LOVELY PROFESSIONAL UNIVERSITY

STRATEGIC MANAGEMENT

Edited By

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SYLLABUS

Objectives: Development and reinforcement of a general management point of view-the capacity to view the firm from an overall perspective, in the context of its environment. Development of an understanding of fundamental concepts in strategic management: the role of the general manager, the levels and components of strategy, competitive analysis, and organizational evolution. Development of those skills and knowledge peculiar to general management and the general manager's job that have not been covered in previous functional courses. Synthesis of the knowledge gained in previous courses and understanding what part of that knowledge is useful to general managers.

DCOM506 Strategic Management

Sr. No.	Description
1.	Nature of Strategic Management, Dimensions, benefits and risks. The strategic management process.
2.	Strategy formulation. Business vision and mission, Importance, Characteristics and components. Evaluating mission statements.
3.	The External Assessment, Porters five force analysis. Industry and competitive analysis. The Global Environment, competitive strategies for firms in global markets.
4.	The Internal Assessment: SWOT Analysis, strategy and culture. Value Chain Analysis. Resource based view of the firm. Benchmarking.
5.	Strategies in Action: The balanced scorecard, types of strategies, Integrative, Intensive, Diversification strategies, defensive strategies, Porters Generic Strategies.
6.	Strategy analysis and choice: Business level strategies. Cost leadership, Differentiation, Speed and market focus. Multi business strategy: BCG matrix, GE Nine Cell matrix. Limitations of portfolio approaches. The Parenting framework.
7.	Strategy Implementation: Short term objectives, functional tactics. Empowering Operating personnel, Allocation of recourses, managing resource conflict.
8.	Structure and strategy: Improving effectiveness of traditional organisational structures. Creating Agile Virtual Organisations, Modular organisation. Towards boundary less structures.
9.	Leadership and culture: Strategic intent, Shaping organisational culture. Role of leader in organisational culture.
10.	Strategy evaluation: Strategy evaluation process.

DMGT502 Strategic Management

Sr. No.	Description
1	**Nature of Strategic Management:** Dimensions, benefits and risks, the strategic management process. **Establishment of Strategic Intent:** Business vision and mission, importance, characteristics and Components, evaluating mission statement, concept of goals and objectives**.**
2	**The Environment Appraisal:** External assessment, concept of environment, porters five force analysis, industry and competitive analysis, environmental scanning.
3	**Organizational Appraisal**: the Internal Assessment: SWOT analysis, strategy and culture, value chain analysis, organizational capability factors, Benchmarking.
4	**Corporate Level Strategies:** Concentration, integration, diversification, expansion strategies, retrenchment and combination strategies, internationalization, cooperation and restructuring.
5	**Business Level Strategies**: Industry structure, positioning of firm, generic strategies, business tactics, Internationalization.
6	**Strategy Analysis and Choice:** Process for strategic choice, strategic analysis, SWOT, industry analysis, corporate portfolio analysis, contingency strategies.
7	**Strategic Implementation**: Activating strategies, nature, barrier and model for strategy implementation, resource allocation.
8	**Structural Implementation**: Types of organizational structures, organizational design and change, structures for strategies. **Behavioural Implementation**: stakeholders and strategy, stakeholder's management, strategic leadership, corporate culture and strategic management, personal values and ethics, social responsibility and strategic management.
9	**Functional and Operational Implementation**: Functional strategies, functional plans and policies, operational plans and policies, personnel plans and strategies.
10	**Strategic Evaluation and Control**: Nature of strategic evaluation and control, strategic control, operational control, techniques for strategic control, role of organizational systems in evaluation.

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Unit 1: Introduction to Strategic Management

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Objectives

After studying this unit, you will be able to:

- State the meaning, nature and importance of strategic management
- Explain the dimensions and benefits of strategic management
- Identify the risks involved in strategic management
- Discuss the strategic management process

Introduction

Strategic Management is exciting and challenging. It makes fundamental decisions about the future direction of a firm – its purpose, its resources and how it interacts with the environment in which it operates. Every aspect of the organisation plays a role in strategy – its people, its finances, its production methods, its customers and so on.

Strategic Management can be described as the identification of the purpose of the organisation and the plans and actions to achieve that purpose. It is that set of managerial decisions and actions that determine the long-term performance of a business enterprise. It involves formulating and implementing strategies that will help in aligning the organisation and its environment to achieve organisational goals. Strategic management does not replace the traditional management

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activities such as planning, organising, leading or controlling. Rather, it integrates them into a broader context taking into account the external environment and internal capabilities and the organisation's overall purpose and direction. Thus, strategic management involves those management processes in organisations through which future impact of change is determined and current decisions are taken to reach a desired future. In short, strategic management is about envisioning the future and realizing it.

1.1 Definition of Strategic Management

We have so far discussed the concepts of strategic thinking, strategic decision-making and strategic approach which, it is hoped, will serve as an a background understand the nature of strategic management. However, to get an understanding of what goes on in strategic management, it is useful to begin with definitions of strategic management. Later in the unit, we introduce the elements and the process of strategic management and the importance, benefits and limitations of strategic management.

As already mentioned, the concepts in strategic management have been developed by a number of authors like Alfred Chandler, Kenneth Andrews, Igor Ansoff, William Glueck, Henry Mintzberg, Michael E. Porter, Peter Drucker and a host of others. There are therefore several definitions of strategic management. Some of the important definitions are:

1. *"Strategic management is concerned with the determination of the basic long-term goals and the objectives of an enterprise, and the adoption of courses of action and allocation of resources necessary for carrying out these goals".*

   – Alfred Chandler, 1962

2. *"Strategic management is a stream of decisions and actions which lead to the development of an effective strategy or strategies to help achieve corporate objectives".*

   – Glueck and Jauch, 1984

3. *"Strategic management is a process of formulating, implementing and evaluating cross-functional decisions that enable an organisation to achieve its objective".*

   – Fed R David, 1997

4. *"Strategic management is the set of decisions and actions resulting in the formulation and implementation of plans designed to achieve a company's objectives."*

   – Pearce and Robinson, 1988

5. *"Strategic management includes understanding the strategic position of an organisation, making strategic choices for the future and turning strategy into action."*

   – Johnson and Sholes, 2002

6. *"Strategic management consists of the analysis, decisions, and actions an organisation undertakes in order to create and sustain competitive advantages."*

   – Dess, Lumpkin & Taylor, 2005

We observe from the above definitions that different authors have defined strategic management in different ways. Note that the definition of Chandler that we have quoted above is from the early 1960s, the period when strategic management was being recognized as a separate discipline. This definition consists of three basic elements:

l. Determination of long-term goals

2. Adoption of courses of action

3. Allocation of resources to achieve those goals

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Though this definition is simple, it does not consist of all the elements and does not capture the essence of strategic management.

The definitions of Fred R. David, Pearce and Robinson, Johnson and Sholes and Dell, Lumpkin and Taylor are some of the definitions of recent origin. Taken together, these definitions capture three main elements that go to the heart of strategic management. The three on-going processes are strategic analysis, strategic formulation and strategic implementation. These three components parallel the processes of analysis, decisions and actions. That is, strategic management is basically concerned with:

1. Analysis of strategic goals (vision, mission and objectives) along with the analysis of the external and internal environment of the organisation.
2. Decisions about two basic questions:
   (a) What businesses should we compete in?
   (b) How should we compete in those businesses to implement strategies?
3. Actions to implement strategies. This requires leaders to allocate the necessary resources and to design the organisation to bring the intended strategies to reality. This also involves evaluation and control to ensure that the strategies are effectively implemented.

The real strategic challenge to managers is to decide on strategies that provide competitive advantage which can be sustained over time. This is the essence of strategic management, and Dess, Lumpkin and Taylor have rightly captured this element in their definition.

1.2 Nature of Strategic Management

Strategic Management can be defined as the art & science of formulating, implementing, and evaluating, cross-functional decisions that enable an organisation to achieve its objectives. Strategic management is different in nature from other aspects of management. An individual manager is most often required to deal with problems of operational nature. He generally focuses on day-to-day problems such as the efficient production of goods, the management of a sales force, the monitoring of financial performance or the design of some new system that will improve the level of customer service.

Caution These are all very important tasks. But they are essentially concerned with effectively managing resources already deployed, within the context of an existing strategy. In other words, operational control is what managers are involved in most of their time. It is vital to the effective implementation of strategy, but it is not the same as strategic management.

Strategic management involves elements geared toward a firm's long term survival and achievement of management goals. The components of the content of a strategy making process include a desirable future, resource allocation, management of the firm-environment and a competitive business ethics. However, some conflicts may result in defining the content of strategy such as differences in interaction patterns among associates, inadequacy of available resources and conflicts between the firm's objectives and its environment.

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1.3 Dimensions of Strategic Management

The characteristics of strategic management are as follows:

1. ***Top management involvement:*** Strategic management relates to several areas of a firm's operations. So, it requires top management's involvement. Generally, only the top management has the perspective needed to understand the broad implications of its decisions and the power to authorize the necessary resource allocations.

2. ***Requirement of large amounts of resources:*** Strategic management requires commitment of the firm to actions over an extended period of time. So they require substantial resources, such as, physical assets, money, manpower etc.

   Example: Decisions to expand geographically would have significant financial implications in terms of the need to build and support a new customer base.

3. ***Affect the firm's long-term prosperity:*** Once a firm has committed itself to a particular strategy, its image and competitive advantage are tied to that strategy; its prosperity is dependent upon such a strategy for a long time.

4. ***Future-oriented:*** Strategic management encompasses forecasts, what is anticipated by the managers. In such decisions, emphasis is placed on the development of projections that will enable the firm to select the most promising strategic options. In the turbulent environment, a firm will succeed only if it takes a proactive stance towards change.

5. ***Multi-functional or multi-business consequences:*** Strategic management has complex implications for most areas of the firm. They impact various strategic business units especially in areas relating to customer-mix, competitive focus, organisational structure etc. All these areas will be affected by allocations or reallocations of responsibilities and resources that result from these decisions.

6. ***Non-self-generative decisions:*** While strategic management may involve making decisions relatively infrequently, the organisation must have the preparedness to make strategic decisions at any point of time. That is why Ansoff calls them "non-self-generative decisions."

1.4 Need for Strategic Management

No business firm can afford to travel in a haphazard manner. It has to travel with the support of some route map. Strategic management provides the route map for the firm. It makes it possible for the firm to take decisions concerning the future with a greater awareness of their implications. It provides direction to the company; it indicates how growth could be achieved.

The external environment influences the management practices within any organisation. Strategy links the organisation to this external world. Changes in these external forces create both opportunities and threats to an organisation's position – but above all, they create uncertainty. Strategic planning offers a systematic means of coping with uncertainty and adapting to change. It enables managers to consider how to grasp opportunities and avoid problems, to establish and coordinate appropriate courses of action and to set targets for achievement.

Thirdly, strategic management helps to formulate better strategies through the use of a more systematic, logical and rational approach. Through involvement in the process, managers and employees become committed to supporting the organisation. The process is a learning, helping,

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educating and supporting activity. An increasing number of firms are using strategic management for the following reasons:

1. It helps the firm to be more proactive than reactive in shaping its own future.
2. It provides the roadmap for the firm. It helps the firm utilize its resources in the best possible manner.
3. It allows the firm to anticipate change and be prepared to manage it.
4. It helps the firm to respond to environmental changes in a better way.
5. It minimizes the chances of mistakes and unpleasant surprises.
6. It provides clear objectives and direction for employees.

Case Study

Star Struck

Iridium is named after the 77th element to signify the 77 satellites that were supposed to beam signals around the world, creating a worldwide mobile satellite telephone service (MSS). However, things did not work out as planned. Motorola, Iridium's chief sponsor, has vowed not to invest any more than the $1.6 billions it has already invested in the venture, unless other investors do so too. Iridium was chasing a very modest goal in terms of number of subscribers - 27,000 by end of July, from 10,000 at the end of March.

These two events are symptoms of deeper problems within the Iridium network, as people try to work out what went wrong. Were its estimates of MSS market (between 32 millions and 45 millions subscribers within ten years) unrealistic? Or, are Iridium's problems due to poor vision and poor planning? Mobile telephony, in general, has been a growth market, with subscribers expected to reach 600 millions within the next two years. MSS providers plan to capture 2.5% of the market by offering handsets that operate as a land-based cellular phone and a satellite telephone when cellular service is unavailable. Apart from business executives, other specialized users include truckers, civil engineers, field scientists, disaster-relief agencies, news organisations, extractive industries, and geologists. Shipping and aviation, as well as operations in less developed countries, which lack traditional telephone infrastructure, are also potential markets. Yet Iridium has not been able to sign up many subscribers. The technology is quite sound - the problem has been poor forecasting, marketing, production glitches, and some unexpected competitive moves.

Iridium's market size forecast and value did not materialize. This may be due to several marketing problems. Iridium's handsets cost more than $3,000, and call charges range from $2 to $7 a minute. Iridium's handset is large (7 inches), and weighs 1 pound, limiting its portability. Manufacturing delays at Motorala and Kyocera left customers waiting to get their telephones. In any case, its marketing partners, Sprint, and Telecom Italia were not prepared to sell the telephones. Its generic. "schmoozy" and "generic life-style marketing" (according to John Richardson, Iridium's new CEO) was not suitable for its specialized target market.

Competitive entry also hurt Iridium's already weak network. Two new entrants to the MSS market, Global star and ICO have been able to promise the same service at a lower cost. At a volume of 1 billion minutes per year, for instance, the cost of a minute using Iridium's system is $1.28, compared to 51 cents a minute for Global star, and 35 cents for

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ICO. The difference arises mainly because of Iridium's numerous satellites and their use of more power to maintain their low earth orbit. This also shortens their life span to 5 - 7 years. ICO's satellites, on the other hand, fly about 6000 miles higher in medium-earth orbit and have a life span of 12 years. With Iridium being forced to charge prices far lower than it had planned, and two low cost operators about to enter the market, Iridium's future is uncertain.

Questions

1. Analyze the role of poor strategic management at Motorola in Iridium's failure.
2. What steps do you think should have been collectively taken by Motorola, Kyocera, Sprint and Telecom Italia to save Iridium?

Source: Adapted from The Economist, July 17, 1999.

1.5 Benefits of Strategic Management

"We are tackling 20-year problems with five-year plans staffed with two-year personnel funded by one–year appropriations".

– Harlan Cleveland

The above quotation sums up why today's decision-makers must plan and manage strategically. In developing as well as in industrialized countries, the increasingly rapid nature of change as well as a greater openness in the political and economic environments, requires a different set of perspective from that needed during more stable times.

When a certain degree of equilibrium existed in the environment, as during the 1950s, with constant positive economic growth, low debt, manageable budgets and relative environmental stability, managers could concentrate almost exclusively on the internal dimensions of their organisations and assume constancy in the external environment. Forward calculations were simple, inputs were predictable, and planning was mostly an arithmetic exercise.

Now, systems are much more open, environment is characterized by increasingly unstable economic growth, budgets are constantly revised, inputs are thoroughly unpredictable, and planning in the traditional sense is no longer tenable.

Therefore, today's enterprises need strategic management to reap the benefits of business opportunities, overcome the threats and stay ahead in the race. The purpose of strategic management is to exploit and create new and different opportunities for tomorrow; while long-term planning, in contrast, tries to optimize for tomorrow the trends of today.

Today, all top companies are involved in strategic management. They are finding ways to respond to competitors, cope with difficult environmental changes, meet changing customer needs and effectively use available resources. At a time when the business environment is changing rapidly, even established firms are paying more attention to strategy because they may face new competitors who threaten their core business. Should a firm compete in all areas or concentrate on one area? Should a company try to extend the brand to even more diverse areas of activity, or would it gain more by building profits in the existing areas, and achieving more synergies across the group? Should the company continue the current strategy as it is now, or would it initiate a radical review of its strategy? These are just a few examples of the strategic part of the management tasks.

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Notes It is important to note that strategic planning goes far beyond the planning process. Unlike traditional planning, strategic planning involves a long-range planning under conditions of uncertainty and complexity Such a planning involves:

1. Strategic thinking
2. Strategic decision-making
3. Strategic approach

A structured approach to strategy planning brings several benefits (Smith, 1995; Robbins, 2000)

1. ***It reduces uncertainty:*** Planning forces managers to look ahead, anticipate change and develop appropriate responses. It also encourages managers to consider the risks associated with alternative responses or options.
2. ***It provides a link between long and short terms:*** Planning establishes a means of coordination between strategic objectives and the operational activities that support the objectives.
3. ***It facilitates control:*** By setting out the organisation's overall strategic objectives and ensuring that these are replicated at operational level, planning helps departments to move in the same direction towards the same set of goals.
4. ***It facilitates measurement:*** By setting out objectives and standards, planning provides a basis for measuring actual performance.

Strategic management has thus both financial and non-financial benefits:

1. ***Financial Benefits:*** Research indicates that organisations that engage in strategic management are more *profitable* and *successful* than those that do not. Businesses that followed strategic management concepts have shown significant improvements in *sales*, *profitability* and *productivity* compared to firms without systematic planning activities.
2. ***Non-financial benefits:*** Besides financial benefits, strategic management offers other intangible benefits to a firm. They are;
   (a) Enhanced awareness of external threats
   (b) Improved understanding of competitors' strategies
   (c) Reduced resistance to change
   (d) Clearer understanding of performance-reward relationship
   (e) Enhanced problem-prevention capabilities of organisation
   (f) Increased interaction among managers at all divisional and functional levels
   (g) Increased order and discipline.

According to Gordon Greenley, strategic management offers the following benefits:

1. It allows for identification, prioritization and exploitation of opportunities.
2. It provides objective view of management problems.

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3. It provides a framework for improved coordination and control of activities.
4. It minimizes the effects of adverse conditions and changes.
5. It allows decision-making to support established objectives.
6. It allows more effective allocation of time and resources to identified opportunities.
7. It allows fewer resources and less time to be devoted to correcting erroneous and *ad hoc* decisions.
8. It creates a framework for internal communication among personnel.
9. It helps integrate the behaviour of individuals into a total effort.
10. It provides a basis for clarifying individual responsibilities.
11. It encourages forward thinking.
12. It provides a cooperative, integrated enthusiastic approach to tackling problems and opportunities.
13. It encourages a favourable attitude towards change.
14. It gives a degree of discipline and formality to the management of a business.

1.6 Risks involved in Strategic Management

Strategic management is an intricate and complex process that takes an organisation into unchartered territory. It does not provide a ready-to-use prescription for success. Instead, it takes the organisation through a journey and offers a framework for addressing questions and solving problems.

Strategic management is not, therefore, a guarantee for success; it can be dysfunctional if conducted haphazardly. The following are its limitations:

1. It is a costly exercise in terms of the time that needs to be devoted to it by managers. The negative effect of managers spending time away from their normal tasks may be quite serious.
2. A negative effect may arise due to the non-fulfillment of the expectations of the participating managers, leading to frustration and disappointment.
3. Another negative effect of strategic management may arise if those associated with the formulation of strategy are not intimately involved in the implementation of strategies. The participants in formulation of the policy may shirk their responsibility for the decisions taken.

As quoted by Fred R. David, some pitfalls to watch for and avoid in strategic planning are:

1. Using strategic planning to control over decisions and resources
2. Doing strategic planning only to satisfy accreditation or regulatory requirements
3. Moving too hastily from mission development to strategy formulation
4. Failing to communicate the strategic plan to the employees, who continue working in the dark
5. Top managers making many intuitive decisions that conflict with the formal plan
6. Top managers not actively supporting the strategic planning process
7. Failing to use plans as a standard for measuring performance

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8. Delegating strategic planning to a consultant rather than involving all managers
9. Failing to involve key employees in all phases of planning
10. Failing to create a collaborative climate supportive of change
11. Viewing planning to be unnecessary or unimportant
12. Becoming so engrossed in current problems that insufficient or no planning is done
13. Being so formal in planning that flexibility and creativity are stifled.

Task Name a few companies that went down due to poor strategic management. What went wrong with them?

1.7 Strategic Management Process

Developing an organisational strategy involves four main elements – strategic analysis, strategic choice, strategy implementation and strategy evaluation and control. Each of these contains further steps, corresponding to a series of decisions and actions, that form the basis of strategic management process.

1. ***Strategic Analysis:*** The foundation of strategy is a definition of organisational purpose. This defines the business of an organisation and what type of organisation it wants to be. Many organisations develop broad statements of purpose, in the form of vision and mission statements. These form the spring – boards for the development of more specific objectives and the choice of strategies to achieve them.

   Environmental analysis – assessing both the external and internal environments is the next step in the strategy process. Managers need to assess the opportunities and threats of the external environment in the light of the organisation's strengths and weaknesses keeping in view the expectations of the stakeholders.

   This analysis allows the organisation to set more specific goals or objectives which might specify where people are expected to focus their efforts. With a more specific set of objectives in hand, managers can then plan how to achieve them.

2. ***Strategic Choice:*** The analysis stage provides the basis for strategic choice. It allows managers to consider what the organisation could do given the mission, environment and capabilities – a choice which also reflects the values of managers and other stakeholders. (Dobson *et al*. 2004). These choices are about the overall scope and direction of the business.

   Since managers usually face several strategic options, they often need to analyze these in terms of their feasibility, suitability and acceptability before finally deciding on their direction.

3. ***Strategy Implementation:*** Implementation depends on ensuring that the organisation has a suitable structure, the right resources and competencies (skills, finance, technology etc.), right leadership and culture. Strategy implementation depends on operational factors being put into place.

4. ***Strategy Evaluation and Control:*** Organisations set up appropriate monitoring and control systems, develop standards and targets to judge performance.

Notes

Table 1.1 summarizes the steps involved in each of the above elements of strategic management.

Table 1.1: Steps in Strategic Management Process

Elements in strategy process	Questions	Description
STRATEGY FORMULATION		
Strategic analysis		
Defining organizational purpose	What is our purpose? What kind of organization do we want to be?	Organizational purpose is generally articulated in vision and mission statements. The first task is, therefore, to identify vision and mission of the organization. Environmental analysis involves the gathering and analysis of intelligence on the business environment. This encompasses the external environment (general and competitive forces), the internal environment (resources, competences, performance relative to competitors), and stakeholder expectations.
Strategic choice		
Objectives	Where do we want to be?	Objectives provide a more detailed articulation of purpose and a basis for monitoring performance.
Options analysis	Are there alternative routes?	Alternative strategic options may be identified; options require to be appraised in order that the best can be selected.
Strategies	How are we going to get there?	Strategies are the *means* or *courses* of action to achieve the purpose of the organization.
STRATEGY IMPLEMENTATION		
Actions	How do we turn plans into reality?	A specification of the operational activities and tasks required to enable strategies to be implemented.
STRATEGY EVALUATION AND CONTROL		
Monitoring and control	How will we know if we are getting there?	Monitoring performance and progress in meeting objectives, taking corrective action as necessary and reviewing strategy.

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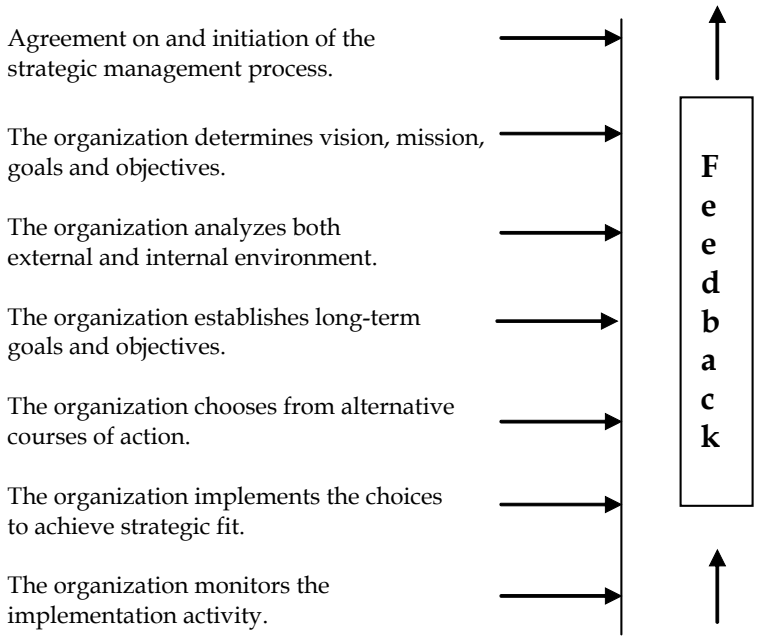
The above steps can also be depicted as a series of processes involved in strategic management.

