Successful Strategic Transformations in the Media

Abstract

The advent of digital technologies has transformed the way many organizations have conducted their business over the past two decades. This transformational context raises two important questions for media management researchers. Firstly, how have media firms adapted their strategies and reconfigured their resources and capabilities to the challenges presented by an increasingly digital environment? Secondly, how have these adaptive practices affected their corporate financial performance?

This paper presents the findings on *how* two media organisations dynamically adapted their strategies, resources and capabilities to the demands of an increasingly competitive and volatile media environment. Hensman, Johnson & Yip (2013) described these types of firms as *'Successful Strategic Transformers'*, that is, those firms that have adapted and transformed their organisations to produce long-term superior financial performance.

The research used a multi-method approach. Firstly, content analysis of corporate Annual Accounts & Reports examined the corporate strategies and dynamic capabilities activities that enabled these media firms to adapt and transform their business to the demands of the digital environment between 1997 and 2015. Secondly, Corporate Financial Analysis was used to illustrate the impact on corporate performance following the adaptation of strategies and capabilities over time.

This paper provides empirical findings, in the form of a longitudinal study, that is both distinctive and insightful in terms of understanding *how* media firms have adapted their strategies, resources and capabilities in order to successfully transform their businesses and produce superior corporate financial performance.

Keywords: Dynamic Capabilities, Strategic Transformation, Adaptation, Strategy, Corporate Financial Performance.

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Introduction

Transformation: a marked change in form, nature, or appearance. It is a word that characterises the impact that digitalization and new media technologies have had on the way that many media companies have managed their business over the past two decades. These disruptive forces have also created a highly uncertain and transformative environment (Doyle, 2013; Oliver 2014; Kung, 2017) where media organizations are increasingly driven to adapt and innovate their strategies, business models, resources and capabilities in order to remain competitive.

The premise of this paper is to consider *how* a firm delivers superior performance in the context of a fast changing external environment. The argument presented in this paper is that media firms with an adaptive strategy and the ability to renew and reconfigure resources and capabilities, produce dynamic capabilities that *transform* the firm over time. Teece, Peteraf & Leih (2016) noted the interdependent nature of 'strategy' and 'dynamic capabilities' as a means to achieve organizational direction, cohesion and competitive advantage. This paper follows this line of reasoning by illustrating *how* media firms have adapted their strategies and reconfigured their resources and capabilities to the challenges presented by an increasingly digital environment. It will also demonstrate *how* these adaptive practices have affected each firm's corporate financial performance over time.

Literature Review

Dynamic business environments place existing and successful media management strategies and practices under strain. Often the source of competitive advantage and superior performance is quickly eroded by these high velocity market conditions. Indeed, the media environment has been characterised as uncertain to the point where industry disruption is highly likely to provide visionary and innovative opportunities for some firms, and strategic drift and declining profitability for others. Whilst media industries have been exposed to continual levels of turbulence, two critical events have acted as key drivers of transformational change. The emergence of widespread digitization in 1997 and new media technologies, circa 2003, are significant events that have acted as catalysts for market disruption and technological innovation. They have also resulted in a blurring of industry boundaries and encouraged new market entrants with innovative business models. These high velocity environmental conditions have largely persisted since the late 1990s, and when viewed over the long term, provide an ideal lens through which to examine organizational strategy, dynamic capabilities, corporate performance and ultimately the strategic transformation of a firm.

This literature review will examine our knowledge and understanding of how dynamic business environments drive firms to respond with dynamic strategic responses in renewing their capabilities. It will also argue that superior firm performance can be derived from a firm's ability to adapt strategy, resources and capabilities faster than rivals, and in doing so, achieve an adaptive advantage.

Dynamic business environments, dynamic capabilities and superior firm performance

The argument that dynamic business environments drive the development of dynamic firm capabilities and innovation is well established in literature (Teece & Pisano, 1994; Zollo & Winter, 2002; Lal & Strachan, 2007: Oliver, 2016; Teece *et al*, 2016). Dynamic Capabilities Theory argues that firms sustain their business through a process of 'managed learning' in a way that adapts and changes their resource base and capabilities in order to produce a series of temporary competitive advantages in what are often considered to be high velocity market conditions.

The literature on this managed learning process is located in the interdependent and complimentary theories of the Knowledge-based View (KBV) and the Resource-based View (RBV) of strategic management. Our understanding of these views and their relevance to the strategic adaptation of the firm contends that it is the management of in-tangible (KBV) and tangible (RBV) activities that can provide a firm with sustainable competitive advantage in dynamic environments. The intangible activities include: an aspirational strategy; persistent communication of the strategy; managerial cognition and sensing skills (Tripsas & Gavetti, 2000; Winter, 2003; Reeves, Haanes & Sinha, 2015; Teece *et al*, 2016). Whilst the tangible activities include; investment in new organisational processes and routines; product innovation and development; forming strategic alliances; corporate acquisitions and mergers (Eisenhardt & Martin, 2000; Helfat, 2000; Danneels, 2002; and Colapinto, 2010).

Given the level of risk and uncertainty involved in reconfiguring firm resources and capabilities at a time of complex change, firms need to ensure they get a return on their investment in the form of superior performance. However, the number studies that link the renewal and reconfiguration of resources to organization performance are relatively small in relation to the body of knowledge on dynamic capabilities. These studies include: Miller & Shamise's (1996) longitudinal study of major U.S. film studios; Ahuja & Katilia's (2004) study of innovative practices in US chemical firms; Macher & Mowery (2009) study of semiconductor manufacturing defect rates; Oliver's (2014) study of financial performance in media firms; and Naldi, Wikström & von Rimscha's (2014) innovation process for small and medium-size audio-visual firms in Europe.

The argument for the strategic adaptation of the firm is presented by Hensman *et al,* (2013:10) who proposed that corporate strategies have historically had competitive advantage at their core. However, due to the dynamic nature of the business environment the "only advantage is the ability to change more quickly than one's rivals" to the extent that strategies now needed to emphasize organizational adaptation, or as they put it, "dynamic capabilities on steroids". It follows then, that in fast changing market conditions, an ability to adapt firm resources to create new and dynamic capabilities, could in itself be the most effective way for firms to remain competitive in the long-term. Indeed, research by Post, Berger & Eunni (2005) and Reeves *et al* (2015) found significant differences in firm performance between the most and least adaptive firms; and that those firms that had internally aligned their strategy and resources to the external environment produced superior performance measures than those that did not.

Linking organizational strategy and dynamic capabilities

Organizational strategy and dynamic capabilities are largely interdependent theories in terms of creating a firm that strives for superior performance. Indeed, Teece *et al* (2016:18) argued that "a strategy that is consistent, coherent, and accommodating of innovation is just as vital as dynamic capabilities to achieving competitive advantage".

