strategy: Texts and Cases*, 8th Edition, Prentice Hall International, United Kingdom.
- Kavale, St. (2012). The Connection between Strategy and Structure. *International Journal of Business and Commerce*, **1(6)**, 60-70.
- Mintzberg, H. (1987). Crafting Strategy, *Harvard Business Review*, July/August 1987.
- Mintzberg, H. (1990). The Design School: Reconsidering the Basic Premises of Strategic Management, *Strategic Management Journal*, **11(3)** (March-April 1990), 171-195.
- National Corporate Governance Committee (2012). National Corporate Governance Code (in the Bulgarian language).
- Porter, M. E. (1980). *Competitive Strategy*, Free Press, New York, 1980.