Figure 1.1: A General Framework of Strategic Management Process



The seven steps in the above model of strategy process fall into three broad phases – formulation, implementation and evaluation – though in practice the three phases interact closely.

Good strategists know that formulation and implementation of strategy rarely proceed according to plan, partly because the constantly changing external environment brings new opportunities or threats, and partly because there may also be inadequate internal competence. Since these may lead the management to change the plan, there will be frequent interaction between the activities of formulating and implementing strategy, and management may need to return and reformulate the plan.

Caselet

Telecom Growth and Tata Strategic

Tata Strategic assessed the telecom environment with respect to customers, regulation, technology and competition, and estimated the market potential for different segments in the Indian telecom market. The group's vision and long-term strategic intent in telecom was formulated, growth options and attractive investment opportunities were recommended to achieve this vision, and an optimum organisation structure covering the various telecom entities in the group was evolved. The group was able to take critical investment decisions based on Tata Strategic's recommendations and is now one of India's leading integrated telecom operators.

Source: tsmg.com

Notes

1.8 Summary

- Strategic or institutional management is the conduct of drafting, implementing and evaluating cross-functional decisions that will enable an organisation to achieve its long-term objectives.
- It is a level of managerial activity under setting goals and over tactics.
- It is the process of specifying the organisation's mission, vision and objectives, developing policies and plans, often in terms of projects and programs, which are designed to achieve these objectives, and then allocating resources to implement the policies and plans, projects and programs.
- Strategic management provides overall direction to the enterprise and is closely related to the field of Organisation Studies.
- Although a sense of direction is important, it can also stifle creativity, especially if it is rigidly enforced. In an uncertain and ambiguous world, fluidity can be more important than a finely tuned strategic compass.
- When a strategy becomes internalized into a corporate culture, it can lead to group think. It can also cause an organisation to define itself too narrowly.
- Even the most talented manager would no doubt agree that "comprehensive analysis is impossible" for complex problems.
- Formulation and implementation of strategy must thus occur side-by-side rather than sequentially, because strategies are built on assumptions which, in the absence of perfect knowledge, will never be perfectly correct.
- The essence of being "strategic" thus lies in a capacity for "intelligent trial-and error" rather than linear adherence to finally honed and detailed strategic plans.
- Strategic management is a question of interpreting, and continuously reinterpreting, the possibilities presented by shifting circumstances for advancing an organisation's objectives.

1.9 Keywords

Environmental Analysis: Evaluation of the possible or probable effects of external as well as internal forces and conditions on an organisation's survival and growth strategies.

Financial Benefits: profits associated with strategic management

Multifunctional Consequences: having complex implications on most of the functions of the organisation

Non-financial Benefits: intangible benefits associated with strategic management

Non-Self Generative Decisions: decisions that are taken infrequently but promptly when needed at any point of time

Plan: A set of intended actions, through which one expects to achieve a goal.

Strategic Choice: choice of course of action given the environment, mission and capabilities

Strategic Management: stream of decisions and actions that lead to development of effective strategy

Strategy: A plan of action designed to achieve a particular goal.

Tactic: A conceptual action taken under a well defined strategy to achieve a specific objective.

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1.10 Self Assessment

Fill in the blanks:

1. Strategic management provides overall ..... to the enterprise.
2. Strategic management is a question of interpreting, and continuously ....., the possibilities presented by ..... circumstances for advancing an organisation's objectives.
3. The foundation of strategy is a definition of organisational .....
4. Organisations set up appropriate monitoring and control systems, develop standards and targets to judge .....
5. ..... and ..... of strategy rarely proceed according to plan.
6. The first step in the strategic management process is to develop the corporate ..... and .....
7. Once a firm has committed itself to a particular strategy, its ..... and ..... are tied to it.
8. A ..... can be defined as the overall goal of an organisation that all business activities and processes should contribute toward achieving.
9. Formulation and implementation of strategy must occur side-by-side rather than .....
10. When a strategy becomes internalized into a corporate culture, it can lead to .....
11. Strategic planning goes far beyond the ..... process.
12. Generally, only the ..... has the perspective needed to understand the broad implications behind the strategic plans.
13. The real strategic goals are realized only along with the analysis of the ..... and ..... environment of the organisation.
14. Developing an organisational strategy involves ..... main elements.
15. Strategic planning is a ..... exercise in terms of the time that needs to be devoted to it by managers.

1.11 Review Questions

1. Discuss the various elements of strategic management.
2. Examine the significance of strategic management.
3. "Strategic management process is the way in which strategists determine objectives and strategic decisions". Discuss.
4. Bring out the distinguishing features of strategic management.
5. Can the process of strategic management really be depicted in a given model or it is a prompt and dynamic process? Give reasons.
6. Depict the model of strategic management and explain its components.

Notes

7. Suppose you are the Managing Director of an organisation. Your organisation is running into losses due to poor management and decision making. How will you analyse the situation and move your organisation out of the situation?
8. Have you ever challenged, shaken old work methods? What problems did you encounter? Did you overcome them? How? If no, what were the reasons for their being insurmountable?
9. With reference to a day's work, what steps do you take to organise and prioritize your tasks?
10. Describe a specific instance, in a group situation, where you made your views known about an issue important to yourself. What was the issue, and why was it crucial?
11. Outline in very broad terms how you would create a strategy for say, a public interest campaign.

Answers: Self Assessment

1.	direction	2.	reinterpreting, shifting
3.	purpose	4.	performance
5.	Formulation, implementation	6.	vision, mission
7.	image, competitive advantage	8.	vision
9.	sequentially	10.	group think
11.	planning	12.	top management
13.	external, internal	14.	four
15.	costly		

1.12 Further Readings

Books

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Notes

Online links

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www.netmba.com/strategy

www.quickmba.com/strategy

www.wisegeek.com/what-is-the-strategic-management

Notes

Unit 2: Strategy Formulation and Defining Vision

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Objectives

After studying this unit, you will be able to:

- Discuss various aspects of strategy formulation
- Explain the relevance business vision

Introduction

Strategy formulation is the process of determining appropriate courses of action for achieving organisational objectives and thereby accomplishing organisational purpose.

Strategy formulation is vital to the well-being of a company or organisation. It produces a clear set of recommendations, with supporting justification, that revise as necessary the mission and objectives of the organisation, and supply the strategies for accomplishing them. In formulation, we are trying to modify the current objectives and strategies in ways to make the organisation more successful. This includes trying to create "sustainable" competitive advantages – although most competitive advantages are eroded steadily by the efforts of competitors.

Notes

A good recommendation should be: effective in solving the stated problem(s), practical (can be implemented in this situation, with the resources available), feasible within a reasonable time frame, cost-effective, not overly disruptive, and acceptable to key "stakeholders" in the organisation. It is important to consider "fits" between resources plus competencies with opportunities, and also fits between risks and expectations.

There are four primary steps in this phase:

1. Reviewing the current key objectives and strategies of the organisation, which usually would have been identified and evaluated as part of the diagnosis
2. Identifying a rich range of strategic alternatives to address the three levels of strategy formulation outlined below, including but not limited to dealing with the critical issues
3. Doing a balanced evaluation of advantages and disadvantages of the alternatives relative to their feasibility plus expected effects on the issues and contributions to the success of the organisation
4. Deciding on the alternatives that should be implemented or recommended.

In organisations, and in the practice of strategic management, strategies must be implemented to achieve the intended results. Here it has to be remembered that the most wonderful strategy in the history of the world is useless if not implemented successfully.

2.1 Aspects of Strategy Formulation

The following three aspects or levels of strategy formulation, each with a different focus, need to be dealt with in the formulation phase of strategic management. The three sets of recommendations must be internally consistent and fit together in a mutually supportive manner that forms an integrated hierarchy of strategy, in the order given.

1. Corporate Level Strategy
2. Competitive Strategy
3. Functional Strategy

Let us understand each of them one by one.

1. ***Corporate Level Strategy:*** In this aspect of strategy, we are concerned with broad decisions about total organisation's scope and direction. Basically, we consider what changes should be made in our growth objective and strategy for achieving it, the lines of business we are in, and how these lines of business fit together. It is useful to think of three components of corporate level strategy:
   (a) *Growth or directional strategy* (what should be our growth objective, ranging from retrenchment through stability to varying degrees of growth - and how do we accomplish this)
   (b) *Portfolio strategy* (what should be our portfolio of lines of business, which implicitly requires reconsidering how much concentration or diversification we should have), and
   (c) *Parenting strategy* (how we allocate resources and manage capabilities and activities across the portfolio – where do we put special emphasis, and how much do we integrate our various lines of business).

Notes

This comprises the overall strategy elements for the corporation as a whole, the grand strategy, if you please. Corporate strategy involves four kinds of initiatives:

(a) Making the necessary moves to establish positions in different businesses and achieve an appropriate amount and kind of diversification. A key part of corporate strategy is making decisions on how many, what types, and which specific lines of business the company should be in. This may involve deciding to increase or decrease the amount and breadth of diversification. It may involve closing out some LOB's (lines of business), adding others, and/or changing emphasis among LOB's.

(b) Initiating actions to boost the combined performance of the businesses the company has diversified into: This may involve vigorously pursuing rapid-growth strategies in the most promising LOB's, keeping the other core businesses healthy, initiating turnaround efforts in weak-performing LOB's with promise, and dropping LOB's that are no longer attractive or don't fit into the corporation's overall plans. It also may involve supplying financial, managerial, and other resources, or acquiring and/or merging other companies with an existing LOB.

(c) Pursuing ways to capture valuable cross-business strategic fits and turn them into competitive advantages – especially transferring and sharing related technology, procurement leverage, operating facilities, distribution channels, and/or customers.

(d) Establishing investment priorities and moving more corporate resources into the most attractive LOBs.

2. ***Competitive Strategy:*** It is quite often called as Business Level Strategy. This involves deciding how the company will compete within each Line of Business (LOB) or Strategic Business Unit (SBU). In this second aspect of a company's strategy, the focus is on how to compete successfully in each of the lines of business the company has chosen to engage in. The central thrust is how to build and improve the company's competitive position for each of its lines of business. A company has competitive advantage whenever it can attract customers and defend against competitive forces better than its rivals. Companies want to develop competitive advantages that have some sustainability (although the typical term "sustainable competitive advantage" is usually only true dynamically, as a firm works to continue it). Successful competitive strategies usually involve building uniquely strong or distinctive competencies in one or several areas crucial to success and using them to maintain a competitive edge over rivals. Some examples of distinctive competencies are superior technology and/or product features, better manufacturing technology and skills, superior sales and distribution capabilities, and better customer service and convenience.

3. ***Functional Strategy:*** These more localized and shorter-horizon strategies deal with how each functional area and unit will carry out its functional activities to be effective and maximize resource productivity. Functional strategies are relatively short-term activities that each functional area within a company will carry out to implement the broader, longer-term corporate level and business level strategies. Each functional area has a number of strategy choices, that interact with and must be consistent with the overall company strategies.

   Three basic characteristics distinguish functional strategies from corporate level and business level strategies: shorter time horizon, greater specificity, and primary involvement of operating managers.

   A few examples follow of functional strategy topics for the major functional areas of marketing, finance, production/operations, research and development, and human resources management. Each area needs to deal with sourcing strategy, i.e., what should be done in-house and what should be outsourced?

Notes

Marketing strategy deals with product/service choices and features, pricing strategy, markets to be targeted, distribution, and promotion considerations. Financial strategies include decisions about capital acquisition, capital allocation, dividend policy, and investment and working capital management. The production or operations functional strategies address choices about how and where the products or services will be manufactured or delivered, technology to be used, management of resources, plus purchasing and relationships with suppliers. For firms in high-tech industries, R&D strategy may be so central that many of the decisions will be made at the business or even corporate level, for example the role of technology in the company's competitive strategy, including choices between being a technology leader or follower. However, there will remain more specific decisions that are part of R&D functional strategy, such as the relative emphasis between product and process R&D, how new technology will be obtained (internal development vs. external through purchasing, acquisition, licensing, alliances, etc.), and degree of centralization for R&D activities. Human resources functional strategy includes many topics, typically recommended by the human resources department, but many requiring top management approval.

Example: Job categories and descriptions

Pay and benefits

Recruiting

Selection and orientation

Career development and training

Evaluation and incentive systems

Policies and discipline

Management/executive selection processes

Task Find out the competitive strategies followed by Pizza Hut.

Case Study

Formulating a Strategy: Following Apple Turnaround

The firm's most important resources and capabilities are those which are durable, difficult to identify and understand, imperfect transferable, not easily replicated, and in which the firm possesses clear ownership. These are the company's 'most important assets' and need to be protected; and they play a pivotal role in the competitive strategy which the company pursues. The essence of strategy formulation, then, is to design a strategy that makes the most effective use of these core resources and capabilities.

Consider, for example, the remarkable turnaround of Apple, the computer company behind the Macintosh computers, between 2000 to date. Fundamental was Steve Job's recognition that the company's sole durable, non-transferable, irreplicable asset was Apple image and the loyalty that accompanied that image. In virtually every other area of competitive

Contd...

Notes

performance-production cost, quality, product and process technology, and global market scope-Apple was greatly inferior to its other rivals, such as IBM. Apple's only opportunity for survival was to pursue a strategy founded upon Apple's image advantage, while simultaneously minimising Apple' disadvantages in other capabilities. Apple' new marketing strategy involved extending the appeal of the Apple image of individuality from its traditional customer group (tech savvy, graphic designers) to more a general, young professional types. Protection of the Apple name by means of tougher controls over dealers was matched by wider exploitation of the Apple name through entry in other industries such as the portable music business.

Apple's share of the computer market went from 15% in 1985 to 4% in 2005 and lost around $700 million in only three months in 1997.

However, thanks to the iPod and to the Apple's iTunes music stores, its shares grew 90% between 2001 up until today, i.e. from a mere $7/share. Apple is today the premier provider of MP3 players.

Designing strategy around the most critically important resources and capabilities may imply that the firm limits its strategic scope to those activities where it possesses a clear competitive advantage. The principal capabilities of Apple, are in design and new products development; it lacked both the manufacturing capabilities to compete effectively in the world's computer market. Apple's turnaround from year 2000 followed it decision to specialise upon design and new product development.

The ability of a firm's resources and capabilities to support a sustainable competitive advantage is essential to the time frame of a firm's strategic planning process. If a company's resources and capabilities lack durability or are easily transferred or replicated, then the company must either adopt a strategy of short-term harvesting or it must invest in developing new sources of competitive advantage.

These considerations are critical for small technological start-ups where the speed of technological change may mean that innovations offer only temporary competitive advantage. The company must seek either to exploit its initial innovation before it is challenged by stronger, established rivals or other start-ups, or it must establish the technological capability for a continuing stream of innovations.

The main issue for Apple is to make sure that it takes advantage of this window of opportunity. Because there are tougher competitors down the road and the more money it makes, the more companies will enter the market making harder for Apple to sustain this new found competitive advantage.

In industries where competitive advantages based upon differentiation and innovation can be imitated (such as financial services, retailing, fashion clothing, toys), firms have a brief window of opportunity during which to exploit their advantage before imitators erode it away. Under such circumstances firms must be concerned not with sustaining the existing advantages, but with creating the flexibility and responsiveness that permits them to create new advantages at a faster rate than the old advantages are being eroded by competition.

Question

What lessons can be learnt from Apple's Turnaround?

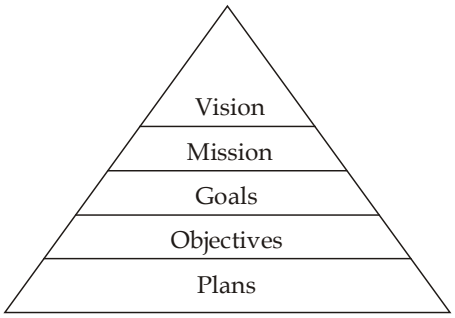
Source: http://www.bestcxo.com/strategic-management/formulating-a-strategy-following-apple-turnaround/

Notes

2.2 Business Vision

The first task in the process of strategic management is to formulate the organisation's vision and mission statements. These statements define the organisational purpose of a firm. Together with objectives, they form a "hierarchy of goals."

Figure 2.1: Hierarchy of Goals



A clear vision helps in developing a mission statement, which in turn facilitates setting of objectives of the firm after analyzing external and internal environment. Though vision, mission and objectives together reflect the "strategic intent" of the firm, they have their distinctive characteristics and play important roles in strategic management.

Vision can be defined as "a mental image of a possible and desirable future state of the organisation" (Bennis and Nanus). It is "a vividly descriptive image of what a company wants to become in future". Vision represents top management's aspirations about the company's direction and focus. Every organisation needs to develop a vision of the future. A clearly articulated vision moulds organisational identity, stimulates managers in a positive way and prepares the company for the future.

"The critical point is that a vision articulates a view of a realistic, credible, attractive future for the organisation, a condition that is better in some important ways than what now exists."

Vision, therefore, not only serves as a backdrop for the development of the purpose and strategy of a firm, but also motivates the firm's employees to achieve it.

According to Collins and Porras, a well-conceived vision consists of two major components:

1. Core ideology
2. Envisioned future

Core ideology is based on the enduring values of the organisation ("what we stand for and why we exists"), which remain unaffected by environmental changes. Envisioned future consists of a long-term goal (what we aspire to become, to achieve, to create") which demands significant change and progress.

2.2.1 Defining Vision

Vision has been defined in several different ways. Richard Lynch defines vision as " a challenging and imaginative picture of the future role and objectives of an organisation, significantly going beyond its current environment and competitive position." E1-Namaki defines it as "a mental perception of the kind of environment that an organisation aspires to create within a broad time horizon and the underlying conditions for the actualization of this perception". Kotter defines it as "a description of something (an organisation, corporate culture, a business , a technology, an activity) in the future."

Notes

Box 2.1 sets out a range of definitions of organisational vision. Most refer to a future or ideal to which organisational efforts should be directed. The vision itself is presented as a picture or image that serves as a guide or goal. Depending on the definition, it is referred to as inspiring, motivating, emotional and analytical. For Boal and Hooijberg, effective visions have two components:

1. A cognitive component (which focuses on outcomes and how to achieve them)
2. An affective component (which helps to motivate people and gain their commitment to it)

Box 2.1: Definitions of Vision

1. ***Johnson:*** Vision is "clear mental picture of a future goal created jointly by a group for the benefit of other people, which is capable of inspiring and motivating those whose support is necessary for its achievement".
2. ***Kirkpatrick et al:*** Vision is "an ideal that represents or reflects the shared values to which the organisation should aspire".
3. ***Thornberry:*** Vision is "a picture or view of the future. Something not yet real, but imagined. What the organisation could and should look like. Part analytical and part emotional".
4. ***Shoemaker:*** Vision is "the shared understanding of what the firm should be and how it must change".
5. ***Kanter et al:*** Vision is "a picture of a destination aspired to, an end state to be achieved via the change. It reflects the larger goal needed to keep in mind while concentrating on concrete daily activities".
6. ***Stace and Dunphy:*** Vision is "an ambition about the future, articulated today, it is a process of managing the present from a stretching view of the future".

2.2.2 Nature of Vision

A vision represents an animating dream about the future of the firm. By its nature, it is hazy and vague. That is why Collins describes it as a "Big hairy audacious goal" (BHAG). Yet it is a powerful motivator to action. It captures both the minds and hearts of people. It articulates a view of a realistic, credible, attractive future for the organisation, which is better than what now exists. Developing and implementing a vision is one of the leader's central roles. He should not only have a "strong sense of vision", but also a "plan" to implement it.

Example: 1. Henry Ford's vision of a "car in every garage" had power. It captured the imagination of others and aided internal efforts to mobilize resources and make it a reality. A good vision always needs to be a bit beyond a company's reach, but progress towards the vision is what unifies the efforts of company personnel.

2. One of the most famous examples of a vision is that of Disneyland "To be the happiest place on earth". Other examples are:

   (a) *Hindustan Lever:* Our vision is to meet the everyday needs of people everywhere.

   (b) *Microsoft:* Empower people through great software any time, any place and on any device.

   (c) *Britannia Industries:* Every third Indian must be a Britannia consumer.

Notes

Although such vision statements cannot be accurately measured, they do provide a fundamental statement of an organisation's values, aspirations and goals.

Some more examples of vision statements are given in Box 2.2

Box 2.2: Examples of Vision Statements

1. A Coke within arm's reach of everyone on the planet (Coca Cola)
2. Encircle Caterpillar (Komatsu)
3. Become the Premier Company in the World (Motorola)
4. Put a man on the moon by the end of the decade (John F. Kennedy, April 1961)
5. Eliminate what annoys our bankers and customers (Texas Commerce Bank)
6. The one others copy (Mobil)

2.2.3 Characteristics of Vision Statements

As may be seen from the above definitions, many of the characteristics of vision given by these authors are common such as being clear, desirable, challenging, feasible and easy to communicate. Nutt and Backoff have identified four generic features of visions that are likely to enhance organisational performance:

1. ***Possibility*** means the vision should entail innovative possibilities for dramatic organisational improvements.
2. ***Desirability*** means the extent to which it draws upon shared organisational norms and values about the way things should be done.
3. ***Actionability*** means the ability of people to see in the vision, actions that they can take that are relevant to them.
4. ***Articulation*** means that the vision has imagery that is powerful enough to communicate clearly a picture of where the organisation is headed.

According to Thompson and Strickland, some important characteristics of an effective vision statement are:

1. ***It must be easily communicable:*** Everybody should be able to understand it clearly.
2. ***It must be graphic:*** It must paint a picture of the kind of company the management is trying to create.
3. ***It must be directional:*** It must say something about the company's journey or destination.
4. ***It must be feasible:*** It must be something which the company can reasonably expect to achieve in due course of time.
5. ***It must be focused:*** It must be specific enough to provide managers with guidance in making decisions.
6. ***It must be appealing to*** the long term interests of the stakeholders.
7. ***It must be flexible:*** It must allow company's future path to change as events unfold and circumstances change.

Notes

In Table 2.1, many writers have presented their views on the key elements that constitute a good vision.

Table 2.1: Characteristics of a Good Vision

Jock	Kotter	Metais	Johnson	El-Namaki
• Clear and concise • Memorable • Exciting and inspiring • Challenging • Centered on excellence • Both stable and flexible • Achievable and tangible	• *Imaginable*— it conveys picture of what future will look like • *Desirable*—It appeals to long-term interests of stakeholders, for example, employees, customers, stockholders • *Feasible*—It embodies realistic, attainable goals • *Focused*—It provides guidance in decision making • *Flexible*—It is general enough to enable individual initiative and alternative responses to changing environments • *Communicable*—It can be explained in five minutes	• It is a dream—it provides emotional involvement • It is excessive—and not attainable within current actions or resources • It is deviant—it breaks conventiona l thinking and frames of reference	• It visualizes a future aim • It is contributed from a variety of sources • It implicates the need for people with specialist skills • It can be communicat -ed easily • It has a powerful motivational effect • It serves an important need • It is aligned with the values of prospective supporters	• Coherence—It integrates the company strategy and the future image of the company • Translatable—It is translatable into meaningful company goals and strategies • Powerful—It generates enthusiasm • Challenging—It is challenging for all organizational participants • Unique—It distinguishes the company from others • Feasible—It is realistic and achievable • Idealistic—It communicates desired outcome

2.2.4 Importance of Vision

Having a strategic vision is linked to competitive advantage, enhancing organisational performance, and achieving sustained organisational growth. Clear vision enable firms to determine how well organisational leaders are performing and to identify gaps between the vision and current practices. Organisations preparing for transformational change regularly undertake "envisioning" exercises to help guide them into the future. The visioning process itself can enhance the self-esteem of the people who participate in it because they can see the potential fruits of their labours.