The need for a firm to adapt their resources and operations is often articulated in their strategic responses to changes in the environment. Oliver (2012:3) argued that this adaptive process was driven from 'the top down' and that corporate level strategy articulated not only the firm's vision, but the levels of "resource investment in new assets, operating routines, capabilities and competencies that would take advantage of the opportunities provided by fast changing market conditions". Whilst our understanding of the effects of CEOs and their senior executives on the contribution to firm performance is debatable (Helfat & Peteraf, 2015) there is no doubt that their role in understanding changing market dynamics and driving strategic change remains important. Indeed, the process of adapting firm resources and capabilities can be a risky and expensive business, and one that carries a higher risk of failure for senior executives due to the level of uncertainty that characterizes many media markets (North & Oliver, 2014; Teece *et al,* 2016; Girod & Karim, 2017). The strategy that guides this process is crucial in delivering a successful strategic adaptation of the firm.

The question of how this corporate level strategy is formulated should then be addressed, since the literature provides conflicting views on the formulation process. The ‘prescriptive approach’ dominated the 20th century and an extensive body of literature argued for strategy to be ‘designed’ through a rational analysis of the competitive environment using numerous diagnostic management tools. This analysis would establish an understanding the firm’s strategic fit and market positioning (Chandler 1962; Steiner 1979; Andrews, 1981; Porter, 1985; Bowman, Singh & Thomas, 2007; Oliver, 2013). As many markets became increasingly turbulent and uncertain toward the end of the 20th century, a counter argument appeared in strategic management literature. The idea that strategy simply ‘emerged’ as a result of firms learning over time, and where executives critically reflected on past experience, current events, and intuitively adapted their strategies incrementally to a changing business environment (Quinn, 1980; Mintzberg 1987; Leavy, 1998; Mintzberg, Ahlstrand & Lampel, 1998, Argyris, 2004).

In many ways these bi-polar views of the strategy making process have been superseded by a 21st Century narrative that argues for a strategy making process that is ‘appropriate’ to the dynamics of the competitive environment. For example, Perrott (2008), Lynch (2015) and Reeves *et al* (2015) support the view that fast changing and uncertain environments encourage emergent strategy making due to its ability to produce experimental and flexible responses to opportunistic conditions. However, in more stable competitive environments, it is more advantageous to employ prescriptive strategies as a means to position the firm in relation to the opportunities and threats presented to them.

Dynamic capabilities, strategic adaptation and adaptive advantage

There is an emerging view that the ability of an organization to adapt to changing market dynamics can be considered to be a dynamic capability in itself. For example, Wei & Lau (2010) argued that the continuous evolution and adaptation of high performance work systems could be considered to be an ‘adaptive capability’ that resulted in improved firm performance. More recently, Dixon, Meyer & Day (2014:198) argued that a firm can create dynamic capabilities in ‘organizational adaptation’ by acquiring existing knowledge from outside of the firm and exploiting and deploying it to create new operational capabilities. They go on to say that the organization that “best leverages these adaptive dynamic capabilities will secure a temporary competitive advantage, outperforming its immediate peer group”.

The theory on the adaptation of the firm is principally based on two contrasting theories in management literature. On the one hand, Evolutionary Theory argues that firm adaptation is considered to be a continuous cycle of adjustment and variation that creates new forms of the organization which emerge by random chance. How firms adapt to new competitive conditions, is therefore, aligned to the Darwinian view of *natural selection* where the competitive survival and sustainability of the firm is determined by trial and error and how successful they are at incrementally adapting their strategies and resource base to the prevailing environmental conditions. The alternative view is derived from Teleological Theory which argues that the strategic adaptation of the firm is not achieved arbitrarily by *'chance'* but by a purposeful desire to realize an organizational goal (Van de Ven & Poole, 1995). This theory considers the adaptation of a firm to be objective driven with a rational management process of "goal formulation, implementation, evaluation and modification of goals" that is again dictated by changes in the competitive environment (Pettigrew, Thomas & Whittington, 2007:208).

Much of the literature on the adaptation of the firm has concentrated on the need for organizational adaptation, rather than the advantage it can deliver to firms. The ability of a firm to adapt to changing environmental conditions, faster than their rivals, can provide them with a competitive advantage in the market place. This ability and its effects are known in literature as Adaptive Advantage, however, it has received surprisingly little attention by way of theoretical development and empirical testing. Prominent studies include Post *et al,* (2005:84) who found a number of internal and external 'alignment' characteristics in US telecom firms that resulted in significant differences in firm performance. They presented a classification of traits that led to corporate success or failure based on various strands in strategic management literature, and from this, developed and empirically tested their conceptual framework on 'strategic adaptation'. Whilst this work examined the '*process of how'* firms adapted they did not develop the idea that this adaptive ability provided firms with a competitive advantage. The Boston Consulting Group have also produced a number of influential papers on organizational adaptability and corporate performance. For example, the paper 'Adaptability: The New Competitive Advantage' (Reeves & Deimler, 2011) presents a powerful argument for firms to develop new adaptive learning capabilities which will create value in the market place, adaptive advantage for the firm and superior corporate performance in both the short and long term. Their arguments are well founded and supported by their 'BCG Adaptive Advantage Index' (Reeves, Love & Nishant, 2012) which examined the volatility in the operating environment and the weighted-average performance of a company's market capitalization growth rates versus the weighted-average market capitalization growth rates in its industry during periods of turbulence in demand, competition and profit margins. A total of 2,500 companies, in 59 U.S. industries, were analyzed between October 2005 and September 2011. Of particular relevance to this paper is their examination of the US Media Industry, which concluded that DirecTV, Time Warner Cable and Disney had all outperformed their industry rivals (including Omnicom Group, The Washington Post, Viacom, Cablevision Systems and Thomson-Reuters) with increases in market capitalization during times of turbulence. Put simply, an ability to adapt to volatile operating conditions, lead to an advantage that delivered superior corporate performance.

Our previous discussion on adapting the firm and their strategic response to turbulence through incremental and experimental adjustments in organizational strategy, processes and resources is supported by Reeves & Deimler (2011) who argued that firms needed to be continually adapted through a process of managed evolution. They argued that adaptive ability was defined by four organizational capabilities in the form of: detecting and acting on signals in the external environment; experimenting and develop ideas fast, at low cost and with less risk than competitors; managing complex and dynamic multi-stakeholder eco-systems; and mobilizing resources by empowering people to proactively respond to changes in the environment.

Positioning this research

The premise of this paper is to consider *how* a media firm delivers superior performance in the context of a fast changing external environment, by providing an empirical analysis of the interdependent variables of organizational strategy and dynamic capabilities. As such, this paper provides illustrative case studies from an industry characterized by relentless changes in technology, which in turn, have created unprecedented change in the operating environment.

This paper builds on the previous research in the field and argues that media firms with an adaptive strategy, and the ability to renew and reconfigure resources and capabilities, produce dynamic capabilities that *transform* the firm and its financial performance over time. It also provides empirical evidence on the links between organizational strategy, dynamic capabilities and notions of superior performance being benchmarked against historical firm, intra-firm, industry and stock market index performance metrics.