Conversely, a "lack of vision" is associated with organisational decline and failure. As Beaver argues "Unless companies have clear vision about how they are going to be distinctly different and unique in adding and satisfying their customers, they are likely to be the corporate failure statistics of tomorrow". Lacking vision is used to explain why companies fail to build their core competencies despite having access to adequate resources to do so. Business strategies that lack visionary content may fail to identify when change is needed. Lack of an adequate process for translating shared vision into collective action is associated with the failure to produce transformational organisational change.

Notes

Thus vision statements serve as:

1. ***A basis for performance:*** A vision creates a mental picture of an organisation's path and direction in the minds of people in the organisation and motivates them for high performance.
2. ***Reflects core values:*** A vision is generally built around core values of an organisation, and channelises the group's energies towards such values and serves as a guide to action.
3. ***Way to communicate:*** A vision statement is an exercise in communication. A well-communicated vision statement will bring the employees together and galvanize them into action.
4. ***A desirable challenge:*** A vision provides a desirable challenge for both senior and junior managers.

While providing a sense of direction, strategic vision also serves as a kind of "emotional commitment". Thompson and Strickland point out the significance of "vision" which is broadly as follows:

1. It crystallizes top management's own view about firm's long-term direction.
2. It reduces the risk of rudderless decision-making.
3. It serves as a tool for maximizing the support of organisation members for internal changes.
4. It serves as a "beacon" to guide managers in decision-making.
5. It helps the organisation to prepare for the future.

Vision poses a challenge and addresses the human need for something to strive for. It can depict an image of the future that is both attractive and worthwhile.

Indeed, developing a strategic vision may be regarded as a managerial imperative in the strategic management process. This is because strategic management presupposes the necessity to look beyond today, to anticipate the impact of new technology, changes in customer needs and market opportunities. Creating a well-conceived vision illuminates an organisation's direction and purpose, and then using it repeatedly as a reminder of "where we are headed and why" helps keep organisation members on the chosen path.

Caution Although the idea of vision is widely accepted as a useful backdrop for the development of purpose and strategy, there is a problem. Vision has little meaning unless it can be successfully communicated to those working in the organisation, since these are the people who will have to realize it.

2.2.5 Advantages of Vision

Several advantages accrue to an organisation having a vision. Parikh and Neubauer point out the following advantages:

1. Good vision fosters long-term thinking.
2. It creates a common identity and a shared sense of purpose.
3. It is inspiring and exhilarating.
4. It represents a discontinuity, a step function and a jump ahead so that the company knows what it is to be.

Notes

5. It fosters risk-taking and experimentation.
6. A good vision is competitive, original and unique. It makes sense in the market place.
7. A good vision represents integrity. It is truly genuine and can be used for the benefit of people.

Did u know? **When does a vision fail?**

A vision may fail when it is:

1. Too specific (fails to contain a degree of uncertainty)
2. Too vague (fails to act as a landmark)
3. Too inadequate (only partially addresses the problem)
4. Too unrealistic (perceived as unachievable)

A.D. Jick observes that a vision is also likely to fail when leaders spend 90 percent of their time articulating it to their staff and only 10 percent of their time in implementing it. There are two other reasons for vision failure:

1. Adaptability of vision over time
2. Presence of competing visions

2.2.6 Formulating a Vision Statement

Generally, in most cases, vision is inherited from the founder of the organisation who creates a vision. Otherwise, some of the senior strategists in the organisation formulate the vision statement as a part of strategic planning exercise.

Nutt and Backoff identify three different processes for crafting a vision:

1. ***Leader-dominated Approach:*** The CEO provides the strategic vision for the organisation. This approach is criticized because it is against the philosophy of empowerment, which maintains that people across the organisation should be involved in processes and decisions that affect them.
2. ***Pump-priming Approach:*** The CEO provides visionary ideas and selects people and groups within the organisation to further develop those ideas within the broad parameters set out by the CEO.
3. ***Facilitation Approach:*** It is a "co-creating approach" in which a wide range of people participate in the process of developing and articulating a vision. The CEO acts as a facilitator, orchestrating the crafting process. According to Nutt and Backoff, it is this approach that is likely to produce better visions and more successful organisational change and performance as more people have contributed to its development and will therefore be more willing to act in accordance with it.

While the above frameworks identify the extent to which there is involvement throughout the organisation in the development of the vision, they do not address the specifics on how to develop the actual vision itself. Some routines for producing vision are outlined in Table 2.2.

Notes

Table 2.2: Developing the Vision

Implementing Strategic Vision (Gratton, 1996)	Vision Retreat (Nanus, 1996)	Strategic Vision and Core Capabilities 1992:67)	Developing the Vision (Pendiebury *et al.*, 1998:63–67)
1. Articulate the long-term vision 2. Identify strategic people and processes critical to achieving the vision 3. Assess alignment of the vision with current capabilities 4. Prioritize key actions to bridge from current reality to vision of the future	*Phase 1: Preparation.* Establish purpose and goals of the retreat *Phase 2: Initial meeting.* Two-day meeting with discussion on vision audit (character of organization), vision scope (who it includes and desired vision characteristics), and vision context (environmental issues) *Phase 3: Analysis and report cycle.* Facilitator prepares three scenarios of the future that are discussed among participants over a number of weeks *Phase 4: Final meeting* One-day discussion and evaluation of vision alternatives and their strategic implications *Phase 5: Post-retreat activities.* Conclusions communicated throughout the organization including ways of implementing it	1. Generate scenarios of possible futures the organization may face 2. Do a competitive analysis of the industry 3. Analyze the core capabilities of the company and its competitors 4. Develop a strategic vision (best) aligned to the strategic options generated from steps 1–3	1. Formalize the need for change 2. Identify the issues that need to be addressed 3. Develop multiple visions 4. Choose an appropriate vision 5. Formalize the vision, ensuring it is clear and communicable

To develop a strategy with a coherent internal logic, the strategists need to understand where the firm and industry are headed. As the future cannot be precisely and definitely described, the strategist has to make some assumptions about it. This requires foresight. Foresight requires imagination of how events might unfold and the role the firm might play in shaping that future to the firm's advantage. "Vision" is therefore needed to guide the strategists' plan for bridging the gap between current reality and a potential future.

Task Visit the websites of a few Blue Chip companies and find out their business vision.

Notes

Caselet

Microsoft Broadens Vision Statement Beyond PCs

Responding to what Microsoft perceives as serious threats, the company changed its "PCcentric" vision statement to one that embraces the impact of the Internet on technology. Specifically the shift is from "a computer on every desk and in every home" to "empower people through great software any time, any place and on any device".

The most serious threat is the decreased need for windows' software and PCs as developers create programmes accessible via web browsers. While the number of developers writing for Windows is currently stable, the percentage targeting the web have increased from 21% to 38% in the past year.

Microsoft has also introduced a pop-up notes feature in their online MSN, that is compatible with and competes with AOl:s instant messaging (IM) feature (Wall Street Journal, July 29, 19990). AOL has blocked Microsoft's "hacking" into their IM feature, as this technology is currently" closed". Microsoft and other Internet service providers such as Yahoo and Prodigy are pursuing AOL to work with them and create interoperable systems (Wall Street Joumal, July 26, 1999b). However, Microsoft continues to adapt its software to enable its Hotmail subscribers to continue instant communication over the Internet-in line with its new vision.

The new corporate vision also indicates Microsoft's intentions to take advantage of new opportunities. Consumers are using their PCs and the Internet to share photography and sample new music. The Windows operating system will integrate digital photography and music, technology, and online services into Windows (Wall Street Journal, July 26, 1999c.) While the company is still under anti-trust scrutiny, they hope to position product integration as a competitive response to changing industries and markets. Clearly, their new vision demands such actions.

Source: Adapted from *WallStreet Journal*, July 26, 1999

2.3 Summary

- Strategic management is the set of managerial decisions and action that determines the way for the long-range performance of the company.
- It includes environmental scanning, strategy formulation, strategy implementation, evaluation and control.
- Strategy formulation is the development of long range plans for the effective management of environmental opportunities and threats in light of corporate strengths and weaknesses.
- It includes defining the corporate mission, specifying achievable objectives, developing strategies and setting policy guidelines.
- Corporate strategy is one, which decides what business the organisation should be in, and how the overall group of activities should be structured and managed.
- Competitive Strategy is concerned with creating and maintaining a competitive advantage in each and every area of business.
- Strategy that is related to each functional area of business such as production, marketing and personnel is called functional strategy.

Notes

- Corporate vision is a short, succinct, and inspiring statement of what the organisation intends to become and to achieve at some point in the future, often stated in competitive terms.

2.4 Keywords

Core Ideology: based on the enduring values of the organisation

Corporate Level Strategy: Involves broad decisions about organisation's scope and direction.

Facilitation Approach: A wide range of people participate in the process of developing and articulating a vision.

Functional Strategy: Involves decisions about each unit of the organisation.

Leader Dominated Approach: The CEO provides the strategic vision for the organisation.

Pump-priming Approach: The CEO provides visionary ideas and selects people and groups within the organisation to further develop those ideas.

Strategic Business Area (SBA): SBA is a distinctive segment of the environment in which the firm wants to do business.

Sustainable Competitive Advantage: getting a substantial edge over the competitors.

Vision: The overall goal of an organisation that all business activities and processes should contribute toward achieving.

2.5 Self Assessment

Fill in the blanks:

1. Strategy formulation is the process of determining appropriate courses of action for achieving organisational .....
2. The most wonderful strategy in the history of the world is useless if not ..... successfully.
3. Corporate strategy involves ..... kinds of initiatives.
4. Strategy formulation includes defining the ....., specifying achievable ....., developing ..... and setting policy guidelines.
5. Corporate vision is a short, succinct, and inspiring statement of what the organisation intends to ..... and to .....
6. ..... basic characteristics distinguish functional strategies from corporate level and business level strategies.
7. Competitive Strategy is concerned with creating and maintaining a competitive ..... in each and every area of business.
8. Lack of vision is associated with organisational ..... and .....
9. ..... of business vision means that it should include innovative possibilities for dramatic organizational improvement.
10. A business vision should be .....; it should be able to paint a picture of the kind of company the management is trying to create.

Notes

2.6 Review Questions

1. Suppose you are the CEO of an organisation that has just launched an I-pod to give competition to Apple and Sony. What will be the key considerations while developing your vision statement?
2. Given the vision, as the new Director, what ideas would you want to implement to achieve the vision?
3. Has there ever been a time on your life when your vision of the future was so inspiring that you converted initial nay-sayers into followers later on? If yes discuss. If no, analyse a situation when it could have happened. Why do you think you failed?
4. Discuss a time when you established a vision for your team. What process was used? Were others involved in setting the vision? How did the vision contribute to the functioning of the unit?
5. "Employees have a greater role to play in formulating strategy". Comment.
6. "Small business' success solely depends upon its strategy formulation approach". To what extent does this statement hold good?
7. Do non-profit organisations benefit from strategy formulation? Why/why not?
8. When is a good time to formulate strategy? Explain with reasons according to your understanding.
9. Critically analyse the leader dominated approach. Is there a better approach?
10. Do you think business vision should be reviewed and upgraded after every few years? Justify your answer by giving suitable arguments.

Answers: Self Assessment

1.	objectives	2.	implemented
3.	four	4.	corporate mission, objectives, strategies
5.	become, achieve	6.	Three
7.	advantage	8.	decline, failure
9.	Possibility	10.	Graphic

2.7 Further Readings

Books

A A. Thompson and AJ. Strickland, *Strategic Management*, Business Publications, Texas, 1984.

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Fred R. David, *Strategic Management – Concepts and Cases*, Pearson Education Inc., 2005.

Ian Palmer, Richard Dunford and Gib Akin, *Managing Organisational Change*, Tata McGraw-Hill, New Delhi, 1957.

Notes

Online links

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www.articlesbase.com/.../strategy-formulation-and-implementation

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Notes

Unit 3: Defining Mission, Goals and Objectives

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Objectives

After studying this unit, you will be able to:

- Define mission
- State the importance, characteristics and components of mission
- Evaluate mission statements
- Explain the concept of goals and objectives

Notes

Introduction

"A mission statement is an enduring statement of purpose". A clear mission statement is essential for effectively establishing objectives and formulating strategies.

A mission statement is the purpose or reason for the organisation's existence. A well-conceived mission statement defines the fundamental, unique purpose that sets it apart from other companies of its type and identifies the scope of its operations in terms of products offered and markets served. It also includes the firm's philosophy about how it does business and treats its employees. In short, the mission describes the company's product, market and technological areas of emphasis in a way that reflects the values and priorities of the strategic decision makers.

As Fred R. David observes, mission statement is also called a creed statement, a statement of purpose, a statement of philosophy etc. It reveals what an organisation wants to be and whom it wants to serve. It describes an organisation's purpose, customers, products, markets, philosophy and basic technology. In combination, these components of a mission statement answer a key question about the enterprise: "What is our business?"

3.1 Defining Mission

Thompson defines mission as "The essential purpose of the organisation, concerning particularly why it is in existence, the nature of the business it is in, and the customers it seeks to serve and satisfy". Hunger and Wheelen simply call the mission as the "purpose or reason for the organisation's existence".

A mission can be defined as a sentence describing a company's function, markets and competitive advantages. It is a short written statement of your business goals and philosophies. It defines what an organisation is, why it exists and its reason for being. At a minimum, a mission statement should define who are the primary customers of the company, identify the products and services it produces, and describe the geographical location in which it operates.

Example:

1. ***Ranboxy Petrochemicals:*** To become a research based global company.
2. ***Reliance Industries:*** To become a major player in the global chemicals business and simultaneously grow in other growth industries like infrastructure.
3. ***ONGC:*** To stimulate, continue and accelerate efforts to develop and maximize the contribution of the energy sector to the economy of the country.
4. ***Cadbury India:*** To attain leadership position in the confectionery market and achieve a strong national presence in the food drinks sector.
5. ***Hindustan Lever:*** Our purpose is to meet everyday needs of people everywhere – to anticipate the aspirations of our consumers and customers, and to respond creatively and competitively with branded products and services which raise the quality of life.
6. ***McDonald:*** To offer the customer fast food prepared in the same high quality worldwide, tasty and reasonably priced, delivered in a consistent low key décor and friendly manner.

Most of the above mission statements set the direction of the business organisation by identifying the key markets which they plan to serve.

Notes

Case Study

Mission MindTree

MindTree which was founded in 1999 in India by a group of IT professionals who wanted to chart a somewhat distinctive path. Today, it has a topline of $269 millions and is rated as one of the most promising mid-sized IT services companies. Creditable as that is, MindTree does not want to be just that.

There is an element of serendipity about what it has been doing over the last year. In 2008, it designated one of its founders Subroto Bagchi 'Gardener', a gimmicky signal, intended to declare that he was moving out of the day-to-day running of the company to nurture talent which would run the company in the future. He has now a report card ready on a year as Gardener.

During this one year, he has also spent around 45 days travelling round the world talking to clients and prospective ones which has yielded remarkable insights into what firms are doing in these traumatic times. Lastly, MindTree as a whole has spent the last year going through the exercise of redefining its mission statement and vision for the next five years. Quite fortuitously these three processes have come together with a unifying thread, presenting a coherent big picture.

MindTree wants to seed the future while still young, and executive chairman Ashok Soota has declared that by 2020, it will be led by a non-founder. So a year ago the Gardener Bagchi set out to "touch" 100 top people in the organisation, with a goal of doing 50 in a year so as to eventually identify the top 20 by 2015. From among them will emerge not just the leader but a team of ten who would eventually, as group heads, deliver $200 millions of turnover each. That will give a turnover of $2 billions. To put it in perspective, only one VC-funded company, which has not closed or been bought over, has been able to get to $2 billions and that is Google.

But to get there it has to periodically redefine its mission (why we exist) and its vision - measurable goals for the next five years. Its redefined mission is built around "successful customers, happy people, innovative solutions". Its new vision targets a turnover of $1 billion by 2014. It wants to be among the globally 20 most profitable IT services companies and also among the 20 globally most admired ones. Admired in terms of customer satisfaction (par for the course), people practices (creditable), knowledge management (exciting) and corporate governance (the Enron-Satyam effect).

The really interesting bit about MindTree in the last one year is what Bagchi has been up to. He has been embedding himself in the 50 lives, working in a personal private continuum, making it a rich learning process "which has helped connect so many dots." Of the hundred who will be engaged, maybe 50 will leave, of them 25 may better themselves only marginally, and from the remaining 25 ten will emerge who will carry the company forward.

Questions

1. What do you analyse as the main reason behind the success of Mindtree?
2. Do you think that redefining the mission statement shows the lacunae on the part of the founder members of an organisation? Why/why not?

Source: www.businesss-standard.com

Notes

Missions have one or more of the five distinct and identifiable components:

1. Customers
2. Products or services
3. Markets
4. Concern for growth
5. Philosophy

Notes It's more important to communicate the mission statement to employees than to customers. Your mission statement doesn't have to be clever or catchy–just accurate.

Once a mission statement has been set, every organisation needs to periodically review and possibly revise it to make sure it accurately reflects its goals and the business and economic climates evolve.

Task Discuss about a time when you lost track when you lost vision/mission of your team/department/organisation. What negative repercussions did it have?

3.2 Importance of Mission Statement

The purpose of the mission statement is to communicate to all the stakeholders inside and outside the organisation what the company stands for and where it is headed. It is important to develop a mission statement for the following reasons:

1. It helps to ensure unanimity of purpose within the organisation.
2. It provides a basis or standard for allocating organisational resources.
3. It establishes a general tone or organisational climate.
4. It serves as a focal point for individuals to identify with the organisation's purpose and direction.
5. It facilitates the translation of objectives into tasks assigned to responsible people within the organisation.
6. It specifies organisational purpose and then helps to translate this purpose into objectives in such a way that cost, time and performance parameters can be assessed and controlled.

Developing a comprehensive mission statement is also important because divergent views among managers can be revealed and resolved through the process.

According to Pearce (1982), vision and mission statements have the following value:

1. They provide managers with a unity of direction that transcends individual, parochial and transitory needs.
2. They promote a sense of shared expectations among all levels and generations of employees.
3. They consolidate values over time and across individuals and interest groups.

Notes

4. They project a sense of worth and intent that can be identified and assimilated by company outsiders.
5. Finally, they affirm the company's commitment to responsible action, in order to preserve and protect the essential claims of insiders for sustained survival, growth and profitability of the firm.

According to Fred R. David, a mission statement is more than a statement of purpose. It is

1. A declaration of attitude and outlook
2. A declaration of customer orientation
3. A declaration of social policy and responsibility

3.3 Characteristics of a Mission Statement

A good mission statement should be short, clear and easy to understand. It should therefore possess the following characteristics:

1. ***Not lengthy:*** A mission statement should be brief.
2. ***Clearly articulated:*** It should be easy to understand so that the values, purposes, and goals of the organisation are clear to everybody in the organisation and will be a guide to them.
3. ***Broad, but not too general:*** A mission statement should achieve a fine balance between specificity and generality.
4. ***Inspiring:*** A mission statement should motivate readers to action. Employees should find it worthwhile working for such an organisation.
5. ***It should arouse positive feelings and emotions*** of both employees and outsiders about the organisation.
6. ***Reflect the firm's worth:*** A mission statement should generate the impression that the firm is successful, has direction and is worthy of support and investment.
7. ***Relevant:*** A mission statement should be appropriate to the organisation in terms of its history, culture and shared values.
8. ***Current:*** A mission statement may become obsolete after some time. As Peter Drucker points out, "Very few mission statements have anything like a life expectancy of thirty, let alone, fifty years. To be good enough for ten years is probably all one can normally expect". Changes in environmental factors and organisational factors may necessitate modification of the mission statement.
9. ***Unique:*** An organisation's mission statement should establish the individuality and uniqueness of the company.
10. ***Enduring:*** A mission statement should continually guide and inspire the pursuit of organisational goals. It may not be fully achieved, but it should be challenging for managers and employees of the organisation.
11. ***Dynamic:*** A mission statement should be dynamic in orientation allowing judgments about the most promising growth directions and the less promising ones.
12. ***Basis for guidance:*** Mission statement should provide useful criteria for selecting a basis for generating and screening strategic options.
13. ***Customer orientation:*** A good mission statement identifies the utility of a firm's products or services to its customers, and attracts customers to the firm.

Notes

14. ***A declaration of social policy:*** A mission statement should contain its philosophy about social responsibility including its obligations to the stakeholders and the society at large.
15. ***Values, beliefs and philosophy:*** The mission statement should lay emphasis on the values the firm stands for; company philosophy, known as "company creed", generally accompanies or appears within the mission statement.

3.4 Components of a Mission Statement

Mission statements may vary in length, content, format and specificity. But most agree that an effective mission statement must be comprehensive enough to include all the key components. Because a mission statement is often the most visible and public part of the strategic management process, it is important that it includes all the following essential components:

1. ***Basic product or service:*** What are the firm's major products or services?
2. ***Primary markets:*** Where does the firm compete?
3. ***Principal technology:*** Is the firm technologically current?
4. ***Customers:*** Who are the firm's customers?
5. ***Concern for survival, growth and profitability:*** Is the firm committed to growth and financial soundness?
6. ***Company philosophy:*** What are the basic beliefs, values, aspirations and ethical priorities of the firm?
7. ***Company self-concept:*** What is the firm's distinctive competence or major competitive advantage?
8. ***Concern for public image:*** Is the firm responsive to social, community and environmental concerns?
9. ***Concern for employees:*** Are employers considered a valuable asset of the firm?
10. ***Concern for quality:*** Is the firm committed to highest quality ?

Products or Services, Markets and Technology

An indispensable component of the mission statement is specification of the firm's basic product or service, markets and technology. These three components describe the company's activity.

Survival, Growth and Profitability

Every firm has to secure its survival through growth and profitability. These three economic goals guide the strategic direction of almost every business organisation.

A firm that is unable to survive will be incapable of satisfying the aims of any of its stakeholders. Profitability is the mainstay goal of a business organisation, and profit over the long term is the clearest indication of a firm's ability to satisfy the claims and desires of all stakeholders. A firm's growth is inextricably linked to its survival and profitability.

Company Philosophy

The statement of a company's philosophy (also called company creed) generally appears within the mission statement. It specifies the basic values, beliefs and aspirations to which the strategic decision-makers are committed in managing the company. The company philosophy provides a distinctive and accurate picture of the company's managerial outlook.

Notes

Company Self-concept

Both individuals and companies have a crucial need to know themselves. The ability of a company to survive in a highly competitive environment depends on its realistic evaluation of its strengths and weaknesses. Description of the firm's self-concept provides a strong impression of the firm's self-image.

Public Image

Mission statements should reflect the public expectations of the firm since this makes achievement of the firm's goals more likely.

Example: "Johnson & Johnson make safe products" reflects the customer expectations of the company in making safe products.

Sometimes, a negative public image can be corrected by emphasizing the beneficial aspects in the mission statements.

Concern for Employees

Mission statements should also emphasize their concern for improvement of quality of work life, equal opportunity for all, measures for employee welfare etc.

Customers

"The customer is our top priority" is a slogan that would be claimed by most of the businesses the world over. A focus on customer satisfaction causes managers to realize the importance of providing an excellent customer service. So, many companies have made customer service a key component of their mission statement.

Quality

The emphasis on quality has received added importance in many corporate philosophies.

Example: Motorola's mission statement contains a statement that "dedication to quality is a way of life at our company, so much so that it goes beyond rhetorical slogans."

3.5 Formulation of Mission Statements

There is no standard method for formulating mission statements. Different firms follow different approaches. As indicated in the strategic management model, a clear mission statement is needed before alternative strategies can be formulated and implemented. It is important to involve as many managers as possible in the process of developing a mission statement, because through involvement, people become committed to the mission of the organisation.

Mission statements are generally formulated as follows:

1. In many cases, the mission is inherited i.e. the founder establishes the mission which may remain unchanged down the years or may be modified as the conditions change.
2. In some cases, the mission statement is drawn up by the CEO and board of directors or a committee of strategists constituted for the purpose.