Method

The UKs Creative Industries have, on the whole, been affected positively by the emergence of digitisation and new media technologies. Between 1997-2014 overall employment increased from 931,000 to 1,808,000 (+94%) and Gross Value Added (GVA) increased by £31,205m to £84,067m (+169%). However, different sectors have been affected by digitisation differently. For example, the Publishing Sector has seen employment plummet over the same period from 308,500 to 197,000 (-36%) but GVA has increased from £6,500m to £9,938m (+53%). In the Film, TV, Video, Radio and Photography industry, employment has increased from 64,200 to 231,000 (+260%) and has GVA increased from £5,400m to £9,308m (+72%). (Department for Culture, Media and Sport, Creative Industries Economic Estimates, January, 2016)

The UKs Creative Industries, therefore, set the broad context to examine how firms had adapted their strategies and transformed their resources and capabilities to produce superior performance over the long-term. Hensman *et al* (2013, p.30) argued that corporate performance should be measured over “decades rather than years” and incorporate at least one 10 year business cycle. The research period for this study incorporated two business cycles over the period 1995-2015 which importantly covered disruptive forces that were aligned closely to the Creative Industries, that is, digitization and new media. However, this period also covered significant macro-environmental forces would affect most businesses performance, that is, the collapse of the Dot.com economy in 2001 and the Global Financial Crisis of 2008-09.

The criteria used to identify the firms that had undergone a successful strategic transformation and in doing so, had outperformed their peers in terms of financial performance consisted of:

- A firm classified as existing in the UKs Creative Industries
- An ability to examine and benchmark corporate financial performance over two business cycles.
- A firm that could be assessed in terms of pre and post digitization and new media effects on strategy, resources and corporate performance.
- A company whose share price performance indicated that they had outperformed the FTSE 100 over the long-term.

Initial desk research identified Pearson Plc (publishing) and Sky (TV) as two companies that met the above criteria.

The research objectives were:

- RO1 What *strategies* have enabled media organizations to adapt and transform their business to the demands of the digital environment?

- RO2 What *intangible* and *tangible* resource-based actions enabled media organizations to adapt and transform their business to the demands of the digital environment?

- RO3 How had these *strategies* and *intangible* and *tangible* resource-based actions affected the firm's *corporate financial performance*?

Research Objectives 1 and 2 were investigated using a qualitative content analysis of company Annual Reports (Miller & Shamise, 1996; Oliver, 2014) to understand and assess how these organisations had adapted their strategies, resources and capabilities to changing competitive dynamics over time. The content analysis was undertaken using the computer software package Nvivo, due to its ability to gain meaningful data from the 'text rich' annual reporting documents. The units of analysis for this part of the research examined the intangible and tangible actions that were previously mentioned in the literature review. That is:

Intangible: an aspirational strategy; persistent communication of the strategy; managerial cognition and sensing skills.

Tangible: investment in new organisational processes and routines; product innovation and development; forming strategic alliances; corporate acquisitions and mergers. It also included a variable that has not been extensively examined in literature, that is, the use of corporate divestment as a means to reconfigure the firm's resource base.

Research Objective 3 examined how the strategic adaptation of the firm had affected their corporate financial performance and whether that performance was 'superior' when benchmarked against historical firm, inter-firm, industry and market performance indicators.

This research used a number of measures to assess corporate financial performance in terms of those metrics that are directly linked to the *value* created from:

1. The firm's corporate strategy and resource management: Market Value (£), Return on Invested Capital (%), Revenue (£), Operating Income (£) and Profit Margin (%).

The financial data was obtained from Thomson Reuters DataStream which provided current and historical financial statistics for both Sky and Pearson and the FTSE 100 index which is composed of the 100 largest companies listed on the London Stock Exchange. The analysis of Market Value and Return of Capital Invested for Sky and Pearson against the FTSE 100, over the time period 1995-2015, ensured that only those firms (57) who had consistently appeared in the index for each of those years was used for data analysis.

2. The firm's management of their human resources, since 'people' are likely to contribute a significant proportion of a firm's total resource base. As such, the 'Number of Employees' was measured against 'Operating Income (£)' to assess the 'Operating per Employee (£)' for each firm. These figures were then benchmarked against labour productivity data in the form of Gross Added Value (£) for the UK Creative Industries[1]. Gross value added (GVA) represents the amount that individual businesses, industries or sectors contribute to the economy. Broadly, this is measured by the income generated by the business, industry or sector less their intermediate consumption of goods and services used up in order to produce their output. As such, it is the closest measure to a firm's Operating Income, and both of these metrics have been used to examine the performance of Sky and Pearson in comparison to labour productivity in the UK Creative Industries. This would also provide an assessment of the corporate performance for each firm as benchmarked against their respective industry and indeed the entirety of the UKs Creative Industries. As such, this analysis would provide an assessment of whether or not each firm had managed their 'human resources' in a way that had created value and delivered superior and sustained performance over the long-term.

[1] This data was produced from the Department of Culture Media & Sport *Creative Industries Economic Estimates* (1997-2014).

Data Analysis

RO1 What *strategies* have enabled media organizations to adapt and transform their business to the demands of the digital environment?

Sky: an aspirational and ambitious growth strategy

From its inception as a public company in 1995, Sky has consistently focused on one primary corporate objective, that is, *'maximising value for shareholders by focusing on profitable growth'.* Delivering on growth objectives has taken the form of building their customer base, selling more products and services which in turn has delivered growth in revenue and operating profits.

The firm's corporate growth objectives are clearly positioned within the Teleological Theory of organisational adaptation (Van de Ven and Poole, 1995; Pettigrew *et al,* 2007) where changes in the competitive environment are met with rational management process of goal formulation and modification. This is illustrated by the corporate target number of pay-tv subscribers being set years in advance. For example, the target number of: 7m by 2003 was set in 2000**;** 8m by 2005 was set in 2003; and 10m subscribers by 2010, set in 2004. Having successfully penetrated the UK pay-tv market, Sky have adopted a less prescriptive and quantified approach to their targets, preferring instead, more equivocal statements, such as:

> *"We exploit the headroom for pay TV growth across our markets using the combination of satellite, cable and over-the-top (OTT) services to meet customers' needs"*
> Jeremy Darroch, CEO, Sky (2015)

Their consistent focus on the growth of pay-tv subscriber numbers and revenues continues to be delivered by a strategic recipe of: negotiating the rights to premium content (sports, film and TV); developing new conditional access technologies; delivering a high quality customer service; and the acquisition of firms for their capabilities.