Notes

3. Engaging consultants for drawing up the mission statement is also common.
4. Many companies hold brainstorming sessions of senior executives to develop a mission statement. Soliciting employee's views is also common.
5. According to Fred R. David, an ideal approach for developing a mission statement would be to select several articles about mission statements and ask all managers to read these as background information. Then ask managers to prepare a draft mission statement for the organisation. A facilitator or a committee of top managers, merge these statements into a single document and distribute this draft mission statement to all managers. Then the mission statement is finalized after taking inputs from all the managers in a meeting. Thus, the process of developing a mission statement represents a great opportunity for strategists to obtain needed support from all managers in the firm.
6. Decision on how best to communicate the mission to all managers, employees and external constituencies of an organisation are needed when the document is in its final form. Some organisations even develop a videotape to explain the mission statement and how it was developed.
7. The practice in Indian companies appears to be a consultative-participative route. For example, at Mahindra and Mahindra, workshops were conducted at two levels within the organisation with corporate planning group acting as facilitators. The State Bank of India went one step ahead by inviting labour unions to partake in the exercise. Satyam Computers went one more step ahead by involving their joint venture companies and overseas clients in the process.

Caution Although many organisations have mission statements, their value has sometimes been questioned. Kay (1996) asserts that visions or missions are indicative of a 'wish - driven strategy' that fails to recognize the limits to what might be possible, given finite organisational resources. He cites the case of Groupe Bull, a French computer company, which for many years sought to challenge the supremacy of IBM, particularly in the large US market. After several attempts, Bull finally conceded that its mission was faulty. Kay's analysis was that for 30 years Groupe Bull was: Driven not by an assessment of what it was, but by a vision of what it would like to be. Throughout, it lacked the distinctive capabilities that would enable it to realize that vision. Bull epitomizes wish-driven strategy, based on aspiration, not capability (Kay, 1996).

In a study of some organisations, Leach (1996) found that mission statements and strategic vision had become fashionable. While in some organisations, mission statements had made a real impact in clarifying organisational values and culture, others regarded them only as symbolic public relations documents that had little effect as a management tool.

The dangers are not just that missions are unrealistic and fail to recognize an organisation's capabilities (as in the case of Groupe Bull), but also that management fails to develop a belief in the mission statement throughout the organisation. People come to believe in and act upon the mission statement only when they see others doing so, especially senior management and other influential players. The ideas of the mission statement need to be cascaded through the structure to ensure a link between mission and day-to-day actions.

Notes

Caselet **Mission of two Global Companies**

Mission Statement of IBM

At IBM, we strive to lead in the invention, development and manufacture of the industry's most advanced information technologies, including computer systems, software, storage systems and microelectronics.

We translate these advanced technologies into value for our customers through our professional solutions, services and consulting businesses worldwide

Mission Statement of FedEx

"FedEx is committed to our People-Service-Profit Philosophy. We will produce outstanding financial returns by providing totally reliable, competitively superior, global, air-ground transportation of high-priority goods and documents that require rapid, time-certain delivery."

Source: ibm.com and fedex.com

3.6 Evaluating Mission Statements

For a mission statement to be effective, it should meet the following ten conditions:

1. The mission statement is clear and understandable to all parties involved. The organisation can articulate and relate to it.
2. The mission statement is brief enough for most people to remember.
3. The mission statement clearly specifies the purpose of the organisation. This includes a clear statement about:
   (a) What needs the organisation is attempting to fill (not what products or services are offered)?
   (b) Who the organisation's target populations are?
   (c) How the organisation plans to go about its business; that is, what its primary technologies are?
4. The mission statement should have a primary focus on a single strategic thrust.
5. The mission statement should reflect the distinctive competence of the organisation (e.g., what can it do best? What is its unique advantage?)
6. The mission statement should be broad enough to allow flexibility in implementation, but not so broad as to permit lack of focus.
7. The mission statement should serve as a template and be the same means by which the organisation can make decisions.
8. The mission statement must reflect the values, beliefs and philosophy of operations of the organisation.
9. The mission statement should reflect attainable goals.
10. The mission statement should be worked so as to serve as an energy source and rallying point for the organisation (i.e., it should reflect commitment to the vision).

Notes

Task Find out the mission statement of any one service company. Do they really work the way their mission says?

3.7 Distinction between Vision and Mission

We have already distinguished between vision and mission statements in the previous section; we throw more light on this distinction in this section. While a mission statement describes what the organisation is now; a vision statement describes what the organisation would like to become. A vision statement defines more of a direction as to "where are we headed" and "what do we want to become", whereas the company's mission broadly indicates the "business purpose" of the organisation. The distinction between vision and mission can be summarized as follows:

Table 3.1: Distinction between Vision and Mission

Vision	Mission
1. A mental image of a possible and desirable future state of the organization.	1. Enduring statement of philosophy, a creed statement.
2. A dream.	2. The purpose or reason for a firm's existence.
3. Broad.	3. More specific than vision
4. Answers the question "what we want to become?"	4. Answers the question "what is our business".

3.8 Concept of Goals and Objectives

3.8.1 Goals

The terms "goals and objectives" are used in a variety of ways, sometimes in a conflicting sense.

The term "*goal*" is often used interchangeably with the term "*Objective*". But some authors prefer to differentiate the two terms.

A *goal* is considered to be an open-ended statement of what one wants to accomplish with no quantification of what is to be achieved and no time criteria for its completion. For example, a simple statement of "increased profitability" is thus a goal, not an objective, because it does not state how much profit the firm wants to make. Objectives are the end results of planned activity. They state what is to be accomplished by when and should be quantified. For example, "increase profits by 10% over the last year" is an objective.

As may be seen from the above, "goals" denote what an organisation hopes to accomplish in a future period of time. They represent a future state or outcome of the effort put in now. "Objectives" are the ends that state specifically how the goals shall be achieved. In this sense, objectives make the goals operational. Objectives are concrete and specific in contrast to goals which are generalized. While goals may be qualitative, objectives tend to be mainly quantitative, measurable and comparable.

Notes

Notes The distinction between goals and objectives is summarized below:

Goals	Objectives
1. General	Specific
2. Qualitative	Quantative, measurable
3. Broad organization–wide target	Narrow targets set by operating divisions
4. Long term results	Immediate, short term results

Some writers, however, have reversed the usage, referring to objectives as the desired long-term results and goals as the desired short-term results. And still others use the terms interchangeably, meaning one and the same. These authors view that, little is gained from semantic distinctions between goals and objectives. The important thing is to recognize that the results an enterprise seeks to achieve vary as to both scope and time-frame. To avoid confusion, it is better to use the single term "objectives" to refer to the performance targets and results an organisation seeks to attain. We can use the adjectives *long-term (long-range)* and *short-term (short-range)* to identify the relevant time-frame, and try to describe their intended scope and level in the organisation, by using expressions like *broad objectives, functional objectives, corporate objectives etc*

Some of the areas in which a company might establish its goals and objectives are:

1. Profitability (net profit)
2. Efficiency (low costs, etc)
3. Growth (increase in sales etc)
4. Shareholder wealth (dividends etc)
5. Utilization of resources (return on investment)
6. Market leadership (market share etc)

Stated vs. Operational Goals

Operational goals are the real goals of an organisation. Stated goals are the official goals of an organisation. Operational goals tell us what the organisation is trying to do, irrespective of what the official goals say the aims are. Official goals generally reflect the basic philosophy of the company and are expressed in abstract terminology, for example, 'sufficient profit', 'market leadership' etc. According to Charles Perrow, the following are the important operational goals:

1. ***Environmental Goals:*** An organisation should be responsive to the broader concerns of the communities in which it operates, and should have goals that satisfy people in the external environment. For example, goals like customer satisfaction and social responsibility may be important environmental goals.
2. ***Output Goals:*** Output goals are related to the identification of customer needs. Issues like what markets should we serve, which product lines should be followed, etc. are examples of output goals.
3. ***System Goals:*** These goals relate to the maintenance of the organisation itself. Goals like growth, profitability, stability etc. are examples.
4. ***Product Goals:*** These goals relate to the nature of products delivered to customers. They define quantity, quality, variety, innovativeness of products.

Notes

5. ***Derived Goals:*** These goals relate to derived or secondary areas like contribution to political activities, promoting social service institutions etc.

3.8.2 Objectives

Objectives are the results or outcomes an organisation wants to achieve in pursuing its basic mission. The basic purpose of setting objectives is to convert the strategic vision and mission into specific performance targets. Objectives function as yardsticks for tracking an organisation's performance and progress.

Characteristics of Objectives

Well – stated objectives should be:

1. Specific
2. Quantifiable
3. Measurable
4. Clear
5. Consistent
6. Reasonable
7. Challenging
8. Contain a deadline for achievement
9. Communicated, throughout the organisation

Role of Objectives

Objectives play an important role in strategic management. They are essential for strategy formulation and implementation because:

1. They provide legitimacy
2. They state direction
3. They aid in evaluation
4. They create synergy
5. They reveal priorities
6. They focus coordination
7. They provide basis for resource allocation
8. They act as benchmarks for monitoring progress
9. They provide motivation

Notes

Nature of Objectives

The following are the characteristics of objectives:

Hierarchy of Objectives

In a multi – divisional firm, objectives should be established for the overall company as well as for each division.

Objectives are generally established at the corporate, divisional and functional levels, and as such, they form a hierarchy. The zenith of the hierarchy is the mission of the organisation. The objectives at each level contribute to the objectives at the next higher level.

Long-range and Short-range Objectives

Organisations need to establish both long-range and short-range objectives (Long–range means more than one year, and short–range means one year and less.) Short-range objectives spell out the near – term results to be achieved. By doing so, they indicate the ***speed*** and the ***level of performance*** aimed at each succeeding period. Short – range objectives can be identical to long–range objectives if an organisation is performing at the targeted long-term level (for example, 20% growth - rate every year). The most important situation where short-range objectives differ from the long-range objectives occurs when managers cannot reach the long-range target in just one year, and are trying to elevate organisational performance. Short–range objectives (one – year goals) are the means for achieving long range objectives. A company that has an objective of doubling its sales within five years can't wait until the third or fourth year of its five-year strategic plan. Short range objectives then serve as stepping-stones or milestones.

Multiplicity of Objectives

Organisations pursue a number of objectives. At every level in the hierarchy, objectives are likely to be multiple.

Example: The marketing division may have the objective of sales and distribution of products. This objective can be broken down into a group of objectives for the product, distribution, research and promotion activities. To describe a single, specific goal of an organisation is to say very little about it. It turns out that there are several goals involved. This may be due to the fact that the enterprise has to meet internal as well as external challenges effectively. Moreover, no single objective can place the organisation on a path of prosperity and progress in the long run.

However, an organisation should not set too many objectives. If it does, it will lose focus. Too many objectives have a number of problems.

Examples: (a) They dilute the drive for accomplishment

(b) Minor objectives get highlighted to the detriment of major objectives

There is no agreement to the number of objectives that a manager can effectively handle. But, if there are so many that none receives adequate attention, the execution of objectives becomes ineffective; there is a need to be cautious. It will be wise to identify the relative importance of each objective, in case the list is not manageable.

Network of Objectives

Notes

Objectives form an interlocking network. They are inter-related and inter-dependent. The implementation of one may impact the implementation of the other. If there is no consistency between company objectives, people may pursue goals that may be good for their own function but detrimental to the company as a whole. Therefore, objectives should not only "fit" but also reinforce each other. As observed by Koontz et al., "it is bad enough when goals do not support and interlock with one another. It may be catastrophic when they interfere with one another."

3.9 Summary

- A mission can be defined as a sentence describing a company's function, markets and competitive advantages.
- Developing your mission statement is the step which moves your strategic planning process from the present to the future.
- The mission should be broad enough to allow for the diversity (new products, new services, new markets) one requires for one's business.
- The mission statement should also be specific enough to provide the focus necessary to the success of your business.
- Once a mission statement has been set, every organisation needs to periodically review and possibly revise it to make sure it accurately reflects its goals and the business and economic climates evolve.

3.10 Keywords

Company philosophy: It is a set of beliefs, principles, or aims, underlying a company's practice or conduct.

Company self concept: how much does the company knows itself

Goals: It is an open ended statement of what one wants to achieve with no quantification of outcomes or time limit.

Mission: A statement that declares what business a company is in and who its customers are.

Objectives: The results an organisation wants to achieve in pursuing its basic mission.

3.11 Self Assessment

Fill in the blanks:

1. The mission statement should have a primary focus on a ..... strategic thrust.
2. The mission statement should reflect ..... goals.
3. A mission can be defined as a sentence describing a company's ....., ... and .....
4. It is more important to communicate the mission statement to .....than to .....
5. A mission statement should be appropriate to the organisation in terms of its ....., ... and .....
6. Every firm has to secure its survival through ..... and .....

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7. A focus on customer satisfaction causes managers to realize the importance of providing excellent .....
8. The company ..... provides a distinctive and accurate picture of the company's managerial outlook.
9. ……can't be quantified, whereas …….can be quantified.
10. Objectives are inter-……and inter-…….

3.12 Review Questions

1. "Mission describes the present and vision the future". With this statement in mind compare mission and vision statements.
2. Are goals and objectives the same thing? Justify your answer. Discuss the unique characteristics of goals and objectives.
3. Suppose you are going to open a new mobile device manufacturing company. Prepare a mission statement for your company. (Try and include as many elements mentioned in the unit as possible)
4. "It is necessary to review the mission statement periodically". Justify the statement
5. How can a mission statement set the tone of the organisation?
6. Analyse the characteristics of a good mission statement.
7. "Like an individual should know him/herself inside out, an organisation should also know itself". Substantiate
8. "Goals are general in nature while objectives are specific". Explain using suitable examples.
9. Explain the concept of stated and operational goals with the help of appropriate examples.
10. What do you mean by multiplicity of objectives? Explain using apt examples.

Answers: Self Assessment

1.	single	2.	attainable
3.	function, markets, competitive advantages	4.	employees, customers
5.	history, culture, shared values	6.	growth, profitability
7.	customer service	8.	philosophy
9.	Goals, Objectives	10.	Related, dependent

3.13 Further Readings

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Unit 4: External Assessment

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Objectives

After studying this unit, you will be able to:

- Realise the concept of environment
- Discuss porter's five forces theory
- Explain the concept of industry analysis
- Discuss environment scanning

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Introduction

At a time of fast growth, rapid changes and cut throat comatetion as exists in about all industries, it is a challenge for the companies to establish a strategic agenda for dealing with these contending currents and to grow despite them.

A company must understand how the above currents work in its industry and how they affect the company in its particular situation. For this a very useful tool is used by the analysts. The name of this tool is external analysis.

External assessment is a step where a firm identifies opportunities that could benefit it and threats that it should avoid. It includes monitoring, evaluating, and disseminating of information from the external and internal environments to key people within the corporation.

4.1 Concept of Environment

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organisation is "the aggregate of all conditions, events and influences that surround and affect it." Davis, K, The Challenge of Business, (New York: McGraw Hill, 1975), p. 43.

Environment refers to all external forces which have a bearing on the functioning of business. Jauch and Gluecke has defined environment as "The environment includes factors outside the firm which can lead to opportunities or a threat to the firm. Although there are many factors the most important of the sectors are socio-economic, technological, supplier, competitor and govt."

The recent changes in tariff rates have changed the toy industry of India with the market now being dominated by Chinese products. A slight change in the Reserve Bank of India's monetary policy can increase or decrease interest rates in the market. A slight shift in the government's fiscal policy can shift the whole demand curve towards the right or the left.

Example: Hindustan Lever Limited (HLL) took advantage of the new takeover and merger codes and acquired brands like Kissan from the UB group, TOMCO (Tata Oil Mills Company) and Lakme from Tata and Modern Foods from the government, besides many other small takeovers and mergers.

The new moguls of the Indian business are those who predicted the changes in the environment and reacted accordingly. Azim Premji of Wipro, Narayana Murthy of Infosys, Subhash Goyal of ZEE, the Ambanis of Reliance, L.N. Mittal of Mittal Steel, Sunil Mittal of Bharti Telecom are some of them.

Even a small businessman who plans to open a small shop as a general merchant in his town needs to study the environment before deciding where he wants to open his shop, the products he intend to sell and what brands he wants to stock.

The relation between a business and an environment is not a one way affair. The business also equally influences the external environment and can bring about changes in it. Powerful business lobbies for instance, actively work towards changing government policies.

The business environment is not all about the economic environment but also about the social and political environment. Politically, after the Congress government came to power at the center with the support of the CPI in May 2004, the whole process of disinvestments took a U-turn. Similarly, a new sociological order in India today has created a market for fast foods, packaged foods, multiplexes, designer names, Valentine day gifts and presents, and gymnasiums and clubs etc.

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So it is quite obvious that success in a business depends upon better understanding of the environment. A successful organisation doesn't look at the environment on an ad hoc basis but develops a system to study the environment on a continuous basis to try and protect the organisation from every possible threat and to take the advantage of every opportunity. Some times better and timely understanding of the environment can even turn a threat into an opportunity.

Importance of Business Environment

1. ***Environment is Complex:*** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these interact with each other to create new sets of influences.
2. ***It is Dynamic:*** The environment by its very nature is a constantly changing one. The varied influences operating upon it impart dynamism to it and cause it to continually change its shape and character.
3. ***Environment is multi -faceted:*** The same environmental trend can have different effects on different industries. For instance, GATS is an opportunity for some companies but a threat for others.
4. ***It has a far-reaching impact:*** The environment has a far-reaching impact on organisations in that the growth and profitability of an organisation depends critically on the environment in which it exists.
5. ***Its impact on different firms with in the same industry differs:*** A change in environment may have different bearings on various firms operating in the same industry. In the pharmaceutical industry in India, for instance, the impact of the new IPR (Intellectual Property Rights) law will different for research-based pharmacy companies such as Ranbaxy and Dr. Reddy's Lab and will be different for smaller pharmacy companies.
6. ***It may be an opportunity as well as a threat to expansion:*** Developments in the general environment often provide opportunities for expansion in terms of both products and markets.

   Example: Liberalization in 1991 opened lot of opportunities for companies and HLL took the advantage to acquire companies like Lakme, TOMCO, KISSAN etc. Changes in environment often also pose a serious threat to the entire industry. Like Liberalization does pose a threat of new entrants to Indian firms in the form of Multi National Corporation (MNCs).
7. ***Changes in the environment can change the competitive scenario:*** General environmental changes may alter the boundaries of an industry and change the nature of its competition. This has been the case with deregulation in the telecom sector in India. Since deregulation, every second year new competitors emerge, old foes become friends and M&As follow every new regulation.
8. ***Sometimes developments are difficult to predict with any degree of accuracy:*** Macroeconomic developments such as interest rate fluctuations, the rate of inflation, and exchange rate variations are extremely difficult to predict on a medium or a long term basis. On the other hand, some trends such as demographic and income levels can be easy to forecast.

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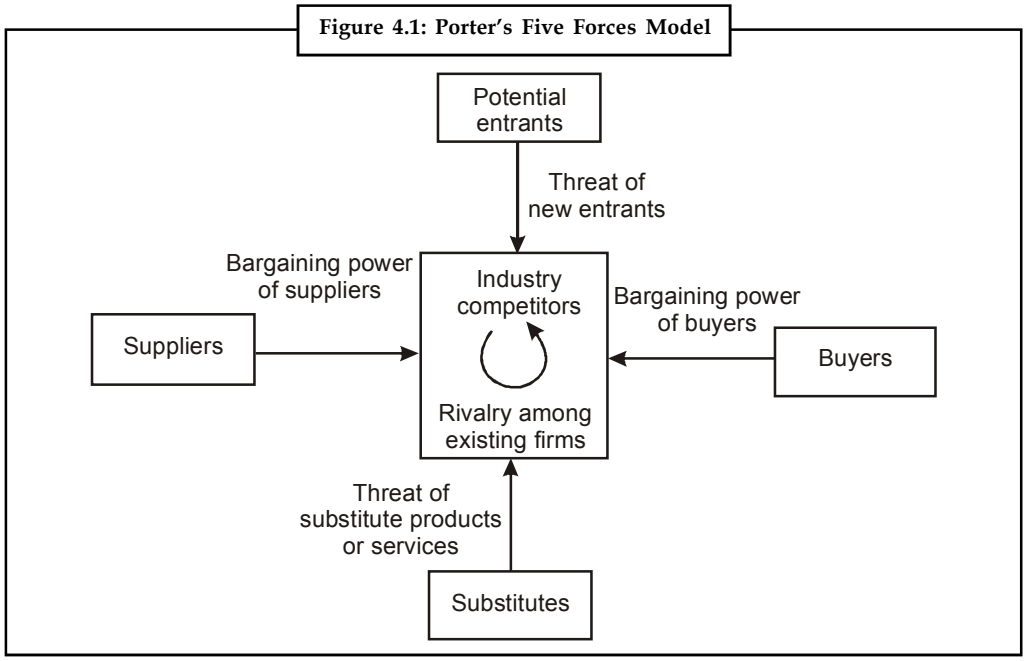
4.2 Porter's Five Force Analysis

In 1979, the Harvard Business Review published the article "How Competitive Forces Shape Strategy" by the Harvard Professor Michael Porter. It started a revolution in the strategy field. In subsequent decades, "Porter's five forces" have shaped a generation of academic research and business practice. This unit explores how competitive analysis can be done using Porter's five forces model.

4.2.1 The Five Forces

In essence, the job of the strategist is to understand and cope with competition. However, managers define competition too narrowly, as if it occurs only among today's direct competitors. Yet competition for profits goes beyond established industry rivals. It includes four other competitive forces as well: customers, suppliers, potential entrants and substitutes.

Figure 4.1: Porter's Five Forces Model



The Five Forces model developed by Michnal E. Porter has been the most commonly used analytical tool for examining competitive environment. According to this model, the intensity of competition in an industry depends on five basic forces. These five forces are:

1. Threat of new entrants
2. Intensity of rivalry among industry competitors
3. Bargaining power of buyers
4. Bargaining power of suppliers
5. Threat of substitute products and services.

Each of these forces affects a firm's ability to compete in a given market. Together, they determine the profit potential for a particular industry. To understand industry competition and profitability, one must analyze the industry's underlying structure in terms of the five forces, as shown in the Figure 4.1.

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Porter argues that the stronger each of these forces are, the more limited is the ability of established companies to raise prices and earn greater profits.

With Porter's framework, a strong competitive force can be regarded as a threat because it depresses profits. A weak competitive force can be viewed as an opportunity because it allows a company to earn greater profits. The strength of the five forces may change with time as industry conditions change. For example, in industries such as airlines, textiles and hotels, where these forces are intense, almost no company earns attractive returns on investment. In pharmaceuticals and toiletries, where these forces are benign, many companies earn attractive profits.

Notes Understanding the competitive forces, and their underlying causes, reveals the roots of an industry's current profitability, while providing a framework for anticipating and influencing competition and profitability over time. Understanding industry structure is also essential to effective strategic positioning. Defending against the competitive forces and shaping them in a company's favour are crucial to strategy.

4.2.2 Forces that Shape Competition

The configuration of the five forces differ from industry to industry. For example in the market for commercial aircraft, fierce rivalry among existing competitors (i.e. Airbus and Boeing) and the bargaining power of buyers of aircrafts are strong, while the threat of entry, the threat of substitutes, and the power of suppliers are more benign. Thus, the strongest competitive force or forces determine the profitability of an industry and becomes the most important to strategy formulation.

1. ***The Threat of New Entrants:*** The first of Porter's Five Forces model is the threat of new entrants. New entrants bring new capacity and often substantial resources to an industry with a desire to gain market share. Established companies already operating in an industry often attempt to discourage new entrants from entering the industry to protect their share of the market and profits. Particularly when big new entrants are diversifying from other markets into the industry, they can leverage existing capabilities and cash flows to shake up competition. Pepsi did this when it entered the bottled water industry, Microsoft did when it began to offer internet browsers, and Apple did when it entered the music distribution business.