Sky's corporate strategy extended their perimeter of activities when taking advantage of the opportunities provided by the new media environment and the harmonisation of technology and regulation across Europe. For example, they broadened the focus of their growth strategy by extending the scope of their activities, via joint ventures and acquisitions, into the provision of UK based broadband and mobile telephony (2006). These strategic moves repositioned the company (Porter, 1985; Bowman *et al,* 2007; Oliver, 2013) from being a pay-TV provider into a multi-product, multi-platform entertainment and communications firm. Their corporate perimeter was further extended, geographically, with the acquisition of Sky Italia and Sky Deutchland (2014), which in turn, repositioned the company as a world-class pay TV operation in Europe and provided a platform on which to expand their growth ambitions.

Pearson Plc: investing in high growth markets with high profit potential

Over the past 20 years Pearson have transformed their organization from being a ‘holding company’ of disparate business, to an ‘Entrepreneurial M-Form media business’ to their current incarnation as a ‘global, single product education company’. As with Sky, their corporate growth objectives follow the Teleological Theory of organisational adaptation, however, in contrast to Sky, the motivation behind each transformational strategy has been a desire to take advantage of (potential) high growth market opportunities provided by both media and non-media markets.

The emergence of an international media company

Prior to 1995, Pearson was a ‘holding company’ for a number of businesses that ranged publishing to investment banking, and tourist attractions. Between 1995-2000 they laid the foundations of an international media company with their expansion into high growth media markets with the acquisitions of global news, TV production, broadcasting and distribution firms. By 2000 they had made $5bn of acquisitions and $2bn in disposals which had transformed and repositioning Pearson into an international media company with three strategic business units: business information, consumer publishing and education.

“It has taken three years of hard work to turn Pearson from an attractive collection of diverse businesses into one company with a coherent strategy single-mindedly pursued by every part of Pearson”.

Dennis Stevenson, Chairman, Pearson (2000:2)

The Entrepreneurial M-form media business

The Entrepreneurial M-form media business started to emerge with the appointment of their activist CEO, Marjorie Scardino, in 1997. Recognising the market opportunities of digitalization and new media, Pearson focused their corporate strategy on building a more integrated media company consisting of three strategic business units: business information, consumer publishing and education. They commented:

“We have transform Pearson from a wide-ranging conglomerate into a world-leading content company”

Dennis Stevenson, Chairman (2003:2)

Whilst they had made significant investments in content, technology, international expansion and efficiency gains, the Entrepreneurial M-form media business 1appeared to be well placed to take advantage of the opportunities provided by high levels of environmental turbulence in the media industries. They noted that:

"The relentless shift to a digital world has huge implications for how we create, store, protect, package and charge for our content".
Glen Moreno, Chairman, Pearson (2005:3)

The advent of digitalization and the new media environment provided many opportunities for Pearson, however, by 2005, their corporate outlook argued for 'strategic flexibility' and the need to constantly think about the future of their firm. Their attention subsequently changed to the role that education would play in their business, and by 2006, they had declared themselves to be an 'international media and education company'. By 2008, Pearson had started to sow the seeds of their next transformation, by declaring their next strategic move would be to reconfigure the company structures and resources toward the potential opportunities provided by an emerging global middle class population of three billion, who recognized the value of education. They commented that:

"We're as sure as we can be that this broad education market we've chosen to work in will be a good, long-term growth industry".
Marjorie Scardino, CEO, Pearson, (2008:7)

Whilst they continued to operate as an Entrepreneurial M-form media company in 2009, they declared themselves to be a "world-leading education company" where digital technologies would make their content more personal and more valuable, and provide access to new, bigger and faster growing sources of corporate revenue.

The single product learning company

In transforming the company, again, Pearson's desire to be the world's leading learning company meant that their strategy and allocation of capital resources would be focused on four global businesses: School, Higher Education, English and Business Education, which they believed provided the biggest growth opportunities. They argued that:

"Global education is a once-in-generation opportunity and Pearson is uniquely placed to grasp it.
John Fallon, Chief Executive, Pearson, (2012:8)

As a result, they disposed of the Financial Times Group (2015) and their equity stake in The Economist (2015) in order to focus their capabilities and products on educational learning technologies.

RO2 What *intangible* and *tangible* resource-based actions enabled media organizations to adapt and transform their business to the demands of the digital environment?

Knowledge-based: intangible activities

Persistent communication of the strategy

Oliver (2012) noted that the corporate mantra for a dynamically capable firm is to ‘‘invest and adapt’’ in order to remain competitive. Firms need to be continually adapted through a process of managed evolution, where an adaptive strategy focuses on the renewal and reconfiguration of resources that transform the firm and their performance. Central to this adaptive process is the top-down role that Chairmen and Chief Executives’ play in communicating the firm’s aspirational strategy to multiple stakeholders (Reeves & Deimler, 2011) in a way that mobilises and empowers them to proactively respond to changes in the uncertain competitive environments.

Sky, in particular, have excelled with their positive and persistent communication of their aspirational strategies over the past 20 years. For example, with the potential for industry disruption in 1997, due to the widespread introduction of digital technologies, the Chairman’s message to stakeholders was:

“The future holds no fear for Sky - our business has always thrived on the need for change”
Gerry Robinson, Chairman, Sky (1997:7)

Furthermore, aspirational statements made by successive leaders illustrate a dynamic firm that is prepared to adapt to new market dynamics and the uncertainty caused by macro-environmental forces and events like digitalization and the emergence of new media. The following quotes provide a good illustration of their invest and adapt approach:

“Opportunities for companies to acquire true market leadership are rare, and BSkyB is uniquely positioned to achieve this on the back of our investment in hardware, programmes and technologies”.
Rupert Murdoch, Chairman, Sky (2000:7)

“This has been a year of significant changes- not just for Sky, but for the entire industry. Throughout the year, our focus has been on setting the pace of change, and re-affirming our appetite for doing so.”
James Murdoch, CEO, Sky (2006:4)

“We believe that those businesses that achieve sustainable success have an appetite for change and a commitment to constant renewal in all that they do”
Jeremy Darroch, CEO, Sky (2013:3)

Pearson, in a similar vein, have met the challenges of a fast moving media environment with equal optimism. For example, they embraced the opportunities provided by digitalisation and new media technologies by re-enforcing their reputation as one of the most innovative media firms in the industry. For example, their leaders commented:

"Pearson operates in an industry changing quickly and constantly. It is our ability to manage the complex creative and commercial mix of that environment that gives us our competitive edge".
Dennis Stevenson, Chairman, Pearson (1997:3)

"In a world mesmerised by technology, it would be easy to find ourselves focusing more on the works of the engine than on its purpose. But we try not to. Instead, we try to think of the technology as fuel and concentrate on how it can get us to where we want to go".
Marjorie Scardino, CEO, Pearson (1999:5)

"The outside environment has inspired us to move more quickly, to be more radical in our approach, to be more courageous".
Glen Moreno, Chairman (2011:5)

Managerial cognition and sensing skills

One of the consistent themes in dynamic capabilities literature is the crucial role of the cognitive and sensing skills of senior management within the organisation. Their ability to detect external signals in a dynamic environment and identify corresponding market opportunities provides the stimulus for the strategic adaption of the firm (Tripsas & Gavetti, 2000; Winter, 2003; Post *et al*, 2005; Reeves & Deimler, 2011; Reeves *et al* , 2015; Teece *et al*, 2016).

The management of both Sky and Pearson appear to consistently be able to comprehend and successfully negotiate the challenges of an uncertain media environment. Their forward-looking approach has put both firms at the forefront of media industry development, making resource investment decisions that deliver new capabilities superior performance. The following statements provide an indication of their ability to anticipate the potential of digital tv, new media platforms and how these disruptive forces influence the effectiveness of traditional business models:

"BSkyB is about to lead Britain into a new era. As a pioneer of the direct-to-home digital platform (DTH), it is on track in 1998 to become the country's first digital television broadcaster."
Gerry Robinson, Chairman, Sky (1997:3)

" This convergence of media and communications has created a dynamic, fast moving sector that not only brings significant opportunities, but also a degree of uncertainty. Media companies that expected historical performance to protect their business models… will continue to fail."
(Rupert Murdoch, Chairman, Sky 2007:2)

"The new economy is transforming the opportunities on offer to management talent around the world. We have examined and rejected, for now, alternatives that would have separated some of our internet activities".
Dennis Stevenson, Chairman, Pearson, (1999:5)

"To seize this opportunity, we need to accelerate our shift from mature to developing markets, from print to digital products".
John Fallon, CEO, Pearson (2013:10)

Resource-based: tangible activities

Investment in new organisational processes and routines

Creating new operational capabilities requires firms to invest in organisational processes and routines at a time when the opportunities provided by dynamic markets make the decision to invest, intuitive at best, and speculative at worst. These investments tend to be significant and require the firm to accept higher costs in the short-term, in order to benefit in the long-term (Helfat & Raubitschek, 2000; Macher & Mowery, 2009; North & Oliver, 2014; Girod & Karim, 2017).

The impact of these investments for Sky are illustrated in their Return on Invested Capital (see Figure 3) which declined into negative territory between 1999-2003 following their multi-billion pound investment in: digital technology, customer relationship management and interactive broadcasting services. Accepting that significant capital investments affect corporate financial performance is illustrated in the following quote:

"We made a huge investment in distribution and programming for the digital launch, an investment which has had an adverse impact on profits and cash flows this year, but which will prove extremely worthwhile".
Rupert Murdoch, Chairman, Sky, (1999:1)

Pearson on the other hand have taken a different approach to their investment in the firm. On the one hand, they have invested in the re-configuration of the firm and transformed it from being a 'holding company' to an 'Entrepreneurial M-form media firm' and into its present iteration as a 'global learning company'. They have also recognised the need to invest in new digital technologies, processes and routines. The following quotes represent their consistent investment approach:

"Over the past few years we've spent a lot of time and effort transforming Pearson from a disparate group into a more coherent company…spending £30m integrating our businesses and their shared functions in ways that will add to our bottom line in the years to come".
Marjorie Scardino Chief Executive, Pearson (2002:7)

"We believe that this constant investment is critical to the quality and effectiveness of our products and that it has helped us gain share in many of our markets".
Marjorie Scardino, Chief Executive, Pearson (2011:10)

Product innovation and development

The output from the renewal and reconfiguration of firm capabilities is often seen in the development of new and existing products and services. The level of product innovation, is therefore, a key characteristic of dynamic firm capabilities (Helfat & Raubitschek, 2000; Winter, 2003; Oliver, 2014; Naldi *et al*, 2014).

Over the past 20 years Sky have continuously innovated numerous products and services. Many of these innovations were industry leading, including: Sky+ the UK's first fully integrated personal television recorder and the Sky Guide an advanced electronic programme guide (2001); Sky Multi-room subscription, and an enhanced version of Sky+ (2004); Sky Gnome the portable device to listen to audio content (2005); Sky HDTV, Sky Broadband and Sky Talk, Sky+ access from customer mobile phones (2006); Sky Anytime an on-demand service (2007); Sky 3D television (2010) and Sky Go (2011); over-the-top streaming service, NOW TV (2014); and Sky Q (2016), the multi-room, multi-device service that merges live TV with catch-up and on-demand content and music and video streaming.

The extent of funding for Pearson's product and service innovation and development is obvious from the statements in their Annual Reports. However, what is less obvious is the specific form of this activity. For example, in 2002 they stated that more than £250m was spent on new product development, and in 2003 an additional £50m was invested service improvements for customers. Between 2004-09 they had invested £2.3bn in content: new education programmes; new authors for Penguin; the FT's digital journalism, claiming that continual investment was critical to the quality and competitiveness of their products and services. However, unlike Sky, these innovations were unspecified in terms of their actual names and functions.

Forming strategic alliances, corporate acquisitions, mergers and divestment

Organic investment in resources provides one route to the development of new organisational capabilities. However, in fast moving and dynamic markets accessing new capabilities through strategic alliances, corporate acquisitions and mergers provides a more expedient route to accessing new capabilities (Danneels, 2002; Macher & Mowery, 2009; Oliver, 2014). Indeed, Oliver (2013) found that 84% of UK media firms engaged in collaborative partnerships as a means to access new capabilities, which in turn, would provide the platform to launch innovative new products and services.

In response to the digital and new media environment, Sky have consistently made strategic investments and acquisitions to access new capabilities and extended the firm's activities from direct-to-home television broadcasting to a multi-platform, multi-product media firm providing TV, broadband and fixed line telephony and mobile services. The most significant investments to acquire new capabilities have been the acquisitions of: British Interactive Broadcasting Holdings Limited for digital interactive broadcast set top boxes (1997); Sports Internet Group for internet content infrastructure and on-line gaming (2000); Easynet for the provision of broadband services (2007); 365 Media Group for sports and gaming websites (2007); Amstrad for their capabilities in designing high definition PVR and set-top boxes (2008); The Cloud, a leading public Wi-Fi network operator who enable customers to connect to content in thousands of locations across the UK (2011); and the acquisition O2, the consumer broadband and fixed-line telephony business (2013).

Strategic acquisitions have consistently featured in Pearson's Corporate Strategy as the firm reshaped their portfolio as they reconfigured and transformed it over the years. Indeed, the number of acquisitions are too numerous to mention here, but three consistent themes emerge in relation to the strategic transformation of the firm. Firstly, the acquisitions have contributed to the new shape of the firm during each transformation. Secondly, the acquisitions have extended the firm's reach and strength in new geographic markets with a market-leading position or good opportunities for high growth. Lastly, the acquisitions have improved the firm's capabilities in digital products and service provision including: eCollege the online distance learning company (2007); MoneyMedia - online news (2008); Fronter, online learning (2008); Money-Media - online financial news (2008); 7ticks - online financial solutions (2009); Wall Street Institute Education - web-based learning (2010); Assanka - web app development (2011); EmbanetCompass - online graduate programmes (2012); GlobalEnglish - cloud-based, on-demand English learning (2012); NOOK Media - digital bookstore (2013).