   The threat of new entrants, therefore, puts a cap on the profit potential of an industry. When the threat is high, existing companies hold down their prices or boost investment to deter new competitors. And the threat of entry in an industry depends on the height of entry barriers (i.e. factors that make it costly for new entrants to enter industry) that are present and on the retaliation from the entrenched competitors. If entry barriers are low and newcomers expect little retaliation, the threat of entry is high and industry profits will be moderate. It is the threat of entry, not whether entry actually occurs, that holds down profitability.

2. ***Barriers to entry:*** Entry barriers depend on the advantages that existing companies have relative to new entrants. There are seven major sources:

   (a) *Economies of scale:* These are relative cost advantages associated with large volumes of production, that lower a company's cost structure. The cost of product per unit declines as the volume of production increases. This discourages new entrants to enter on a large scale. If the new entrant decides to enter on a large-scale to obtain economies of scale, it has to bear high risks associated with a large investment.

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A further risk is that the increased supply of products will depress prices and results in vigorous retaliation by established companies. For these reasons, the threat of new entrants is reduced when established companies have economies of scale.

Example: In microprocessors, existing companies such as Intel are protected by economies of scale in research, chip fabrication and consumer marketing.

(b) *Product differentiation:* Brand loyalty is buyer's preference for the differentiated products of any established company. Strong brand loyalty makes it difficult for new entrants to take market share away from established companies. It reduces threat of entry because the task of breaking down well-established customer preferences is too costly for them.

(c) *Capital requirements:* The need to invest large financial resources in order to compete can deter new entrants. Capital may be necessary not only for fixed assets, but also to extend customer credit, build inventories and fund start-up losses. The barrier is particularly great if the capital is required for unrecoverable expenditure, such as up-front advertising or research and development. While major corporations have the financial resources to invade almost any industry, the capital requirements in certain fields limit the pool of likely entrants.

It is important not to overstate the degree to which capital requirements alone deter entry; if industry returns are attractive and are expected to remain so, and if capital markets are efficient, investors will provide new entrants with the funds they need. For example, in airlines industry, financing is available to purchase expensive aircrafts because of their resale value, and that is why there have been a number of new airlines in almost every region.

(d) *Switching costs:* Switching costs are the one-time costs that a customer has to bear to switch from one product to another. When switching costs are high, customers can be locked up in the existing product, even if new entrants offer a better product. Thus, the higher the switching costs are, the higher is the barrier to entry. Enterprise Resource Planning (ERP) software is an example of a product with very high switching costs. Once a company has installed SAP's ERP system, the cost of moving to a new vendor are astronomical.

(e) *Access to distribution channels:* The new entrant's need to secure distribution channel for the product can create a barrier to entry. The established companies have already tied up with distribution channels. For example, a new food item may have to displace others from the supermarket shelf via price breaks, promotions, intense selling efforts or some other means. The more limited the wholesale or retail channels are, tougher will be the entry into an industry. Sometimes, if the barrier is so high, a new entrant must create its own distribution channels as Timex did in the watch industry in the 1950s.

(f) *Cost disadvantages independent of size:* Some existing companies may have advantages other than size or economies of scale. These are derived from:

(i) Proprietary technology

(ii) Preferential access to raw material sources

(iii) Government subsidies

(iv) Favorable geographical locations

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(v) Established brand identities

(vi) Cumulative experience

New entrants may not have these advantages.

(g) *Government policy:* Historically, government regulations have constituted a major entry barrier into many industries. The government can limit or even foreclose entry into industries, with such controls as license requirements and limits on access to raw materials. The liberalization policy of the Indian government relating to deregulation, delicensing and decontrol of prices opened up the economy to many new entrepreneurs.

Caution Even if entry barriers are very high, new firms may still enter an industry if they perceive that the benefits outweigh the substantial costs of entry. Such a situation creates excess capacity in the industry and sparks off intense price competition that might depress the returns for all players – new entrants as well as established companies.

So, the strategist must be mindful of the creative ways newcomers might find to circumvent apparent barriers.

3. ***Expected Retaliation:*** How new entrants believe that the existing companies may react will also influence their decision to enter or stay out of an industry. If reaction is vigorous and protracted enough, the profit potential in the industry can fall below the cost of capital for all participants. Existing companies often use public statements to send massages to new entrants about their commitment to defending market share.

New entrants are likely to fear expected retaliation if:

(a) Existing companies have previously responded vigorously to new entrants

(b) Existing companies possess substantial resources to fight back

(c) Existing companies seem likely to cut prices to protect their market share

(d) Industry growth is slow, so newcomers can gain volume only by taking the market share from existing companies.

An analysis of entry barriers and expected retaliation is obviously crucial for any company contemplating entry into a new industry. The challenge is to find ways to surmount the entry barriers without nullifying the profitability of the industry.

4. ***Intensity of Rivalry among Competitors:*** The second of Porter's Five-Forces model is the intensity of rivalry among established companies within an industry. Rivalry means the competitive struggle between companies in an industry to gain market share from each other. Firms use tactics like price discounting, advertising campaigns, new product introductions and increased customer service or warranties. Intense rivalry lowers prices and raises costs. It squeezes profits out of an industry. Thus, intense rivalry among established companies constitutes a strong threat to profitability. Alternatively, if rivalry is less intense, companies may have the opportunity to raise prices or reduce spending on advertising etc. which leads to higher level of industry profits.

The intensity of rivalry is greatest under the following conditions:

(a) *Numerous competitors or equally powerful competitors:* When there are many competitors in an industry or if the competitors are roughly of equal size and power, the intensity of rivalry will be more. Any move by one firm is matched by an equal countermove. In such situations rivals find it hard to avoid poaching business.

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(b) *Slow industry growth:* Slow industry growth turns competition into fight because the only path to growth is to take sales away from a competitor.

(c) *High fixed but low marginal costs:* This creates intense pressure for competitors to cut prices below their average costs even close to their marginal costs, to steal customers.

Example: Many paper and aluminium businesses suffer from this problem, especially if demand is not growing.

(d) *Lack of differentiation or switching costs:* If products or services of rivals are nearly identical and there are few switching costs, this encourages competitors to cut prices to win new customers. Years of airline price wars reflect these circumstances in that industry.

(e) *Capacity augmentation in large increments:* If the only way a manufacturer can increase capacity is in a large increment, such as building a new plant, it will run that new plant at full capacity to keep its unit costs low. Such capacity additions can be very disruptive to the supply/demand balance and cause the selling prices to fall throughout the industry.

(f) *High exit barriers:* Exit barriers keep a company from leaving the industry. Exit barriers can be economic, strategic or emotional factors that keep firms competing even though they may be earning low or negative returns on their investments. If exit barriers are high, companies become locked up in a non-profitable industry where overall demand is static or declining. Excess capacity remains in use, and the profitability of healthy competitors suffers as the sick ones hang on.

Did u know? **What are the Common Exit Barriers?**

Common exit barriers are:

1. Investment in specialized assets like plant and machinery are of little or no value, and cannot be put to alternative use. So, they have to be continued.
2. High costs of exit such as retrenchment benefits, etc. that have to be paid to the redundant workers when a company ceases to operate.
3. Emotional attachment to an industry keep owners or employees unwilling to exit from an industry for sentimental reasons.
4. Economic dependence on the industry when the firm depends on a single industry for revenue and profit.
5. Government and social pressures discourage exit of industries out of concern for job loss.
6. Strategic interrelationships between business units and others prevent exit because of shared facilities, image and so on.

5. ***Bargaining power of buyers:*** The third of Porter's five competitive forces is the bargaining power of buyers. Bargaining power of buyers refers to the ability of buyers to bargain down prices charged by firms in the industry or driving up the costs of the firm by demanding better product quality and service. By forcing lower prices and raising costs, powerful buyers can squeeze profits out of an industry. Thus, powerful buyers should be viewed as a threat. Alternatively, if buyers are in a weak bargaining position, the firm can raise prices, cut costs on quality and services and increase their profit levels. Buyers are

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powerful if they have more negotiation leverage than the firms in the industry, using their clout primarily to pressure price reductions. According to Porter, buyers are most powerful under the following conditions:

(a) *There are few buyers:* If there are few buyers or each one does bulk purchases, then they have more bargaining power. Large buyers are particularly powerful in industries like telecommunication equipment, off-shore drilling, and bulk chemicals. High fixed costs and low marginal costs increase the pressure on rivals to keep capacity filling through discounts.

(b) *The products are standard or undifferentiated:* If the products purchased from the firm are standard or undifferentiated, the buyers can easily find alternative sources of supplies. Then buyers can play one company against the other, as in commodity grain markets.

(c) *The buyer faces low switching costs:* Switching costs lock the buyer to a particular firm. If switching costs are low, buyers can easily switch from one firm's product to another.

(d) *The buyer earns low profits:* If the buyer is under pressure to trim its purchasing costs, the buyer is price sensitive and bargains more.

(e) *The quality of buyer's products:* If the quality of buyer's product is little affected by industry's products, buyers are more price sensitive.

Most of the above sources of buyer power can be attributed to consumers as a group as well as to industrial and commercial buyers. The buying power of retailers is determined by the same factors, with one important addition. Retailers can gain significant bargaining power over manufacturers when they can influence consumers. Purchasing decisions as they do in audio components, jewellery, appliances, sporting goods etc., are examples.

6. ***Bargaining power of suppliers:*** The fourth of Porter's Five Forces model is the bargaining power of suppliers. Suppliers are companies that supply raw materials, components, equipment, machinery and associated products. Powerful suppliers make more profits by charging higher prices, limiting quality or services or shifting the costs to industry participants. Powerful suppliers squeeze profits out of an industry and thus, they are a threat. For example, Microsoft has contributed to the erosion of profitability among PC makers by raising prices on operating systems. PC makers, competing fiercely for customers, have limited freedom to raise their prices accordingly.

A supplier's bargaining power will be high under the following conditions:

(a) *Few suppliers:* When the supplier group is dominated by few companies and is more concentrated than the firms to whom it sells, an industry is called concentrated. The suppliers can then dictate prices, quality and terms.

(b) *Product is differentiated:* When suppliers offer products that are unique or differentiated or built-up switching costs, it cuts off the firm's options to play one supplier against the other. For example, pharmaceutical companies that offer patented drugs with distinctive medical benefits have more power over hospitals, drug buyers etc.

(c) *Dependence of supplier group on the firm:* When suppliers sell to several firms and the firm does not represent a significant fraction of its sales, suppliers are prone to exert power. In other words, the supplier group does not depend heavily on the industry for revenues. Suppliers serving many industries will not hesitate to extract maximum

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profits from each one. If a particular industry accounts for a large portion of a supplier group's volume or profit, however, suppliers will want to protect the industry through reasonable pricing.

(d) *Importance of the product of the firm:* When the product is an important input to the firm's business or when such inputs are important to the success of a firm's manufacturing process or product quality, the bargaining power of suppliers is high.

(e) *Threat of forward integration:* When the supplier poses a credible threat of integrating forward, this provides a check against the firm's ability to improve the terms by which it purchases.

(f) *Lack of substitutes:* The power of even large, powerful suppliers can be checked if they compete with substitutes. But, if they are not obliged to compete with substitutes as they are not readily available, the suppliers can exert power.

7. ***Threat of substitute products:*** The fifth of Porter's Five Forces model is the threat of substitute products. A substitute performs the same or a similar function as an industry's product. Video conferences are a substitute for travel. Plastic is a substitute for aluminum. E-mail is a substitute for a mail. All firms within an industry compete with industries producing substitute products. For example, companies in the coffee industry compete indirectly with those in the tea and soft drink industries because all these serve the same need of the customer for refreshment.

The existence of close substitutes is a strong competitive threat because this limits the price that companies in one industry can charge for their product. If the price of coffee rises too much relative to that of tea or soft drink, coffee drinkers may switch to those substitutes. Thus, according to Porter, "substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge". For example, the price of tea puts a ceiling on the price of coffee. To the extent that switching costs are low, substitutes may have a strong effect on the profitability of an industry.

The more attractive is the price/performance ratio of substitute products, the more likely they affect an industry's profits. In other words, when the threat of substitutes is high, industry profitability suffers. If an industry does not ward off the substitutes through product performance, marketing, price or other means, it will suffer in terms of profitability and growth potential in the following circumstances:

(a) *It offers an attractive price and performance:* The better the relative value of the substitute, the worse is the profit potential of the industry. For example, long distance telephone service providers suffered with the advent of Internet-based phone services.

(b) *The buyer's switching costs to the substitutes is low:* For example, switching from a proprietary, branded drug to a generic drug usually involves minimum switching costs.

Strategists should be particularly alert to changes in other industries that may make attractive substitutes. For example, improvements in plastic materials prompted the automobile manufactures to substitute plastic for steel in many automobile components.

Task Compare FMCG and Automobile sectors based on Porter's five forces model.

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Case Study

IKEA: Earning through Five Forces

National Competitive Advantage of IKEA IKEA Group, a Swedish company founded in 1943 with its headquarters in Denmark, is a multinational operator of a chain of stores for home furnishing and furniture. It is the world's largest furniture retailer, which specializes, in stylish but inexpensive Scandinavian designed furniture. At the end of 2005, the IKEA Group of Companies had a total of 175 stores in 31 countries. In addition, there are 19 IKEA stores owned and run by franchisees, outside the IKEA Group, in 12 countries. During the IKEA financial year 2004-2005, 323 million people visited our IKEA stores around the world.

In Sweden, nature and the home both play a big part in people's lives. In fact, one of the best ways to describe the Swedish home furnishing style is to describe nature – full of light and fresh air, yet restrained and unpretentious.

To match up, the artists Carl and Karin Larsson combined classical influences with warmer Swedish folk styles. They created a model of Swedish home furnishing design that today enjoys world-wide renown. In the 1950s the styles of modernism and functionalism developed at the same time as Sweden established a society founded on social equality. The IKEA product range – modern but not trendy, functional yet attractive, human-centered and child-friendly – carries on these various Swedish home furnishing traditions.

The IKEA Concept, like its founder, was born in Småland. This is a part of southern Sweden where the soil is thin and poor. The people are famous for working hard, living on small means and using their heads to make the best possible use of the limited resources they have. This way of doing things is at the heart of the IKEA approach to keeping prices low.

IKEA was founded when Sweden was fast becoming an example of the caring society, where rich and poor alike were well looked after. This is also a theme that fits well with the IKEA vision. In order to give the many people a better everyday life, IKEA asks the customer to work as a partner. The product range is child-friendly and covers the needs of the whole family, young and old. So together we can create a better everyday life for everyone.

In addition to working with around 1,800 different suppliers across the world, IKEA produces many of its own products through sawmills and factories in the IKEA industrial group, Swedwood.

Swedwood also has a duty to transfer knowledge to other suppliers, for example by educating them in issues such as efficiency, quality and environmental work.

Swedwood has 35 industrial units in 11 countries.

Purchasing: IKEA has 42 Trading Service Offices (TSO's) in 33 countries. Proximity to their suppliers is the key to rational, long-term co-operation. That's why TSO co-workers visit suppliers regularly to monitor production, test new ideas, negotiate prices and carry out quality audits and inspections.

Distribution: The route from supplier to customer must be as direct, cost-effective and environmentally friendly as possible. Flat packs are an important aspect of this work: eliminating wasted space means we can transport and store goods more efficiently. Since efficient distribution plays a key role in the work of creating the low price, goods routing and logistics are a focus for constant development.

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The Business Idea: The IKEA business idea is to offer a wide range of home furnishings with good design and function at prices so low that as many people as possible will be able to afford them. And still have money left! The company targets the customer who is looking for value and is willing to do a little bit of work serving themselves, transporting the items home and assembling the furniture for a better price. The typical IKEA customer is young low to middle income family.

The Competition Advantage: The Competition Advantage Strategy of IKEA's product is reflected through IKEA's success in the retail industry. It can be attributed to its vast experience in the retail market, product differentiation, and cost leadership.

IKEA Product Differentiation: A Wide Product Range The IKEA product range is wide and versatile in several ways. First, it's versatile in function. Because IKEA think customers shouldn't have to run from one small specialty shop to another to furnish their home, IKEA gather plants, living room furnishings, toys, frying pans, whole kitchens – i.e., everything which in a functional way helps to build a home – in one place, at IKEA stores.

Second, it's wide in style. The romantic at heart will find choices just as many as the minimalist at IKEA. But there is one thing IKEA don't have, and that is, the far-out or the over-decorated. They only have what helps build a home that has room for good living.

Third, by being coordinated, the range is wide in function and style at the same time. No matter which style you prefer, there's an armchair that goes with the bookcase that goes with the new extending table that goes with the armchair. So their range is wide in a variety of ways.

Cost Leadership: A wide range with good form and function is only half the story. Affordability has a part to play – the largest part. A wide range with good form and function is only half the story. Affordability has a part to play – the largest part. And the joy of being able to own it without having to forsake everything else. And the customers help, too, by choosing the furniture, getting it at the warehouse, transporting it home and assembling it themselves, to keep the price low.

Questions

1. Do you think that IKEA has been successful to utilize Porter's Five force analysis? Give reasons.
2. Where do you think can IKEA improve?

Source: www.echeat.com

4.3 Industry Analysis

Each business operates among a group of firms that produce competing products or services known as an "industry". An industry is thus a group of firms producing similar products or services. By similar products we mean products that customers perceive to be substitutes for one another.

Example: Firms that produce and sell textiles such as Reliance Textiles, Raymond, S. Kumars etc. belong to the textile industry.

Similarly, firms that produce PCs, such as Apple, Compaq, AT&T, IBM, etc. belong to the microcomputer industry.

Notes

Although there are usually some differences among competitors, each industry has its own set of "rules of combat" governing such issues as product quality, pricing and distribution. This is especially true in industries that contain a large number of firms offering standardized products and services. As such, it is important for strategic managers to understand the structure of the industry in which their firms operate before deciding how to compete successfully. Industry analysis is therefore a critical step in the strategic analysis of a firm.

In a perfect world, each firm would operate in one clearly defined industry. However, many firms compete in multiple industries, and strategic managers in similar firms often differ in their conceptualization of the industry environment. In addition, the advent of Internet has completely changed the way business is done. As a result, the process of industry definition and analysis can be specially challenging when internet competition is considered.

The basic purpose of industry analysis is to assess the strengths and weaknesses of a firm relative to its competitors in the industry. It tries to highlight the structural realities of particular industry and the extent of competition within that industry. Through industry analysis, an organisation can find whether the chosen field is attractive or not and assess its own position within the industry.

4.3.1 Framework for Industry Analysis

Industry analysis covers two important components:

1. Industry environment
2. Competitive environment

The following are the aspects to be covered in the above analysis:

Industry Analysis

1. Industry features
2. Industry boundaries
3. Industry environment
4. Industry structure
5. Industry performance
6. Industry practices
7. Industry attractiveness
8. Industry prospects for future

Competitive Analysis

Competitive analysis basically addresses two questions:

1. Which firms are our competitors?
2. What factors shape competition in industry?

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4.3.2 Industry Analysis

1. ***Industry Features:*** Industries differ significantly. So, analyzing a company's industry begins with identifying the industry's dominant economic features and forming a picture of the industry landscape. An industry's dominant economic features include such factors as:

   (a) Overall size

   (b) Market growth rate

   (c) Geographic boundaries of the market

   (d) Number and sizes of competitors

   (e) Pace of technological change

   (f) Product innovations etc.

   Getting a handle on an industry features promotes understanding of the kinds of strategic moves that managers should employ. For example, in industries characterized by one product advance after another, a strategy of continuous product innovation becomes a condition for survival.

   Example: Video games, computers and pharmaceuticals.

2. ***Industry Boundaries:*** All the firms in the industry are not similar to one another. Firms within the same industry could differ across various parameters, such as:

   (a) Breadth of market

   (b) Product/service quality

   (c) Geographic distribution

   (d) Level of vertical integration

   (e) Profit motives

3. ***Industry Environment:*** Based on their environment, industries are basically of two types:

   (a) *Fragmented Industries:* A fragmented industry consists of a large number of small or medium-sized companies, none of which is in a position to determine industry price. Many fragmented industries are characterized by low entry barriers and commodity type products that are hard to differentiate.

   (b) *Consolidated Industries:* A consolidated industry is dominated by a small number of large companies (an oligopoly) or in extreme cases, by just one company (a monopoly). These companies are in a position to determine industry prices. In consolidated industries, one company's competitive actions or moves directly affect the market share of its rivals, and thus their profitability. When one company cuts prices, the competitors also cut prices. Rivalry increases as companies attempt to undercut each other's prices or offer customers more value in their products, pushing industry profits down in the process. The consequence is a dangerous competitive spiral.

   According to Michael Porter, industries can be categorized into:

   Emerging industries: Are those in the introductory and growth phases of their life cycle.

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Mature industries: Are those who reached the maturity stage of their life cycle.

Declining industries: Are those in the transition stage from maturity to decline.

Global industries: Are those with manufacturing bases and marketing operations in several countries.

Competition varies during each stage of industry life cycle.

4. ***Industry Structure:*** Defining an industry's boundaries is incomplete without an understanding of its structural attributes. Structural attributes are the enduring characteristics that give an industry its distinctive character.

   Industry structure consists of four elements:

   (a) Concentration

   (b) Economies of scale

   (c) Product differentiation

   (d) Barriers to entry.

   (a) *Concentration:* It means the extent to which industry sales are dominated by only a few firms. In a highly concentrated industry (i.e. an industry whose sales are dominated by a handful of firms), the intensity of competition declines over time. High concentration serves as a barrier to entry into an industry, because it enables the firms to hold large market shares to achieve significant economies of scale.

   (b) *Economies of scale:* This is an important determinant of competition in an industry. Firms that enjoy economies of scale can charge lower prices than their competitors, because of their savings in per unit cost of production. They also can create barriers to entry by reducing their prices temporarily or permanently to deter new firms from entering the industry.

   (c) *Product differentiation:* Real perceived differentiation often intensifies competition among existing firms.

   (d) *Barriers to entry:* Barriers to entry are the obstacles that a firm must overcome to enter an industry, and the competition from new entrants depends mostly on entry barriers.

5. ***Industry attractiveness:*** Industry attractiveness is dependent on the following factors:

   (a) Profit potential

   (b) Growth prospects

   (c) Competition

   (d) Industry barriers etc.

   As a general proposition, if an industry's profit prospects are above average, the industry can be considered attractive; if its profit prospects are below average, it is considered unattractive. If the industry and competitive situation is assessed as attractive, firms employ strategies to expand sales and invest in additional facilities as needed to strengthen their long-term competitive position in business. If the industry is judged as unattractive, firms may choose to invest cautiously, look for ways to protect their profitability. Strong companies may consider diversification into more attractive businesses. Weak companies may consider merging with a rival to bolster market share and profitability.

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6. ***Industry performance:*** This requires an examination of data relating to:
   (a) Production
   (b) Sales
   (c) Profitability
   (d) Technological advancements etc.
7. ***Industry practices:*** Industry practices refer to what a majority of players in the industry do with respect to products, pricing, promotion, distribution etc. This aspect involves issues relating to:
   (a) Product policy
   (b) Pricing policy
   (c) Promotion policy
   (d) Distribution policy
   (e) R&D policy
   (f) Competitive tactics.
8. ***Industry's future prospects:*** The future outlook of an industry can be anticipated based on such factors as:
   (a) Innovation in products and services
   (b) Trends in consumer preferences
   (c) Emerging changes in regulatory mechanisms
   (d) Product life cycle of the industry
   (e) Rate of growth etc.

4.4 Competitive Analysis

The degree of competition in an industry is influenced by a number of forces. To establish a strategic agenda for dealing with these forces and grow despite them, a firm must understand:

1. How these forces work in an industry?
2. How they affect the firm in its particular situation?

The essence of strategy formulation is coping with competition. Intense competition in an industry is neither a coincidence nor a bad luck. It is rooted in its underlying economics. There are two theories of economics – theory of monopoly and theory of perfect competition. These represent two extremes of industry competition. In a monopoly context, a single firm is protected by barriers to entry, and has an opportunity to appropriate all the profits generated in the industry.

In a "perfectly competitive" industry, competition is unbridled and entry to the industry is easy. This kind of industry structure, of course, offers the worst prospects for long-run profitability. The weaker the forces collectively, however, the greater the opportunity for superior performance in terms of profit.

According to Porter, "each industry's attractiveness or profitability potential is a direct function of the interactions of various environmental forces that determine the nature of competition".

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Buyers, suppliers, new entrants and substitute products are all competitive forces. The state of competition in an industry is shaped by these forces. The collective strength of these forces determines the ultimate profit potential of an industry. It ranges from intense in certain industries to mild in certain industries.

Whatever their collective strength, the corporate strategist's goal is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favour. The strategist must delve below the surface and analyze the underlying sources of competition. Knowledge of these underlying sources of competition helps:

1. To provide the groundwork for a strategic agenda.
2. To highlight the competitive strengths and weaknesses of the company.
3. To animate the positioning of the company in its industry.
4. To clarify the areas where strategic changes may yield the greatest payoff and
5. To highlight the sources of greatest significance, either as opportunity or thereat. Understanding these sources will also help in considering areas for diversification.

The strongest competitive forces determine the profitability of an industry; so, competitive analysis is of crucial importance in strategy formulation.

4.5 Environmental Scanning

Environmental analysis or scanning is the process of monitoring the events and evaluating trends in the external environment, to identify both present and future opportunities and threats that may influence the firm's ability to reach its goals. Strategists need to analyze a variety of different components of the external environment, identify "*Key Players*" within those domains, and be very cognizant of both threats and opportunities within the environment. It is from such an analysis that managers can make decisions on whether to react to, ignore, or try to influence or anticipate future opportunities and threats discovered. The main purpose of environmental scanning is therefore to find out the correct "*fit*" between the firm and its environment, so that managers can formulate strategies to take advantage of the opportunities and avoid or reduce the impact of threats.

4.5.1 Features of Environmental Analysis

In the context of a changing environment, the process of environmental analysis is very well comparable to the functions of radar. From this analogy, it is possible to derive three important features of the process of environmental analysis (Ian Wilson).

Holistic Exercise

Environmental analysis is a holistic exercise in the sense that it must comprise a total view of the environment rather than a piecemeal view of trends. It is a process of looking at the forest, rather than the trees.

Continuous Activity

The analysis of environment must be a continuous process rather than a one – shot deal. Strategists must keep on tracking shifts in the overall pattern of trends and carry out detailed studies to keep a close watch on major trends.

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Exploratory Process

Environmental analysis is an exploratory process. A large part of the process seeks to explore the unknown terrain and the dimensions of possible future. The emphasis must be on speculating systematically about alternative outcomes, assessing probabilities, questioning assumptions and drawing rational conclusions.

4.5.2 Techniques of Environmental Scanning

So far, we have discussed the constituents of macro and operating environment and how these can become a threat or opportunity. As a corporate strategist, one has to identify the impact of these environmental forces on firm's choice of direction and action.

Environmental analysis involves two phases, viz; information gathering and evaluation.

Glueck and Jauch mention the following sources for environmental analysis:

1. ***Verbal and written information:*** Verbal information is generally obtained by direct talk with people, by attending meetings, seminars etc, or through media. Written or documentary information includes both published and unpublished material.
2. ***Search and scanning:*** This involves research for obtaining the required information.
3. ***Spying:*** Although it may not be considered ethical, spying to get information about competitor's business is not uncommon.
4. ***Forecasting:*** This involves estimating the future trends and changes in the environment. There are many techniques of forecasting. It can be done by the corporate planners or consultants.

For the above purpose, firms use a number of tools and techniques depending on their specific requirements in terms of quality, relevance, cost etc.

Some of the techniques which are generally used for carrying out environmental analysis are:

1. PESTEL analysis
2. SWOT analysis
3. ETOP
4. QUEST
5. EFE Matrix
6. CPM
7. Forecasting techniques
   - (a) Time series analysis
   - (b) Judgmental forecasting
   - (c) Expert opinion
   - (d) Delphi's technique
   - (e) Multiple scenario
   - (f) Statistical modeling
   - (g) Cross-impact analysis

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(h) Brainstorming

(i) Demand/hazard forecasting

The above techniques are briefly discussed below:

PESTEL Analysis

PESTEL Analysis is a checklist to analyse the political, economic, socio-cultural, technological, environmental and legal aspects of the environment.

While doing PESTEL analysis, it is better to have three or four well-thought-out items that are justified with evidence than a lengthy list. Although the items in a PESTEL analysis rely on *past* events and experience, the analysis can be used as a *forecast of the future.* The past is history and strategic management is concerned with future action, but the best evidence about the future *may* derive from what happened in the past. It is worth attempting the task of deciphering this hidden assumption anyway. For example, when the Warner Brothers invested several hundred million dollars in the first Harry Porter film, they made an assumption that the fantasy film market would remain attractive throughout the world. A structured PESTEL analysis might have given the same outcome even though it is difficult to predict.

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Checklist for a PESTEL Analysis

Political future
• Political parties and alignments at local and national level
• Legislation, e.g. on taxation and employment law
• Relations between government and the organization (possibly influencing the preceding items in a major way and forming a part of future corporate strategy)
• Government ownership of industry and attitude to monopolies and competition
Socio-cultural future
• Shifts in values and culture
• Change in lifestyle
• Attitudes to work and issues
• 'Green' environmental issues
• Education and health
• Demographic changes
• Distribution of income
Economic future
• Total GDP and GDP per head
• Inflation
• Consumer expenditure and disposable income
• Interest rates
• Currency fluctuations and exchange rates
• Investment – by the state, private enterprise and foreign companies
• Cyclicality
• Unemployment
• Energy costs, transport costs, communication costs, raw material costs
Technological future
• Government investment policy
• Identified new research initiatives
• New patents and products

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• Speed of change and adoption of new technology
• Level of expenditure on R&D by organisation's rivals
• Developments in nominally unrelated industries that might be applicable
Environmental future
• 'Green' issues that affect the environment
• Level and type of energy consumed – renewable energy?
• Rubbish, waste and its disposal
Legal future
• Competition law and government policy
• Employment and safety law
• Product safety issues

Some strategists may comment that the future is so uncertain that prediction is useless. If this view were true, then strategic management would not be playing such a significant role in organisations today. It is recognized that the future cannot be controlled, but by anticipating the future, organisations can avoid strategic surprises and be prepared to meet environmental changes.

SWOT Analysis

SWOT analysis is discussed in more detail in Unit 5.

ETOP

Environmental Threats and Opportunities Profile (ETOP) gives a summarized picture of environmental factors and their likely impact on the organisation. ETOP is generally prepared as follows.

1. ***List environmental factors:*** The different aspects of the general as well as relevant environmental factors are listed. For example, economic environment can be divided into rate of economic growth, rate of inflation, fiscal policy etc.
2. ***Assess impact of each factor:*** At this stage, the impact of each factor is assessed closely and expressed in qualitative (high, medium or low) or quantitative factors (1, 2, 3). It is to be noted that not all identified environmental factors will have the same degree of impact. The impact is assessed as positive or negative.
3. ***Get a big picture:*** In the final stage, the impact of each factor and its importance is combined to produce a summary of the overall picture. An example of ETOP is given below:

Table 4.1: Environmental Threat and Opportunity Profile (ETOP)

Environmental Factors	Impact of each factor
Economic	(+) Rising income levels
	(–) Price competition
Social	(–) Change in lifestyles
	(–) Change in consumer tastes
Technological	(+) Product becomes unique
	(–) Acquisition of new technology is expensive
Customer	(+) Loyalty is high
	(+) Buyer preference for differentiated goods
Supplier	(–) High input costs
	(+) Improved quality

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As observed from the above, the firm can capitalize on rising income levels, buyer loyalty to the firm's products and buyer's preference for differentiated products even though the price is high. But this would depend on the firm's acquisition of latest technology, which is expensive. Thus, the preparation of an ETOP provides the strategists with a clear picture of which environmental factors have a favourable impact on the firm and which have an unfavourable or adverse effect. With the help of an ETOP, a firm can judge where it stands with respect to its environment, and such an understanding is helpful in formulating appropriate strategies.

Alternative Framework for ETOP

An alternative framework to analyse the impact of threats and opportunities is explained below:

1. **The Opportunity and Threat Matrices**

(a) *The Threat matrix*

Seriousness		High	Low
	High	Major threats	Moderate threats
	Low	Moderate threats	Minor threats

Probability of occurrence

A company, after identifying various threats, can use its judgment to place the threats in any one of the four cells. Thus, for an aluminum plant, erratic availability and high cost of electrical power, can become a major threat if the probability of its occurrence is high. Placing this threat in cell-1 would mean strategic decisions like setting up of a captive power plant or shifting the plant to another location.

(b) *The Opportunity Matrix*

Attractiveness		High	Low
	High	Very attractive	Moderately attractive
	Low	Moderately attractive	Least attractive

Probability of occurrence

A company based on its own assessment and judgment can place the trends in various cells. A company's success probability with a particular opportunity depends on whether its business strength (i.e., distinctive competence) matches the success requirements of the industry. For example, entry into light commercial vehicles was an attractive opportunity for TELCO in which it had distinctive competence.

(c) *The Impact Matrix:* The impact of the trends (opportunities and threats) on various strategies can be visualized with the help of an impact matrix. This is discussed below.

After identifying the emerging trends in mega and micro or relevant environment, the degree of their impact can be assessed with the help of an impact scale. The matrix enables us to have a summary view of the impact on different strategies which a firm may be following. The strategies may relate to various functional

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areas (e.g. marketing, finance, production) with a specific business unit or they may relate to a specific business unit or to the overall company for all its business units (e.g. diversification).

(d) *The Impact Scale:* We can use a 5 – point impact scale to assess the 'degree' and 'quality' of impact of each trend on different strategies. The pattern of scoring can be as follows:

Figure 4.2: The Impact Matrix

Trend	Probability of occurrence	Impact on strategies			
		S1	S2	S3	S4
T1 T2 T3 T4					
T1, T2, T3, T4 refer to trends in the environment S1, S2, S3, S4 refer to strategies					

+ 2 extremely favourable impact

+ 1 moderately favourable impact

0 no impact

– 1 moderately unfavourable impact

– 2 extremely unfavourable impact

Like the Threat and Opportunity Matrices discussed above, we can assign probability of occurrences for each trend. You would observe that the above framework gives an objective picture of the impact of the environmental forces on different strategies of the organisation.

EFE Matrix

Just like ETOP, the External Factor Evaluation Matrix (EFE Matrix) helps to summarize and evaluate the various components of external environment. The EFE Matrix can be developed in five steps:

1. List 10 to 20 important opportunities and threats.
2. Assign a weight to each factor from 0.0 (not important) to 1.0 (most important). The higher the weight, the more important is the factor to the current and future success of the company.
3. Assign a rating to each factor 1(poor), 2 (average), 3 (above average), 4 (superior). The rating indicates how effectively the firm's current strategies respond to that particular factor.
4. Multiply each factor's weight by its rating to determine a weighted score.
5. Finally, add the individual weighted scores for all the external factors to determine the total weighted score for the organisation.

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An example of EFE Matrix for a hypothetical company is given below:

Table 4.2: EFE Matrix for Hypothetical Company

Key external factor	Weight	Rating	Weighted score
Opportunities:			
1. Emerging new markets	0.15	2	0.30
2. Decrease in the cost of components	0.10	3	0.30
3. Internet use growing rapidly	0.15	3	0.45
4.Trend is to have quality products	0.10	3	0.30
Threats:			
1. Obsolescence of technology	0.10	2	0.20
2.Cheap Chinese imports	0.15	2	0.30
3. Increase in labour costs due to legislation	0.10	3	0.30
4. Attrition of skilled manpower	0.15	3	0.45
	1.00		2.60

The total weighted score indicates how well a particular company is responding to current and expected factors in the environment. The highest possible total weighted score will be 4.0 and the lowest will be 1.0. The average score is 2.5. A score of 4.0 indicates that an organisation is responding in an outstanding way to existing opportunities and threats. In the example above, the total weighted score of 2.6 means the company is above average in responding to factors in the environment.

QUEST

QUEST (Quick Environment Scanning Technique) is a four step process, which uses scenario-building for environmental analysis.

The four steps are:

1. Managers make observations about major events and trends in the environment.
2. They speculate on a wide range of issues that are likely to affect the future of the business enterprise.
3. A report is prepared summarizing the issues and their implications to the firm, together with 2 to 3 scenarios.
4. The report and the scenarios are reviewed by strategists, based on which they identify feasible options.

Thus, QUEST helps in generating feasible alternative strategies for consideration of the management.

Competitive Profile Matrix (CPM)

This is a competitor analysis, which focuses on each company against whom a firm competes directly. It helps to identify the strengths and weaknesses of the major competitors of the firm, vis-à-vis the firm. Generally, the Critical Success Factors (CSFs) are compared. In addition, other factors that can be compared are breadth of product line, sales, distribution, production capacity and efficiency, technological advantages etc. Using the format shown in Table, a firm can prepare competitor profile matrix.

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Table 4.3: Competitive Profile Matrix (CPM)

CRITICAL SUCCESS FACTOR	FIRM			COMPETITOR I		COMPETITOR II		COMPETITOR III	
	Weight	Rating	Score	Rating	Score	Rating	Score	Rating	Score
1. Market share									
2. Product quality									
3. Consumer loyalty									
4. Price competitiveness									
5. Sales distribution									
6. Customer service									
7. Global expansion									
8. Advertising, etc.									

After calculating the weighted scores for the firm, and the major competitors, they are compared to prepare a competitive profile.

Forecasting Techniques

Macro environmental and industry scanning and analysis are only marginally useful if what they do is to reveal current conditions. To be truly useful, such analysis must forecast future trends and changes. Forecasting is a way of estimating the future events that are likely to have a major impact on the enterprise. It is a technique whereby managers try to predict the future characteristics of the environment to help managers take strategic decisions. Various techniques are used to forecast future situations. Important among these are:

1. ***Time series analysis:*** Extrapolation is the most widely practiced form of forecasting. Simply stated, extrapolation is the extension of present trends into the future. It rests on the assumption that the world is reasonably consistent and changes slowly in the short run. They attempt to carry a series of historical events forward into the future. Because time series analysis projects historical trends into the future, its validity depends on the similarity between past trends and future conditions.

2. ***Judgemental forecasting:*** This is a forecasting technique in which employees, customers, suppliers etc., serve as a source of information regarding future trends. For example, sales representatives may be asked to forecast sales growth in various product categories based on their interaction with customers. Survey instruments may be mailed to customers, suppliers or trade associations to obtain their judgments on specific trends.

3. ***Expert opinion:*** This is a non-quantitative technique in which experts in a particular area attempt to forecast likely developments. Knowledgeable people are selected and asked to assign importance and probability rating to various future developments. This type of forecast is based on the ability of a knowledgeable person to construct probable future developments on the interaction of key variables. The delphi technique is one such technique.

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4. ***Delphi Technique:*** This is a forecasting technique in which the opinion of experts in the appropriate field are obtained about the probability of the occurrence of specified events. The responses of the experts are compiled and a summary is sent to each expert. This process is repeated until consensus is arrived at regarding the forecast of a particular event.

5. ***Statistical modeling:*** It is a quantitative technique that attempts to discover causal factors that link two or more time series together. They use different sets of equations. Regression analysis and other econometric methods are examples. Although very useful for grasping historical trends, statistical modeling is based on historical data. As the patterns of relationships change, the accuracy of the forecast deteriorates.

6. ***Cross-impact Analysis:*** By this analysis, researchers analyze and identify key trends that will impact all other trends. The question is then put: "If event A occurs, what will be the impact on all other trends". The results are used to build "domino chains", with one event triggering others.

7. ***Brainstorming:*** Brainstorming is a technique to generate a number of alternatives by a group of 6 to 10 persons. The basic ground rule is to propose ideas without first mentally evaluating them. No criticism is allowed. Ideas tend to build on previous ideas until a consensus is reached. This is a good technique to create ideas.

8. ***Demand/Hazard forecasting:*** Researchers identify major events that would greatly affect the firm. Each event is rated for its convergence with several major trends taking place in society and its appeal to a group of the public; the higher the event's convergence and appeal, the higher its probability of occurring.

Caselet

Scooters wants Bigger Slice of Pizza Market

DURBAN Pizza franchise group Scooters had passed the critical 50 store mark and was nudging a R100m turnover in the year to February, MD Carlo Gonzaga said yesterday.

Established in 2000 with the aim of securing half of the R1, 8bn pizza market within a decade, Scooters lifted turnover 23% in the past year.

The group opened 14 new stores since last February, including an aggressive launch in Western Cape.

The move gave the group a national footprint that came after its expansion into Botswana. Gonzaga said Scooters would open a second store in Botswana in the new financial year as well as establish at least one store in west Africa.

Gonzaga said west Africa's market afforded the group sufficient size to justify the establishment and servicing costs associated with an international expansion.

The group will also open another 15 stores throughout SA, including nine in Western Cape to achieve critical mass in that region.

Gonzaga expected Scooters to achieve 20% real growth in the year ahead, coming from a combination of new stores and increased turnover from existing shops.

Contd...

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He dismissed the possibility of expanding Scooters beyond a pizza delivery company, saying the market held sufficient room for expansion without having to acquire brands not related to pizzas.

The group has an association with fast-food chain Nando's that affords a cross-subsidization on menu and sites.

Gonzaga also dismissed the possibility of listing Scooters on either the JSE Securities Exchange or the Alt-X, saying the group financed expansions via its franchisees.

Scooters currently has a 5% share of the pizza market, but Gonzaga aimed to boost that tenfold within five years.

Source: Business Day (Electronic Edition), 27 February 2004.

4.6 Summary

- External assessment is a step where a firm identifies opportunities that could benefit it and threats that it should avoid.
- It involves monitoring, evaluating, and disseminating of information from the external and internal environments to key people within the corporation.
- The nature and degree of competition in an industry hinge on five forces, viz. the threat of new entrants, the bargaining power of customers, the bargaining power of suppliers, the threat of substitute products or services and the jockeying among current contestants.
- To establish a strategic agenda for dealing with these contending currents and to grow despite them, a company must understand how they work in its industry and how they affect the company in its particular situation.
- The process of conducting external environment assessment starts with collating information and intelligence on factors affecting the external environment.
- Industry analysis is a tool that facilitates a company's understanding of its position relative to other companies that produce similar products or services.
- Environmental analysis or scanning is the process of monitoring the events and evaluating trends in the external environment, to identify both present and future opportunities and threats that may influence the firm's ability to reach its goals.

4.7 Keywords

Competition: Rivalry between two or more parties to achieve a similar goal.

Environment: The totality of surrounding conditions.

Environmental Scanning: Process of gathering, analyzing, and dispensing information for tactical or strategic purposes.

Fragmented Industries: Consists of a large number of small or medium-sized companies, none of which is in a position to determine industry price.

Porters Five Forces: Named after Michael E. Porter, this model identifies and analyzes 5 competitive forces that shape every industry, and helps determine an industry's weaknesses and strengths.

Switching Costs: One-time costs that a customer has to bear to switch from one product to another.

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4.8 Self Assessment

Fill in the blanks:

1. At the level of marketing strategy, a competitor has four variables: ....., ..., ... and .....
2. Competitors' reactions can be studied at ..... levels.
3. The five forces and strategic group models present a ..... picture of competition while emphasizing the role of .....
4. The shakeout stage ends when the industry enters its ..... stage.
5. Under the shakeout stage, ... are forced out, and a small number of industry leaders emerge.
6. The ..... represents all the players in the game and analyses how their interactions affect the firm's ability to generate and appropriate value.
7. Buyers, suppliers, new entrants and substitute products are all ..... forces.
8. A primary industry may be considered as a group of ....., whereas a secondary industry includes .....
9. ....., ... and ..... are essential for conducting an environmental survey.
10. Analyzing a company's industry begins with identifying the industry's dominant ..... features.
11. A ..... industry is dominated by a small number of large companies.
12. Defining an industry's boundaries is incomplete without an understanding of its ..... attributes.
13. Firms that enjoy ..... can charge lower prices than their competitors.
14. With Porter's framework, a strong competitive force can be regarded as a .....
15. ..... are the one-time costs that a customer has to bear to switch from one product to another.
16. The new entrant's need to secure ..... for the product can create a barrier to entry.

4.9 Review Questions

1. "The five forces model provides the rationale for increasing or decreasing resources commitment". Comment.
2. Are there any disadvantages in using Porter's five forces model? Elucidate the pros and cons of using the model.
3. "The five forces theory is a short-sighted theory". Why/why not?
4. Discuss Industry analysis using Porter's five forces theory.
5. Present at least 7 points to highlight the importance of industry analysis.
6. Do you think it is important to define an industry's boundaries? Why/why not?
7. Suppose a firm competes in the microcomputer industry. Where in your opinion, the boundaries of this industry begin and end?

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8. Analyse the features that determine the strength of the competitive forces operating in the industry.
9. "Each industry's attractiveness or profitability potential is a direct function of the interactions of various environmental forces that determine the nature of competition." Discuss.
10. Is it feasible to create strategic group in any industry? Explain the rationale behind creating these groups.
11. Present a critical assessment of industry life cycle analysis.
12. These days, the industry uses a very popular term- hyper-competition. Find out what it means and elucidate through examples.

Answers: Self Assessment

1.	product, distribution, price, promotion	2.	two
3.	static, innovation	4.	mature
5.	marginal competitors	6.	value net
7.	competitive	8.	close competitors, less direct competitors
9.	Industry structure, industry boundaries, industry attractiveness		
10.	economic	11.	consolidated
12.	structural	13.	economies of scale
14.	threat	15.	Switching costs
16.	distribution channel		

4.10 Further Readings

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Unit 5: Organisational Appraisal: The Internal Assessment 1

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Objectives

After studying this unit, you will be able to:

- State the importance of internal analysis
- Discuss SWOT analysis

Introduction

Internal analysis is also referred to as "internal appraisal", "organisational audit", "internal corporate assessment" etc. Over the years, research has shown that the overall strengths and weaknesses of a firm's resources and capabilities are more important for a strategy than environmental factors. Even where the industry was unattractive and generally unprofitable, firms that came out with superior products enjoyed good profits.

Managers perform internal analysis to identify the strengths and weaknesses of a firm's resources and capabilities. The basic purpose is to build on the strengths and overcome the weaknesses in order to avail of the opportunities and minimize the effects of threats. The ultimate aim is to gain and sustain competitive advantage in the marketplace.

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5.1 Importance of Internal Analysis

Strategic management is ultimately a "matching game" between environmental opportunities and organisational strengths. But, before a firm actually starts tapping the opportunities, it is important to know its own strengths and weaknesses. Without this knowledge, it cannot decide which opportunities to choose and which ones to reject. One of the ingredients critical to the success of a strategy is that the strategy must place "realistic" requirements on the firm's resources. The firm therefore cannot afford to go by some untested assumptions or gut feelings. Only systematic analysis of its strengths and weaknesses can be of help. This is accomplished in internal analysis by using analytical techniques like RBV, SWOT analysis, Value chain analysis, Benchmarking, IFE Matrix etc.

Thus, systematic internal analysis helps the firm:

1. To find where it stands in terms of its strengths and weaknesses
2. To exploit the opportunities that are in line with its capabilities
3. To correct important weaknesses
4. To defend against threats
5. To asses capability gaps and take steps to enhance its capabilities.

This exercise is also the starting point for developing the competitive advantage required for the survival and growth of the firm.

Notes The opportunities that can be successfully exploited depend upon the strengths of its resources and the skills the firm employs to transform those resources into outputs. In this sense, organisational resources and capabilities become a lynchpin over which hinges the success and survival of a strategy.

5.2 SWOT Analysis

SWOT stands for strengths, weaknesses, opportunities and threats. SWOT analysis is a widely used framework to summaries a company's situation or current position. Any company undertaking strategic planning will have to carry out SWOT analysis: establishing its current position in the light of its strengths, weaknesses, opportunities and threats. Environmental and industry analyses provide information needed to identify opportunities and threats, while internal analysis provides information needed to identify strengths and weaknesses. These are the fundamental areas of focus in SWOT analysis.