Divestment

The literature on dynamic capabilities tends to focus on the role of 'investment' in reconfiguring and renewing a firm's resources and capabilities. However, the role of 'divestment' in reconfiguring resources has received less theoretical inquiry and debate, and yet, the disposal of strategic resources as an intentional decision that can lead to considerable organizational change (Moliterno & Wiersema, 2007; Barreto, 2010). Perhaps one of the most striking aspects of the data analysis was that the number of references to in the Annual Reports of both Sky and Pearson revealed that the 'divestment' of resources was mentioned just as much as the 'acquisition of resources.

Sky's Annual Reports, for example, mentioned acquisitions and divestments in 16 out of 21 years and were referenced 64 and 66 times respectively. Whilst Sky had disposed of its equity holdings in a number of different firms, their divestment of resource-based capabilities tended to focus on non-core TV Channels (eg. Sky Soap and Playboy TV, 1999; Static 2358 interactive gaming, 2002; QVC Shopping Channel, 2004; BSkyB Nature, 2008); Entertainment and Gaming Services (eg. Gameplay plc, 2002; Toyzone, 2002; Streetsonline Ltd, 2004; LetsBuyIt, 2004; Sky Bet, 2015) and communication platforms (closing analogue operations, 2001; Easynet, 2010).

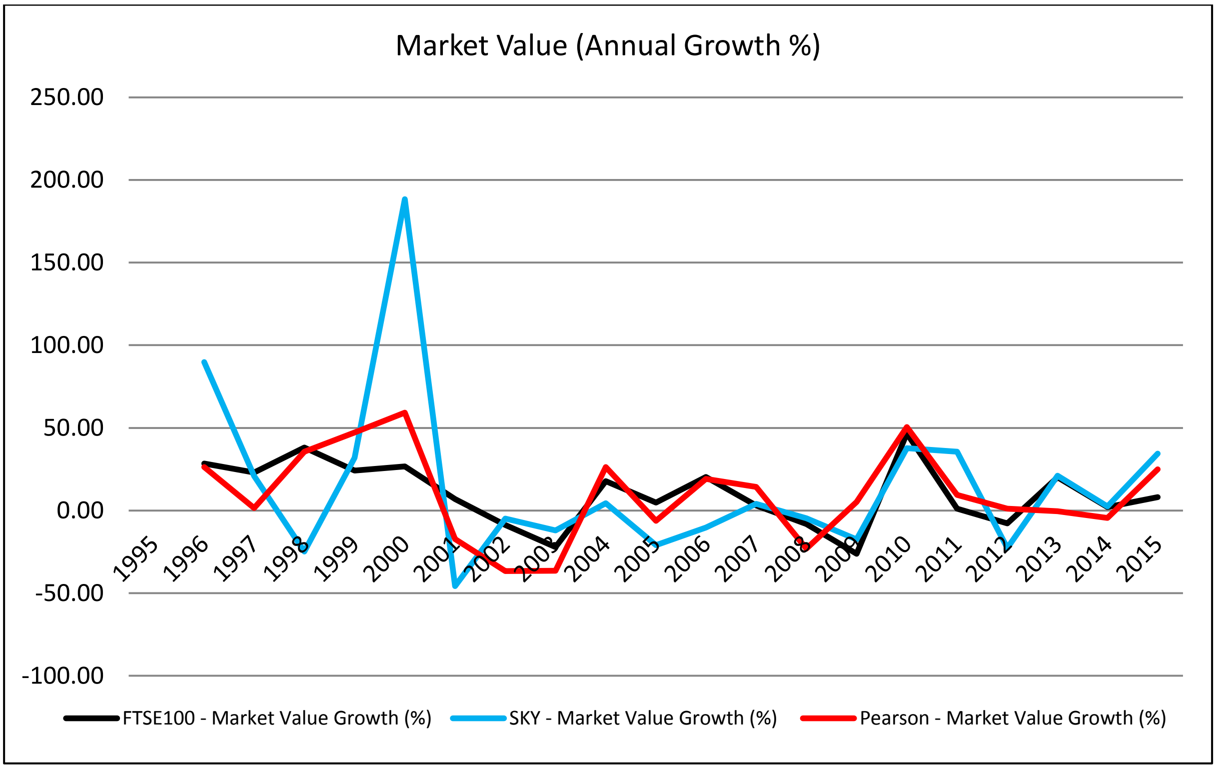
The figures for Pearson were equally significant with 145 references to acquisitions and 63 for divestments that occurred in 19 out of the 21 years in the study. There were also numerous mentions in the reports to the role that the divestment of often long established businesses played in shaping the portfolio and providing the financial resources to invest in new acquisitions. For example, the entertainment business, The Tussauds Group, was sold (1998) after 20 years in the portfolio, as theme parks no longer contributed to their emerging media business. In 2005, they commented that *"over the past four years, we sold three times (by value) as many assets as we acquired";* and in 2015 they sold the Financial Times Group and their stake in The Economist in order to focus on education and learning.

RO3 How have these *strategies* and *intangible* and *tangible* resource-based actions affected the firm's *corporate financial performance*?

An underlying principle of Dynamic Capabilities Theory is that the costs of resource reconfiguration, to generate new capabilities, needs to deliver a return on that investment in the form of superior firm performance. This research measured this performance of Sky and Pearson in terms of corporate financial performance which was benchmarked against market and industry performance indicators, as well, as historical firm and inter-firm results.

In terms of market performance, the annual Market Valuation increase/decrease was compared against the FTSE100 between 1995-2015. Whilst the market valuations differed from year to year, Sky's average market valuation increased 15.38% over this period, compared to 9.82% for Pearson and 9.92% for the FTSE100 (see Figure 1). The analysis of market value also demonstrated that both Sky and Pearson were more susceptible to macro-environmental forces than the FTSE100. For example, at the peak of the Dot.com bubble, Sky posted a +188% annual increase in market valuation, only to be followed by three years of declines (-45.64%, -4.79%, -12.06%) in the wake of the collapse of the Dot.com economy and the uncertainty created by the introduction of new media technologies. Further turbulence in the form of the Global Financial Crisis resulted in market valuation declines in 2008 (-4.66%) and 2009 (-17.53%). The comparative figures for Pearson follow the same trend, a +59.18% increase in 2000, with subsequent annual decreases in market value in the following three years of -17.19%, -36.62% and -36.34%. Pearson's exposure to the effects of the Global Financial Crisis were not as severe as Sky, with only 2008 recording a decline in annual market valuation of -23.06%.