SWOT analysis stands at the core of strategic management. It is important to note that strengths and weaknesses are intrinsic (potential) value creating skills or assets or the lack thereof, relative to competitive forces. Opportunities and threats, however, are external factors that are not created by the company, but emerge as a result of the competitive dynamics caused by 'gaps' or 'crunches' in the market.

We had briefly mentioned about the meaning of the terms opportunities, threats, strengths and weaknesses. We revisit the same for purposes of SWOT analysis.

1. ***Opportunities:*** An opportunity is a major favourable situation in a firm's environment. Examples include market growth, favourable changes in competitive or regulatory framework, technological developments or demographic changes, increase in demand, opportunity to introduce products in new markets, turning R&D into cash by licensing or selling patents etc. The level of detail and perceived degree of realism determine the extent of opportunity analysis.

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2. ***Threats:*** A threat is a major unfavourable situation in a firm's environment. Examples include increase in competition; slow market growth, increased power of buyers or suppliers, changes in regulations etc. These forces pose serious threats to a company because they may cause lower sales, higher cost of operations, higher cost of capital, inability to make break-even, shrinking margins or profitability etc. Your competitor's opportunity may well be a threat to you.

3. ***Strengths:*** Strength is something a company possesses or is good at doing. Examples include a skill, valuable assets, alliances or cooperative ventures, experienced sales force, easy access to raw materials, brand reputation etc. Strengths are not a growing market, new products, etc.

4. ***Weaknesses:*** A weakness is something a company lacks or does poorly. Examples include lack of skills or expertise, deficiencies in assets, inferior capabilities in functional areas etc. Though weaknesses are often seen as the logical 'inverse' of the company's threats, the company's lack of strength in a particular area or market is not necessarily a relative weakness because competitors may also lack this particular strength.

5.2.1 Carrying out SWOT Analysis

The first thing that a SWOT analysis does is to evaluate the strengths and weaknesses in terms of skills, resources and competencies. The analyst then should see whether the internal capabilities match with the demands of the key success factors. The job of a strategist is to capitalize on the organisation's strengths while minimizing the effects of its weaknesses in order to take advantage of opportunities and overcome threats in the environment. SWOT analysis for a typical firm is given below (Table 5.1).

5.2.2 Steps in SWOT Analysis

The three important steps in SWOT analysis are:

1. Identification
2. Conclusion
3. Translation

1. ***Identification:***
   (a) Identify company resource strengths and competitive capabilities
   (b) Identify company resource weaknesses and competitive deficiencies
   (c) Identify company's opportunities
   (d) Identify external threats

Notes

Table 5.1: SWOT Analysis

Strengths	**Weaknesses**
• Strong brand image • High quality products • Latest technology • High intellectual capital • Cordial industrial relations	• Weak distribution network • Narrow product lines • Rising costs • Poor marketing plan
Opportunities	**Threats**
• New markets • Profitable new acquisitions • R&D skills in new areas • New businesses	• Increase in competition • Barriers to entry • Change in consumer tastes • New or substitute products • Threat of takeover

2. ***Conclusion:***
   (a) Draw conclusions about the company's overall situation
3. ***Translation:*** Translate the conclusions into strategic actions by acting on them:
   (a) Match the company's strategy to its strengths and opportunities
   (b) Correct important weaknesses
   (c) Defend against external threats

In devising a SWOT analysis, there are several factors that will enhance the quality of the material:

1. Keep it brief, pages of analysis are usually not required.
2. Relate strengths and weaknesses, wherever possible, to industry key factors for success.
3. Strengths and weaknesses should also be stated in competitive terms, that is, in comparison with competitors.
4. Statements should be specific and avoid blandness.
5. Analysis should reflect the gap, that is, where the company wishes to be and where it is now.
6. It is important to be realistic about the strengths and weaknesses of one's own and competitive organisations.

Probably the biggest mistake that is commonly made in SWOT analysis is to provide a long list of points but little logic, argument and evidence. A short list with each point well argued is more likely to be convincing.

Did u know?

What is TOWS Matrix?

TOWS matrix is just an extension of SWOT matrix. TOWS stand for threats, opportunities, weaknesses and strengths. This matrix was proposed by Heinz Weihrich as a strategy formulation – matching tool.

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TOWS analysis poses a number of questions:

What actions should a company take? Should it focus on using company's strengths to capitalize on opportunities, or acquire strengths in order to be able to capture opportunities? Or should it actively try to minimize weaknesses and avoid threats?

TOWS matrix illustrates how internal strengths and weaknesses can be matched with external opportunities and threats to generate four sets of possible alternative strategies. This matrix can be used to generate corporate as well as business strategies. An example of TOWS matrix is shown below:

Internal factors/ External factors	Strengths(S)	Weaknesses(W)
Opportunities(O)	***SO strategies:*** strategies that use strengths to take advantage of opportunities.	***WO strategies:*** strategies that take advantage of opportunities by over -coming weaknesses
Threats(T)	***ST strategies:*** strategies that use strengths to avoid threats.	***WT strategies:*** strategies that minimize weaknesses and avoid threats.

To generate a TOWS matrix, the following steps are to be followed:

1. List external opportunities available in the company's current and future environment, in the 'opportunities block' on the left side of the matrix.
2. List external threats facing the company now and in future in the "threats block" on the left side of the matrix.
3. List the specific areas of current and future strengths for the company, in the "strengths block" across the top of the matrix.
4. List the specific areas of current and future weaknesses for the company in the "weaknesses box" across the top of the matrix.
5. Generate a series of possible alternative strategies for the company based on particular combinations of the four sets of factors.

The four sets of strategies that emerge are:

SO Strategies

SO strategies are generated by thinking of ways in which a company can use its strengths to take advantage of opportunities. This is the most desirable and advantageous strategy as it seeks to mass up the firm's strengths to exploit opportunities. For example, Hindustan Lever has been augmenting its strengths by taking over businesses in the food industry, to exploit the growing potential of the food business.

ST Strategies

ST strategies use a company's strengths as a way to avoid threats. A company may use its technological, financial and marketing strengths to combat a new competition. For example, Hindustan Lever has been employing this strategy to fight the increasing competition from companies like Nirma, Procter & Gamble etc.

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WO Strategies

WO Strategies attempt to take advantage of opportunities by overcoming its weaknesses. For example, for textile machinery manufacturers in India the main weakness was dependence on foreign firms for technology and the long time taken to execute an order. The strategy followed was the thrust given to R&D to develop indigenous technology so as to be in a better position to exploit the opportunity of growing demand for textile machinery.

WT Strategies

WT Strategies are basically defensive strategies and primarily aimed at minimizing weaknesses and avoiding threats. For example, managerial weakness may be solved by change of managerial personnel, training and development etc. Weakness due to excess manpower may be addressed by restructuring, downsizing, delayering and voluntary retirement schemes. External threats may be met by joint ventures and other types of strategic alliances. In some cases, an unprofitable business that cannot be revived may be divested.

Strategies which utilize a strength to take advantage of an opportunity are generally referred to as "exploitative" or "developmental strategies". Strategies which use a strength to eliminate a weakness may be referred to as "blocking strategies". Strategies which overcome a weakness to take advantage of an opportunity or eliminate a threat may be referred to as "remedial strategies".

The TOWS matrix is a very useful tool for generating a series of alternative strategies that the decision-makers of the firm might not otherwise have considered. It can be used for the company as a whole or it can be used for a specific business unit within a company. However, it may be noted that the TOWS matrix is only one of many ways to generate alternative strategies.

Caselet

SWOT Analysis of Tata Motors

Tata Motors began in 1945 and has produced more than 4 million vehicles. Tata Motors Limited is the largest car producer in India. It manufactures commercial and passenger vehicles, and employs in excess of 23,000 people. This SWOT analysis is about Tata Motors.

Strengths

1. The internationalisation strategy so far has been to keep local managers in new acquisitions, and to only transplant a couple of senior managers from India into the new market. The benefit is that Tata has been able to exchange expertise. For example after the Daewoo acquisition the Indian company leaned work discipline and how to get the final product 'right first time.'
2. The company has a strategy in place for the next stage of its expansion. Not only is it focusing upon new products and acquisitions, but it also has a programme of intensive management development in place in order to establish its leaders for tomorrow.
3. The company has had a successful alliance with Italian mass producer Fiat since 2006. This has enhanced the product portfolio for Tata and Fiat in terms of production and knowledge exchange. For example, the Fiat Palio Style was launched by Tata in 2007, and the companies have an agreement to build a pick-up targeted at Central and South America.

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Weaknesses

1. The company's passenger car products are based upon 3rd and 4th generation platforms, which put Tata Motors Limited at a disadvantage with competing car manufacturers.
2. Despite buying the Jaguar and Land Rover brands (see opportunities below); Tat has not got a foothold in the luxury car segment in its domestic, Indian market. Is the brand associated with commercial vehicles and low-cost passenger cars to the extent that it has isolated itself from lucrative segments in a more aspiring India?
3. One weakness which is often not recognised is that in English the word 'tat' means rubbish. Would the brand sensitive British consumer ever buy into such a brand? Maybe not, but they would buy into Fiat, Jaguar and Land Rover (see opportunities and strengths).

Opportunities

1. In the summer of 2008 Tata Motor's announced that it had successfully purchased the Land Rover and Jaguar brands from Ford Motors for UK £2.3 million. Two of the World's luxury car brand have been added to its portfolio of brands, and will undoubtedly off the company the chance to market vehicles in the luxury segments.
2. Tata Motors Limited acquired Daewoo Motor's Commercial vehicle business in 2004 for around USD $16 million.
3. Nano is the cheapest car in the World - retailing at little more than a motorbike. Whilst the World is getting ready for greener alternatives to gas-guzzlers, is the Nano the answer in terms of concept or brand? Incidentally, the new Land Rover and Jaguar models will cost up to 85 times more than a standard Nano!
4. The new global track platform is about to be launched from its Korean (previously Daewoo) plant. Again, at a time when the World is looking for environmentally friendly transport alternatives, is now the right time to move into this segment? The answer to this question (and the one above) is that new and emerging industrial nations such as India, South Korea and China will have a thirst for low-cost passenger and commercial vehicles. These are the opportunities. However the company has put in place a very proactive Corporate Social Responsibility (CSR) committee to address potential strategies that will make is operations more sustainable.
5. The range of Super Milo fuel efficient buses are powered by super-efficient, eco-friendly engines. The bus has optional organic clutch with booster assist and better air intakes that will reduce fuel consumption by up to 10%.

Threats

1. Other competing car manufacturers have been in the passenger car business for 40, 50 or more years. Therefore Tata Motors Limited has to catch up in terms of quality and lean production.
2. Sustainability and environmentalism could mean extra costs for this low-cost producer. This could impact its underpinning competitive advantage. Obviously, as Tata globalises and buys into other brands this problem could be alleviated.
3. Since the company has focused upon the commercial and small vehicle segments, it has left itself open to competition from overseas companies for the emerging Indian luxury segments. For example ICICI bank and DaimlerChrysler have invested in a new Pune-based plant which will build 5000 new Mercedes-Benz per annum. Other

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players developing luxury cars targeted at the Indian market include Ford, Honda and Toyota. In fact the entire Indian market has become a target for other global competitors including Maruti Udyog, General Motors, Ford and others.

4. Rising prices in the global economy could pose a threat to Tata Motors Limited on a couple of fronts. The price of steel and aluminium is increasing putting pressure on the costs of production. Many of Tata's products run on Diesel fuel which is becoming expensive globally and within its traditional home market.

Source: www.marketingteacher.com

5.2.3 Critical Assessment of SWOT Analysis

SWOT analysis is one of the most basic techniques for analyzing firm and industry conditions. It provides the "raw material" for analyzing internal conditions as well as external conditions of a firm. SWOT analysis can be used in many ways to aid strategic analysis. For example, it can be used for a systematic discussion of a firm's resources and basic alternatives that emerge from such an analysis. Such a discussion is necessary because a strength to one firm may be a weakness for another firm, and vice-versa. For example, increased health consciousness of people is a threat to some firms (e.g. tobacco) while it is an opportunity to others (e.g. health clubs).

According to Johnson and Sholes (2002), a SWOT analysis summarises the key issues from the business environment and the strategic capability of an organisation that impacts strategy development. This can also be useful as a basis for judging future courses of action. The aim is to identify the extent to which the current strengths and weaknesses are relevant to, and capable of, dealing with the changes taking place in the business environment. It can also be used to assess whether there are opportunities to exploit further the unique resources or core competencies of the organisation. Overall, SWOT analysis helps focus discussion on future choices and the extent to which the company is capable of supporting its strategies.

5.2.4 Advantages and Limitations

Advantages

1. It is simple.
2. It portrays the essence of strategy formulation: matching a firm's internal strengths and weaknesses with its external opportunities and threats.
3. Together with other techniques like Value Chain Analysis and RBV, SWOT analysis improves the quality of internal analysis.

Limitations

1. It gives a static perspective, and does not reveal the dynamics of competitive environment.
2. SWOT emphasizes a single dimension of strategy (i.e. strength or weakness) and ignores other factors needed for competitive success.
3. A firm's strengths do not necessarily help the firm create value or competitive advantage.
4. SWOT's focus on the external environment is too narrow.

Notes

5. Hill and Westbrook criticize SWOT analysis by saying that it is not a panacea. According to them, some of the criticisms against SWOT analysis are:
   (a) It generates lengthy lists
   (b) It uses no weights to reflect priorities
   (c) It uses ambiguous words and phrases
   (d) The same factor can be placed in two categories (e.g. an opportunity may also be a threat).
   (e) There is no obligation to verify opinions with data or analysis.
   (f) It is only a simple level of analysis. There is no logical link to strategy implementation.
   (g) SWOT helps only as a starting point. By itself, SWOT analysis rarely helps a firm develop competitive advantage that it can sustain over time.

In spite of the above criticism and its limitations, SWOT analysis is still a popular analytical tool used by most organisations. It is definitely a useful aid in generating alternative strategies, through what is called TOWS matrix.

Task Conduct a SWOT analysis of Vodafone and Airtel.

Case Study

Nokia's Global Opportunities

Over the last 15 years, the Finnish company Nokia has built global leadership of the mobile telephone market. After dramatic growth in recent years, Nokia has faced problems in making the best strategic choice for continued growth. This case explores its strategic decision making and the risks that it now faces.

Background

In the late 1980s, the small Finnish company Nokia was involved in a wide range of businesses. For example, it made televisions and other consumer electronics in which it claimed to be 'third in Europe'. It also had a thriving business in industrial cables and machinery and manufactured a wide range of other goods from forestry logging equipment to tyres. It had been expanding fast since the 1960s and was beginning to struggle under the vast range of goods that it sold. Sadly, group's chief executive at that time, Kari Kairamo, was overwhelmed that he committed suicide. It is rare that strategic pressures are so intense but the impact on managers of strategy evaluation and development is an important factor in generating stress.

The Early 1990s

In 1991 and 1992, Nokia lost US$120 millions on its major business activities. The company had to find new strategies to remedy this situation. It had already cut out some of its activities but was still left with a telephone manufacturing operation, an unprofitable TV and video manufacturing business and a strong industrial cables business. Nokia began the process by seeking a new group chief executive. Its choice was Jorma Ollila, who had previously run the small Nokia mobile phone division, which was loss-making at the

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time. "My brief was to decide whether to sell it or keep it. After four months, I proposed we keep it. We had good people, we had know-how and there was market growth opportunity", explained Ollila.

In 1992, Nokia chose to develop two existing divisions that had related technologies: mobile telephone and telecommunications equipment (switches and exchanges). Subsequently, it focused mainly on the mobile business but did not pull completely out of the telecommunications equipment market.

There were four criteria to justify the strategic choice to focus on mobile telephones:

1. It was judged that the mobile telephone market had great worldwide growth potential and was growing fast.
2. Nokia already had profitable businesses in this area.
3. Deregulation and privatisation of tele-communications markets around the world were providing specific opportunities.
4. Rapid technological change – especially the new pan-European GSM mobile system – provided the opportunity to alter fundamentally the balance between competitors.

Clearly, all the above judgements carried significant risk. In addition, the company's strategic choice was limited by constraints on its resources. The heavy losses of the group overall were a severe financial constraint. In addition, it was not able to afford the same level of expenditure on research and development as its two major rivals, Motorola (US) and Ericsson (Sweden). Moreover, although it had the in-house skills and experience of working with national deregulated telecommunications operators through competing in world markets in the 1970s and 1980s, it would need many more employees if it was to develop the market opportunities. However, by selling off its other interests and concentrating on mobile telephones it was able to overcome some of the difficulties.

Looking back on that time, Ollila commented: "In order to be really successful you have to globalise your organisation and focus your business portfolio. We have been able to grow and be global and maintain our agility and be fast at the same time". What Ollila did not say was that Finland is a small country, so to build any sizeable business, it is essential to think beyond the country's national boundaries.

1992-2000: Building Global Leadership

One of Ollila's first tasks was to build a management team. He chose two new, young executives as part of his team: Sari Baldauf as head of Nokia networks and Matti Alahuhta as head of Nokia mobile telephones. Alahuhta had recently attended IMD Business School in Switzerland where he had written a dissertation on how to turn a medium-size technology-based company into a world-class enterprise against larger rivals with greater resources. He clearly had in mind how Nokia could compete with competitors like its Swedish rivals Ericsson, the Dutch company Philips, the French company Alcatel and the American company Motorola, all of whom had considerably greater resources in terms of finance and technical knowledge. Alahuhta identified three important factors to help Nokia: first, it was important to find a new technology that would change the rules of the game and turn all existing competitors into beginners; second, it was essential to move fast internationally and respond flexibly as international markets developed; third, the company had to assess and deliver what customers really wanted from mobile telephones. Alahuhta did not especially identify one technology development that proved highly valuable in the early 1990s. This was the agreement within the European Union to adopt the GSM technical standard for mobile telephones. This allowed company like Nokia to

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have access to a large market where the technology was standardised and major economies of scale were therefore possible. Such a development was important because the GSM standard was subsequently used worldwide, with around 500 millions of the world's 700 millions mobiles using this standard by 2000. This was fortunate for companies like Nokia: "Good luck favours the prepared mind" was Alahuhta's cryptic comment some years later.

Benefits and Problems of Strategic Choice

In fact, Nokia was highly successful in its expansion.: moved rapidly to design phones that would appeal to global customers by designing mobile phones that offered reliability and ease-of-use. This meant that it had to invest heavily in software development and it formed an alliance with the British company, Symbian, subsequently taking a majority share in order to ensure that developments remained on track. Nokia was also single-minded in its investment in factories in order to deliver economies of scale, reduce costs and raise profit margins.

Nokia was particularly good at reading what customers wanted and then moving quickly into the market place with new telephones: it realised that the mobile phone during this period was almost a fashion accessory and designed phones to reflect this. It made the important judgement that the market during the 1990s was moving from being a high-tech market into a mass-market, where cheaper, entry-level phones were required. This was in sharp contrast to its Nordic competitor, Ericsson, who had remained with high-tech phones: "We had the wrong profile in our portfolio," was the later comment from Kurt Hellstrom, Ericsson's chief executive. By 2000, Nokia had developed a range of mobile telephones that were both attractive to look at and innovative in their use of the new digital technology that had become available. The result was that by 2000 Nokia was world leader in mobile telephone manufacture, with 35% global share.

2000-2005: Coping with New Challenges

Having concentrated its resources into mobile telephones, Nokia then had to cope with a major downturn in the world market 2000-2002 which occurred for three main reasons. The first reason was that the market became saturated in some parts of the world – for example, 80% of people in the EU had mobile telephones. Other markets were also becoming saturated – only America lagged behind because of the profusion of mobile standards in that market. Even in countries like China and India, around 30% of the population had mobiles and the take-up was much higher in Asian countries like Singapore and Japan, though the latter country had developed its own technical standards outside the GSM system.

The second reason for problems was that the technology bubble of the late 1990s came to an end in 2001. This left the leading telecommunications companies over-burdened with debt and wanting to slash their costs. Sales in Nokia's telecommunications equipment division - related to mobile phones but more associated with the surrounding infrastructure of telephone exchanges dropped 50% over three years. Nokia itself had to make some 7,500 workers redundant in order to recover the situation.

In the mobile phone division of Nokia, there was a third additional problem for Nokia. The telephone service providers like Vodafone and Orange were delaying the introduction of the next generation of mobile telephone technology for reasons of technical feasibility and lack of funds through paying too much for the licenses. The '3G' pure digital technology would introduce a whole new market for telephone services that would need a totally new series of product designs. In turn, this would require new manufacturing processes inside companies like Nokia. The result was that all the mobile telephone manufacturers, including Nokia, were hit by falling profits in 2001-2002.

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The early markets for the new 3G technology were in Japan and Korea, where the GSM standard was not used. In addition, some of the Asian electronics manufacturers like Samsung and Sony realised that the new technology gave them another chance to enter the global mobile markets, particularly if they had missed out on the benefits of the GSM standard. Sony combined with Ericsson to launch a new joint venture and Samsung invested heavily in new 3G technology. The result was that Samsung had built a global market share of 14% by 2005 and Sony Ericsson had a share of 6%. However, Motorola still kept its second position with 17% of the market. Competition was therefore increasing for Nokia.

New Challenges and New Management

At this point, Nokia lost its way slightly. It failed to read customer demand correctly around the year 2003/2004. The new 'clam shell' folding designs and mid-price photo imaging screens from its competitors proved popular in the market place. Nokia did not move to match these but stuck with its existing 'stick' designs. There was some suggestion that this may partly have been because Nokia's economies of scale were more associated with its existing designs. Certainly, Nokia had easily the highest profit margins in the industry and was reluctant to reduce these. Eventually, Nokia decided that its dominant world market share was highly valuable and it would be preferable to reduce its prices, take a loss of profit margin and also introduce new 'clam shell' designs. At the end of 2004, the company's share had begun to rise again and was back around 35%.

More generally around 2004, Nokia realised that it needed to review its position. It had taken a hit from its competitors and it had failed to read the market changes fully. Importantly, it also faced new challenges that would come as 3G digital technology became the accepted medium of telephony. Essentially, this would open up opportunities that were unclear but potentially important – live transmission of television to mobile phones, new games to mobile phones, instant web access, etc. All these were technically feasible but still remained to be exploited fully. New mobile phones needed to be multimedia and also needed to consider the extent to which they would converge in terms of performance with other consumer electronics like the highly successful Apple iPod.

There was also another new trend that Nokia needed to master. The world market for mobile telephone providers was becoming more concentrated. Companies like Vodafone, Orange, Telekom and others were Nokia's major customers. The mobile telephone service customers were buying around 65-70% of all the world's mobiles, which they were then selling or offering free to customers. The Japanese electronics company Sharp had been able to move into mobile telephones from nothing in the early 2000s by doing a deal to supply Vodafone with some of its models. This was a serious matter for Nokia since such large customers required more than the standard models: customers like Vodafone wanted customised phones that would deliver competitive advantages over their rivals and large orders meant real bargaining power. Nokia has been hit hard by the strategies of Samsung, Motorola and Sony Ericsson. Nokia has responded with a new product range but has lost some market share. Nokia needed to introduce a whole new area of customer management for such large customers. "It's a very different era in terms of management requirements, in terms of skills, know-how, how you build your customer relationship," explained Nokia's Chief Executive, Ollila.

The outcome of all the above was the introduction of new management at Nokia in December 2004. 'From a management point of view, it began in spring or summer 2003 when we in the management team started discussing the need to look at the organisation afresh,' said Ollila. In a period of change in the industry, Nokia needed to adapt and restructure its management team. The result was that both Sari Baldauf and Matti Alahuhta left Nokia. Mr Alahuhta went to a leading position at another Finnish company and

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Baldauf to do something 'completely different'. Hence, as Nokia faced up to the new challenges, it decided that a new organisation structure and a new management team would be needed. Ollila commented: "You don't make generational changes easily. . . It's a big change. But change allows you to reposition, to rethink." Nokia's profitability had stabilised in the short term but the company needed to think carefully about new technologies, new trends and new strategic choices.

It was announced that Nokia's widely admired Chief Executive, Jorma Ollila, would be leaving this position in May 2006 but would remain non-executive Chairman. The Nokia Management team that guided the company to world leadership in mobile phones would largely have left the company.