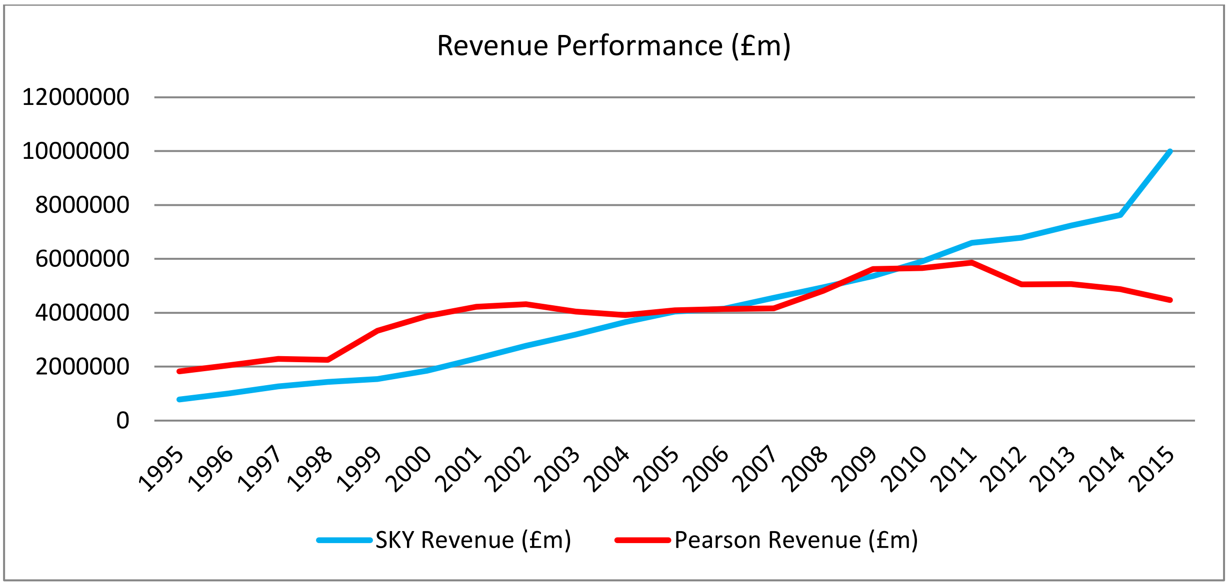
Figure 1: Market Value Annual Growth % (1995-2015)



Source: Thomson Reuters DataStream

The comparisons of historical firm and inter-firm revenue performance are illustrated in Figure 2. This shows that Sky continued to deliver impressive and consistently increasing annual corporate revenue figures. In 1995, their revenue was £777m and had grown to £9.98bn by 2015, which had been driven by a succession of corporate strategies that have successfully transformed the firm from being a UK based television broadcaster into a European multi-platform, multi-product media firm. In comparison, Pearson’s corporate revenue was £1.83bn in 1995 and had grown to £4.47bn by 2015. This significant increase was driven by a consistent growth strategy that saw Pearson’s revenue figures peak in 2011 at £5.86bn.

Figure 2: Revenue Performance (1995-2015)

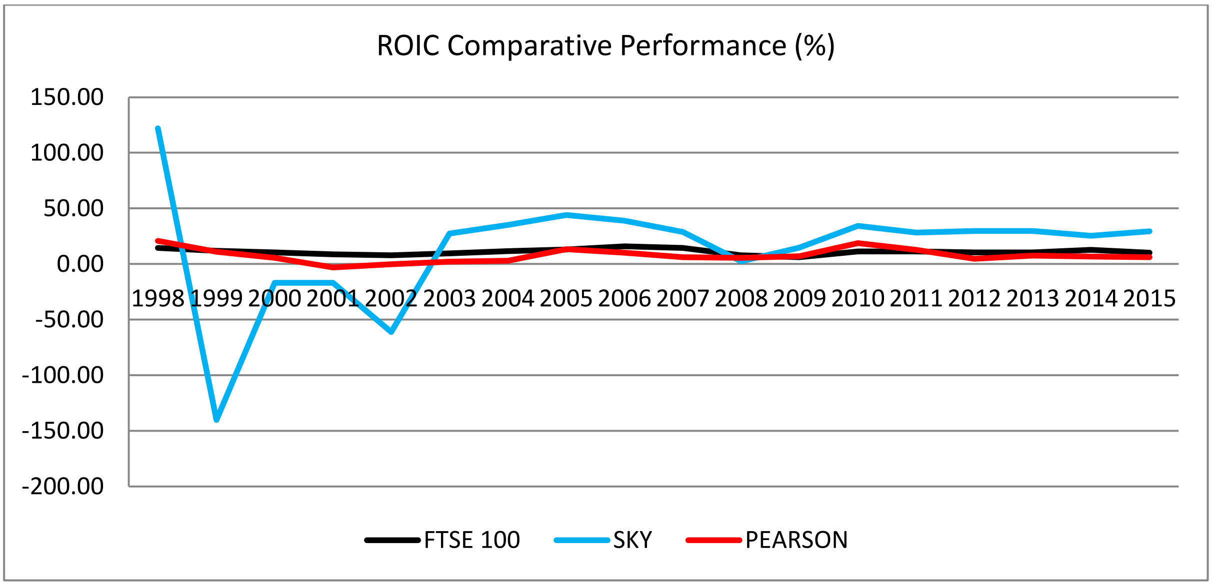


Source: Thomson Reuters DataStream

The comparisons of the Return on Invested Capital (ROIC) for the period 1995-2015 illustrate Sky's a superior ability to make a profit from invested capital. Over this period the *average* ROIC for Sky's was 66.27%, well ahead of the averages for Pearson (8.71%) and the FTSE100 (11.60%). Indeed, apart from the period 1999-2002 when Sky made significant capital investment (£1,512m in 2000 and £1,163m in 2001) in interactive services, customer relationship management systems and interactive broadcasting services.

Sky have consistently outperformed both Pearson and the FTSE100. Figure 3 below illustrates the comparative ROIC performance over the long-term. The time period for this comparison has been adjusted slightly, from 1995 to 1998 due to Sky's impressive ROIC figures (ranging from +224% to +555%) skewing the illustration.

Figure 3: ROIC Comparative Performance (1998-2015)

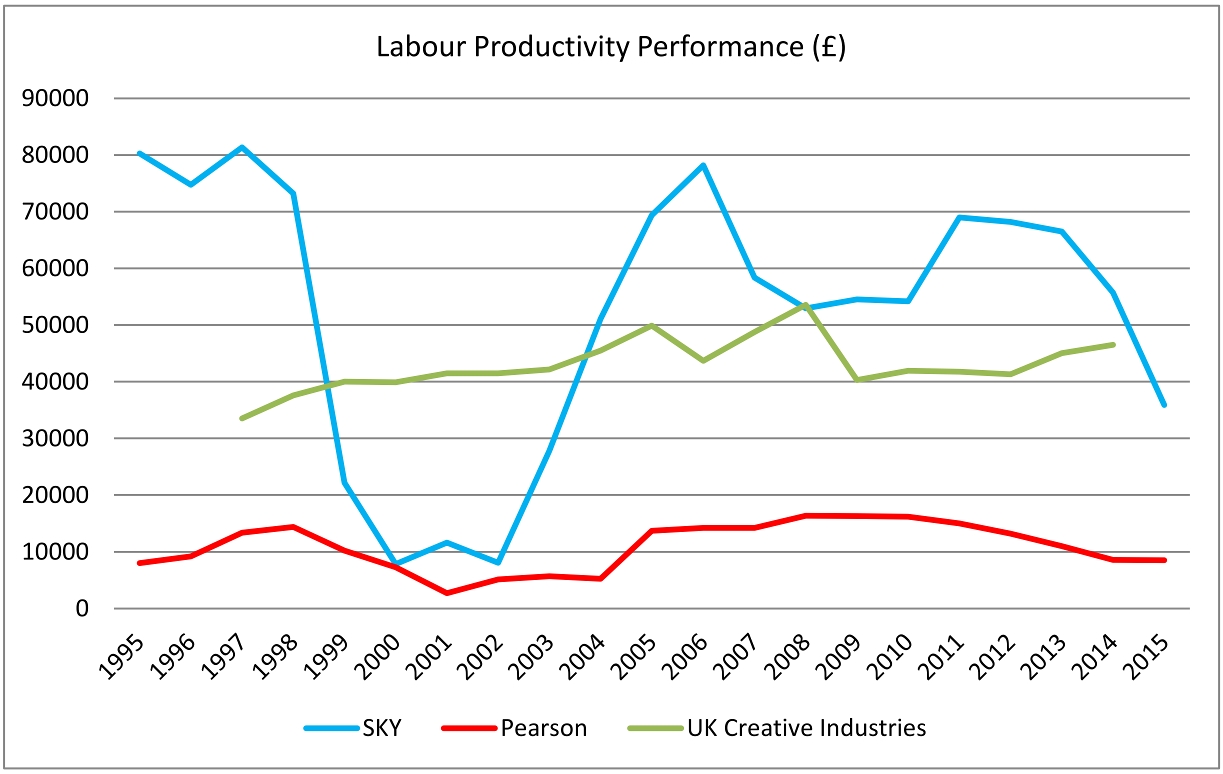


Source: Thomson Reuters DataStream

As a significant proportion of a firm's entire resource base, an analysis of the productivity of human resources in provided some interesting insights into the performance management of human resources. The 'Operating Income per Employee' for Sky and Pearson was compared to the 'Gross Value Added' for the UK Creative Industries as a whole and for the respective sub-industries of Film, TV, Radio, Video (for Sky) and Publishing (for Pearson).

Figure 4 below illustrates labour productivity for Sky, Pearson and the UK Creative Industries over the long-term. Sky's impressive 'Operating Income per Employee' indicates an impressive and superior ability to generate income from their employees. The *average* Operating Income per Employee (1995-2015) was £52,433 which is significantly higher than Pearson (£10,877), the UK Creative Industries (£40,760) and the UK Film, TV, Radio and Video Industry (£43,579). Sky's labour productivity performance has been influenced by the significant capital investments, joint ventures and acquisition during 1999-2002 and the resultant step change in the number of employees which increased from 4,634 (1998) to 10,730 (2000). Furthermore, the corporate acquisitions of Sky Italia and Sky Germany in 2014 increased the number of employees from 20,841 (2014) to 27,060 (2015). The creation of dynamic firm capabilities requires a long term commitment to resource reconfiguration and renewal, and as a result, Sky have had to endure higher labour costs and lower level of productivity for sustained periods of time.

Figure 4: Labour Productivity (1995-2015)



Source: Adapted from Department for Culture, Media and Sport, Creative Industries Economic Estimates 1997-2014

Conclusions

The premise of this paper was to evaluate *how* media firms deliver superior performance in the context of a fast changing and uncertain operating environment. The two firms in this empirical study have demonstrated over the course of two business cycles that an ambitious organizational strategy, that invests and adapts their resource base to produce new and dynamic capabilities has every chance of producing superior firm performance. Whilst the research did not set out to establish a causal relationship between organizational strategy, dynamic capabilities and superior firm performance, the findings do contribute to a better theoretical and empirical understanding of the importance played by each constituent in the transformation of their firm.

The findings reveal that both firm’s corporate objectives and strategies focussed on ambitious levels of growth and the opportunities provided by an increasingly digital environment. However, the configuration of each firm over time differed, with Sky transforming themselves from being a single product media firm, into a multi-product media firm with impressive results. In contrast, Pearson have engaged in three strategic transformations, moving from being a holding company, an Entrepreneurial M-form, and into their current form as a single product learning company. As case studies of corporate *Transformation*, both firms are in stark contrast to their form, nature and appearance now, compared to 1995.

Both Sky and Pearson have adapted their firms through a process of managed evolution and the purposeful desire to realize organizational objectives that have been dictated by changes in the competitive environment. This has been achieved through organic investment in resources that has delivered new digital capabilities, products and services. In addition, they have also gained more expedient access to new resources, capabilities and markets through numerous strategic acquisitions of firms with capabilities crucial to the development of the firm. Whilst acquisitions have played a central, and consistent, role in transformation of both firms over the course of two business cycles, the divestment of strategic business units has been equally important. These decisions have largely been taken on the basis that they were a drain on corporate resources, or that they do not fit into the firm's future, or that they provide a valuable source of funds to invest in future and more profitable ventures.

As noted previously, organizational strategy and dynamic capabilities are largely interdependent theories connected by one primary aim, that is, delivering the value that produces superior measures of corporate performance. The findings of this research illustrate how both firms engaged in high growth strategies that were executed through a consistent approach to the investment in the resources that delivered new capabilities and competitive advantage. The findings clearly illustrate how Sky has delivered superior corporate financial performance using those metrics that are directly linked to the value created from a firm's resource based. Indeed, they have outperformed their competitive set, the wider creative industries and the top 100 firms in the UK. The case for Pearson delivering 'superior' firm performance is less clear. Whilst the consistent increases in Market Value growth and Revenue will have delivered value to shareholders, the average ROIC fell below the FTSE100, whilst their average 'Operating Income per Employee' over the duration of this study was well below that of the UK Creative Industries. Whilst the historic financial data up to 2014 presents a positive view of Pearson's strategic approach, their disposal of important media assets (The FT Group and The Economist in 2015) has delivered less than impressive financial results over the past two years. In essence, they 'bet the company' on a single product, and one can only conclude that to be successful in a volatile digital media environment, having a more diversified portfolio of strategic business units would enable a media firm to take advantage of the opportunities, whilst also off-setting the potential threats of poor strategic investment decisions.

The findings have also revealed the importance of strategic acquisitions and divestment to the reconfiguration and renewal of a firm's resource base. Whilst there is a common understanding in the literature on the role that acquisitions play in accessing new resources and capabilities, there is not the same level of understanding on how the divestment of strategic assets helps to deliver resource renewal and superior corporate performance. As such, future researchers working in this field may find a fruitful area of inquiry.

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