Questions

1. Why did Nokia select only one area for development? What risk would it involve?
2. What problems did Nokia face in 2004?
3. What was the significance of the introduction of the new GSM system for Nokia's chosen strategy?
4. How important was the management team to strategic choice? Did it really have to change in 2004?

5.3 Summary

- The internal environment of an organisation contains the internal resources and possesses internal capabilities and core competencies.
- SWOT Analysis is a strategic planning method used to evaluate the Strengths, Weaknesses, Opportunities, and Threats involved in a project or in a business venture.

5.4 Keywords

Opportunities: A time or place favorable for executing a policy/strategy.

Resource: an asset, skill, process or knowledge controlled by an organisation.

SWOT Analysis: Strengths, Weakness, Opportunities and Threat Analysis.

Threat: A major unfavourable situation in a firm's environment.

5.5 Self Assessment

Fill in the blanks:

1. SWOT stands for ....., ..., ... and .....
2. An ..... is a major favourable situation in a firm's environment.
3. ..... is something a company possesses or is good at doing.
4. SWOT Analysis provides the "raw material" for analyzing ..... and ..... conditions of a firm.
5. ..... portrays the essence of strategy formulation.
6. SWOT's focus on the external environment is too .....

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7. ……is the starting point of developing competitive advantage.
8. Increase in competition and high inflation rate are potential……for a company.
9. At the……..stage of SWOT analysis, companies try to correct their major weaknesses.
10. ……matrix is just an extension of the SWOT matrix.

5.6 Review Questions

1. Suppose you are newly appointed CEO of a retail major. How would you perform the internal analysis to identify the resources and capabilities of the firm?
2. Analyses the role of internal analysis in strategy formulation.
3. What points would you keep in mind to enhance the quality of the material while devising a SWOT Analysis?
4. "SWOT Analysis portrays the essence of strategy formulation". Comment.
5. How would you carry out SWOT analysis for a software and electronic media company?
6. Critically assess the significance of SWOT Analysis in Strategic Management.
7. You are the CEO of a footwear manufacturing company. Your company manufactures shoes and sandals for both the sexes. The designs of the shoes and sandals have not changed over the years. Your shoes sold like hot cakes in early 2000s but now the sales have declined heavily. Analyse the situation and suggest appropriate solutions to get the company back on track.
8. Is it not enough for a company to analyse its own strengths and weaknesses? Justify your answer
9. "SWOT analysis stands at the core of strategic management". Substantiate
10. Conduct a SWOT analysis for any two major companies in the FMCG market.

Answers: Self Assessment

1. strengths, weaknesses, opportunities, threats
2. opportunity
3. Strength
4. internal, external
5. SWOT
6. narrow
7. Internal analysis
8. Threats
9. Translation
10. TOWS

Notes

5.7 Further Readings

Books

AA. Thompson and AJ. Strickland, *Strategic Management*, Business Publications, Texas, 1984.

Francis Cherunilam, *Strategic Management*, Himalaya Publishing Home, Mumbai, 1998.

Johnson Gerry and Sholes Kevan, *Exploring Corporate Strategy*, 6th Edition, Pearson Education Ltd., 2002.

Michael Porter, *Competitive Advantage*, Free Press, New York.

Online links

mystrategicplan.com/resources/internal-and-external-analysis

www.quickmba.com/strategy/swot

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Unit 6: Organisational Appraisal: Internal Assessment 2

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Objectives

After studying this unit, you will be able to:

- Realise the concept between strategy and culture
- Discuss value chain analysis
- Identify organisational capability factors
- Describe the concept of benchmarking

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Introduction

In the previous unit, we discussed about SWOT analysis which is a very important tool of carrying out internal analysis. In this unit we are going to learn the other tools that help a company conduct their internal analysis. The corporate level internal analysis is about identifying your businesses value proposition or core competencies. These are sometimes referred to as your core capabilities; strategic competitive advantages or competitive advantage these terms all represent essentially the same thing. The reason for completing an internal analysis is to allow you to create an exclusive market position.

6.1 Strategy and Culture

An organisation's culture can exert a powerful influence on the behaviour of all employees. It can, therefore, strongly affect a company's ability to adopt new strategies. A problem for a strong culture is that a change in mission, objectives, strategies or policies is not likely to be successful if it is in opposition to the culture of the company. Corporate culture has a strong tendency to resist change because its very existence often rests on preserving stable relationships and patterns of behaviour. For example, the male-dominated Japanese centered corporate culture of the giant Mitsubishi Corporation created problems for the company when it implemented its growth strategy in North America. The alleged sexual harassment of its female employees by male supervisors resulted in lawsuits and a boycott of the company's automobiles by women activists.

There is no one best corporate culture. An optimal culture is one that best supports the mission and strategy of the company. This means that, like structure and leadership, corporate culture should support the strategy. Unless strategy is in complete agreement with the culture, any significant change in strategy should be followed by a change in the organisation's culture. Although corporate cultures can be changed, it may often take long time and requires much effort. A key job of management therefore involves "managing corporate culture". In doing so, management must evaluate what a particular change in strategy means to the corporate culture, assess if a change in culture is needed and decide if an attempt to change culture is worth the likely costs.

'FIT' between Strategy and Culture

A culture grounded in values, practices and behavioural norms that match what is needed for good strategy implementation, helps energize people throughout the company to do their jobs in a strategy supportive manner. But when the culture is in conflict with some aspects of the company's direction, performance targets, or strategy, the culture becomes a stumbling block. Thus, an important part of managing the strategy implementation process is establishing and nurturing a good 'fit' between culture and strategy.

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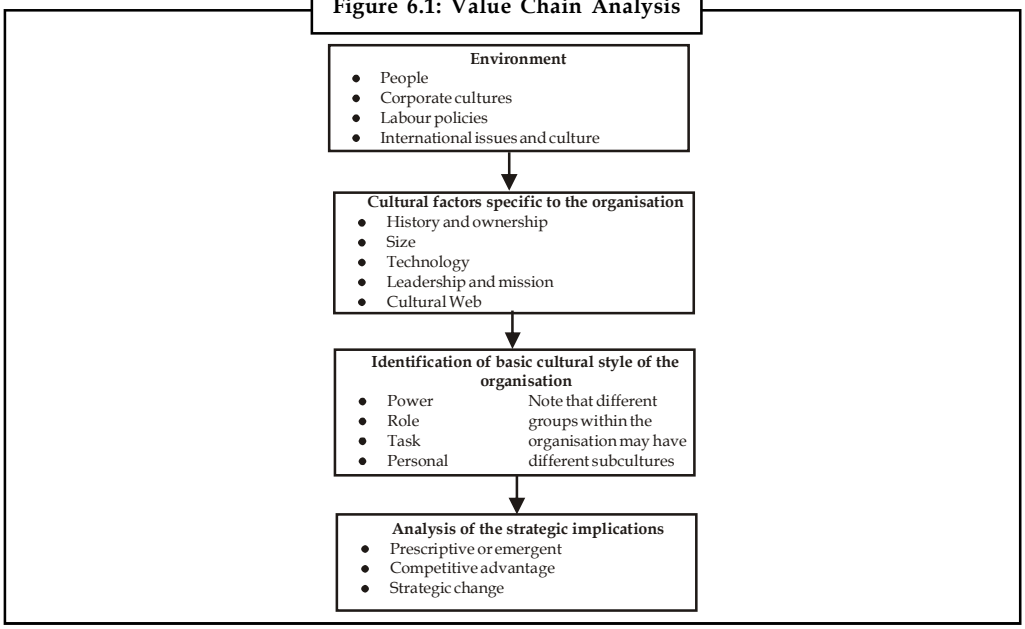
Figure 6.1: Value Chain Analysis



For this purpose, the main elements of organisational culture, as indicated in Figure 6.1 needs to be analyzed.

Assessing Strategy – Culture Match

When implementing a new strategy, a company should take time to assess strategy-culture compatibility by considering the following questions:

1. Is the planned strategy compatible with the company's current culture? If not,
2. Can the culture be easily modified to make it more compatible with the new strategy? If not,
3. Is management willing and able to make major organisational changes and likely increase in costs? If not,
4. Is management still committed to implement the strategy? If not,
5. Formulate a different strategy. If yes,
6. Manage cultural change.

Matching Strategy with Culture

When matching strategy with culture, it is important to understand:

1. There is no 'best' and 'worst' culture. The issue is how well the culture matches and supports the strategy of the organisation. Cultural mismatches are likely to occur when organisations are trying to adapt a new strategy.
2. This matching of strategy and culture is likely to become embedded over a period of time. That is, key elements of the strategy and the culture will reinforce each other gradually. In other words, the relationship between strategy and culture is usually self-perpetuating, each matching and reinforcing the other over a period of time.

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3. In many organisations, cohesiveness of culture is found at levels below the corporate entity. There is a continuing debate about the extent to which cohesiveness or diversity of culture is a strength or a weakness of the organisations.

Task Can you name few companies that have struggle due to their organisation culture? Consider one of them and write a short note.

Case Study

Organisational Culture at Southwest Airlines

In 1967, Air Southwest Co. (later Southwest Airlines Co.) was started by Rollin King and, John Parker, who were later joined by Herbert D. Kelleher.

They wanted to provide the best service with the lowest fares for short-haul, frequent-flying and point-to-point 'non-interlining' travelers The trio decided to commence operations in the state of Texas, connecting Houston, Dallas and San Antonio (which formed the 'Golden Triangle' of Texas). These cities were growing rapidly and were also too far apart for travelers to commute conveniently by rail or road. With other carriers pricing their tickets unaffordably high for most Texans, Southwest sensed an attractive business opportunity.

Southwest's objective was to provide safe, reliable and short duration air service at the lowest possible fare. With an average aircraft trip of roughly 400 miles, or a little over an hour in duration, the company had benchmarked its costs against ground transportation. Southwest focused on short-haul flying, which was expensive because planes spent more time on the ground relative to the time spent in the air, thus reducing aircraft productivity. Thus it was necessary for Southwest to have quick turnarounds of aircraft to minimize the time its aircraft spend on the ground.

Since its inception, Southwest attempted to promote a close-knit, supportive and enduring family-like culture. The company initiated various measures to foster intimacy and informality among employees. Southwest encouraged its people to conduct business in a loving manner. Employees were expected to care about people and act in ways that affirmed their dignity and worth. Instead of decorating the wall of its headquarters with paintings, the company hung photographs of its employees taking part at company events, news clippings, letters, articles and advertisements. Colleen Barrett even went on to send cards to all employees on their birthdays.

The organisational culture of the company was shaped by Kelleher's leadership also. Kelleher's personality had a strong influence on the culture of Southwest, which epitomized his spontaneity, energy and competitiveness. "Culture is the glue that holds our organisation together. It encompasses beliefs, expectations, norms, rituals, communication patterns, symbols, heroes, and reward structures. Culture is not about magic formulas and secret plans; it is a combination of a thousand things", he used to say.

Southwest's culture had three themes: love, fun and efficiency. Kelleher treated all the employees as a "lovely and loving family". Kelleher knew the names of most employees and insisted that they referred to him as Herb or Herbie. Kelleher's personality charmed workers and they reciprocated with loyalty and dedication. Friendliness and familiarity also characterized the company's relationships with its customers.

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Kelleher was so much into this culture that he once said, "Nothing kills your company's culture like layoffs. Nobody has ever been furloughed [at Southwest], and that is unprecedented in the airline industry. It's been a huge strength of ours. It's certainly helped us negotiate our union contracts. One of the union leaders….came in to negotiate one time, and he said, "We know we don't need to talk with you about job security." We could have furloughed at various times and been more profitable, but I always thought that was shortsighted. Post-September 11, 2001, when most airlines in the US went in for massive layoffs, Southwest avoided laying off any employee.

Southwest showed its people that it valued them and it was not going to hurt them just to get a little more money in the short term. The culture at the organisation spoke about its belief in the thought that not furloughing people breeds loyalty. At Southwest, it bred a sense of security and trust. So in bad times the organisation took care of them, and in good times they're thought, perhaps, "We've never lost our jobs. That's a pretty good reason to stick around."...

As a result, Southwest was the only airline to remain profitable in every quarter since the September 11 attack. Although its stock price dropped 25% since September 11, it was still worth more than all the others big airlines combined. Its balance sheet looked strong with a 43% debt-to-equity ratio and it had a cash of $1.8 billion with an additional $575 million in untapped credit lines. The entire credit to the profit was given to the loyal employee base the company had and it could be developed only as a result of the organisational culture at Southwest. The company left no stone unturned to boost employee loyalty and morale and made many a competitors to follow suit.

Questions

1. What do you analyse as the most influential characteristic of Southwest's culture?
2. Do you really think that the reason behind Southwest's profit's was its culture or the leadership was just playing it humble?
3. Do you think that following the Southwest way, the other airlines would have also made profits?

Source: www.ibscdc.com

6.2 Value Chain Analysis

Every organisation consists of a chain of activities that link together to develop the value of the business. They are basically purchasing of raw materials, manufacturing, distribution, and marketing of goods and services. These activities taken together form its value chain. The value chain identifies where the value is added in the process and links it with the main functional parts of the organisation. It is used for developing competitive advantage because such chains tend to be unique to an organisation. It then attempts to make an assessment of the contribution that each part makes to the overall added value of the business. Essentially, Porter linked two areas together:

1. the added value that each part of the organisation contributes to the whole organisation; and
2. the contribution that each part makes to the competitive advantage of the whole organisation.

In a company with more than one product area, the analysis should be conducted at the level of product groups, not at corporate strategy level.

Value Chain thus views the organisation as a chain of value-creating activities. Value is the amount that buyers are willing to pay for what a product provides them. A firm is profitable to

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the extent the value it receives exceeds the total cost involved in creating its products. Creating value for buyers that exceeds the cost of production (i.e. margin) is a key concept used in analyzing a firm's competitive position.

Notes The concept of value chain analysis was introduced by Michael Porter in 1985 in his seminal book "Competitive Advantage". This concept is derived from an established accounting practice that calculates the value added to a product by individual stages in a manufacturing or service process. Porter has applied this idea to the activities of an organisation as a whole, arguing that it is necessary to examine activities separately in order to identify sources of competitive advantage.

According to Porter, customer value is derived from three basic sources.

1. Activities that differentiate the product
2. Activities that lower its costs
3. Activities that meet the customer's need quickly.

Competitive advantage, argues Michael Porter (1985), can be understood only by looking at a firm as a whole, and cost advantages and successful differentiation are found in the chain of activities that a firm performs to deliver value to its customers.

6.2.1 Analysis

According to Porter, value chain activities are divided into two broad categories, as shown in the figure.

1. Primary activities
2. Support activities

Primary activities contribute to the physical creation of the product or service, its sale and transfer to the buyer and its service after the sale.

Support activities include such activities as procurement, HR etc. which either add value by themselves or add value through primary activities and other support activities.

Advantage or disadvantage can occur at any one of the five primary and four secondary activities, which together form the value chain for every firm.

Primary Activities

Inbound Logistics

These activities focus on inputs. They include material handling, warehousing, inventory control, vehicle scheduling, and returns to suppliers of inputs and raw materials.

Operations

These include all activities associated with transforming inputs into the final product, such as production, machining, packaging, assembly, testing, equipment maintenance etc.

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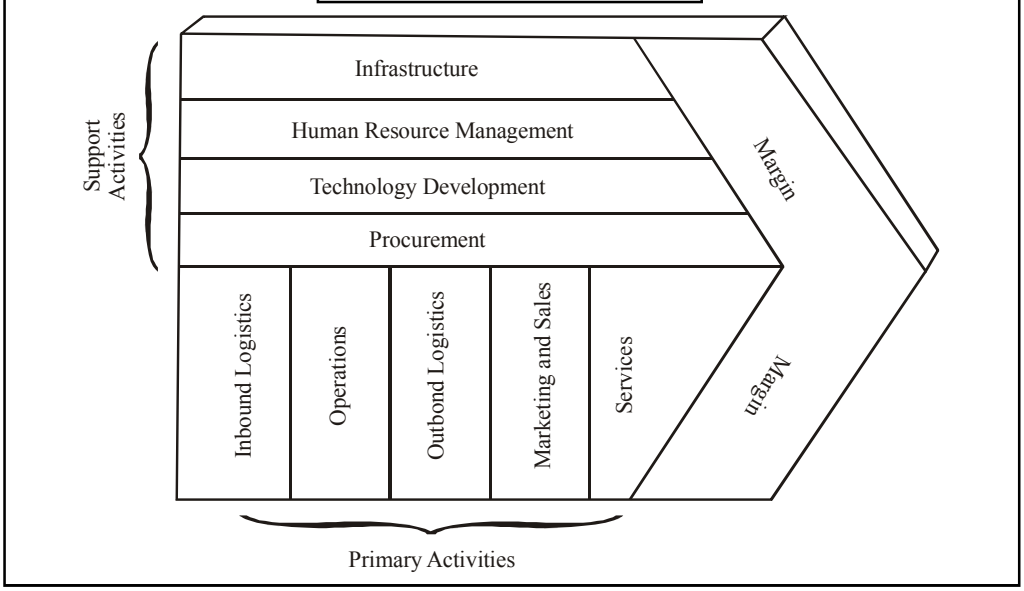
Outbound Logistics

These activities are associated with collecting, storing, physically distributing the finished products to the customers. They include finished goods warehousing, material handling and delivery, vehicle operation, order processing and scheduling.

Marketing and Sales

These activities are associated with purchase of finished goods by the customers and the inducement used to get them buy the products of the company. They include advertising, promotion, sales force, channel selection, channel relations and pricing.

Figure 6.2: Value Chain Analysis



Services

This includes all activities associated with enhancing and maintaining the value of the product. Installation, repair, training, parts supply and product adjustment are some of the activities that come under services.

Support Activities

Procurement

Activities associated with purchasing and providing raw materials, supplies and other consumable items as well as machinery, laboratory equipment, office equipment etc.

Porter refers to procurement as a secondary activity, although many purchasing gurus would argue that it is (at least partly) a primary activity. Included are such activities as purchasing raw materials, servicing, supplies, negotiating contracts with suppliers, securing building leases and so on.

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Technology Development

Activities relating to product R&D, process R&D, process design improvements, equipment design, computer software development etc.

Human Resource Management

Activities associated with recruiting, hiring, training, development, compensation, labour relations, development of knowledge-based skills etc.

Firm Infrastructure

Activities relating to general management, organisational structure, strategic planning, financial and quality control systems, management information systems etc.

Johnson and Sholes (2002) observe that few organisations undertake all activities from production of raw materials to the point–of–sale of finished products themselves. But, the value chain exercise must incorporate the whole process, that is, the entire value system. This means, for example, that even if an organisation does not produce its own raw materials, it must nevertheless seek to identify the role and impact of its supply sources on the final product. Similarly, even if it is not responsible for after-sales service, it must consider how the performance of those who deliver the service contribute to overall product/service cost and quality.

6.2.2 Conducting a Value Chain Analysis

Value chain analysis involves the following steps.

Identify Activities

The first step in value chain analysis is to divide a company's operations into specific activities and group them into primary and secondary activities. Within each category, a firm typically performs a number of discrete activities that may reflect its key strengths and weaknesses.

Allocate Costs

The next step is to allocate costs to each activity. Each activity in the value chain incurs costs and ties up time and assets. Value chain analysis requires managers to assign costs and assets to each activity. It views costs in a way different from traditional cost accounting methods. The different method is called activity-based costing.

Identify the Activities that Differentiate the Firm

Scrutinizing the firm's value chain not only reveals cost advantages or disadvantages, but also identifies the sources of differentiation advantages relative to competitors.

Examine the Value Chain

Once the value chain has been determined, managers need to identify the activities that are critical to buyer satisfaction and market success. This is essential at this stage of the value chain analysis for the following reasons:

1. If the company focuses on low-cost leadership, then managers should keep a strict vigil on costs in each activity. If the company focuses on differentiation, advantage given by each activity must be carefully evaluated.

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2. The nature of value chain and the relative importance of each activity within it, vary from industry to industry.
3. The relative importance of value chain can also vary by a company's position in a broader value system that includes value chains of upstream suppliers and downstream distributors and retailers.
4. The interrelationships among value-creating activities also need to be evaluated.

The final basic consideration in applying value chain analysis is the need to use a comparison when evaluating a value activity as a strength or weakness. In this connection, RBV and SWOT analysis will supplement the value chain analysis.

To get the most out of the value-chain analysis, as already noted, one needs to view the concept in a broader context. The value chain must also include the firm's suppliers, customers and alliance partners. Thus, in addition to thoroughly understanding how value is created within the organisation, one must also know how value is created for other organisations involved in the overall supply chain or distribution channel in which the firm participates.

Therefore, in assessing the value chains there are two levels that must be addressed.

1. Interrelationships among the activities within the firm.
2. Relationships among the activities within the firm and with other organisations that are a part of the firm's expanded value chain.

6.2.3 Usefulness of the Value Chain Analysis

The value chain analysis is useful to recognize that individual activities in the overall production process play an important role in determining the cost, quality and image of the end-product or service. That is, each activity in the value chain can contribute to a firm's relative cost position and create a basis for differentiation, which are the two main sources of competitive advantage. While a basic level of competence is necessary in all value chain activities, management needs to identify the core competences that the organisation has or needs to have to compete effectively. Analyzing the separate activities in the value chain helps management to address the following issues:

1. Which activities are the most critical in reducing cost or adding value? If quality is a key consumer value, then ensuring quality of supplies would be a critical success factor.
2. What are the key cost or value drivers in the value chain?
3. What linkages help to reduce cost, enhance value or discourage imitation?
4. How do these linkages relate to the cost and value drivers?

Porter identified the following as the most important cost and value drivers:

Cost Drivers

1. Economies of scale
2. Pattern of capacity utilization (including the efficiency of production processes and labour productivity)
3. Linkages between activities (for example, timing of deliveries affect storage costs, just-in time system minimizes inventory costs)
4. Interrelationships (for example, joint purchasing by two units reduces input costs)

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5. Geographical location (for example, proximity to supplies reduces input costs)
6. Policy choices (such as the choices on the product mix, the number of suppliers used, wage costs, skills requirements and other human resource policies affect costs)
7. Institutional factors (which include political and legal factors, each of which can have a significant impact on costs).

Value Drivers

Value drivers are similar to cost drivers, but they relate to other features (other than low price) valued by buyers. Identifying value derivers comes from understanding customer requirements, which may include:

1. Policy choices (choices such as product features, quality of input materials, provision of customer services and skills and experience of staff).
2. Linkages between activities (for example, between suppliers and buyers; sales and after-sales staff).

The cost and value drivers vary between industries. The value chain concept shows that companies can gain competitive advantage by controlling cost or value drivers and/or reconfiguring the value chain, that is, a better way of designing, producing, distributing or marketing a product or service. For example, Ryanair has become one of the most profitable airlines in Europe through concentrating on the parts of its value chain, such as ticket transaction costs, no frills etc.

6.3 Organisational Capability Factors

Organisations capabilities lies in its resources. The resources are the means by which an organisation generates value. It is this value that is then distributed for various purposes. Resources and capabilities of a firm can be best explained with the help of Resource Based View (RBV) of a firm which is popularized by Barney. RBV considers the firm as a bundle of resources – tangible resources, intangible resources, and organisational capabilities. Competitive advantage, according to this view, generally arises from the creation of bundles of distinctive resources and capabilities.

6.3.1 Resources

A 'resource' can be an asset, skill, process or knowledge controlled by an organisation. From a strategic perspective, an organisation's resources include both those that are owned by the organisation and those that can be accessed by the organisation to support its strategies. Some strategically important resources may be outside the organisation's ownership, such as its network of contacts or customers.

Typically, resources can be grouped into four categories:

1. ***Physical resources*** include plant and machinery, land and buildings, production capacity etc.
2. ***Financial resources*** include capital, cash, debtors, creditors etc.
3. ***Human resources*** include knowledge, skills and adaptability of human resources.
4. ***Intellectual capital*** is an intangible resource of an organisation. This includes the knowledge that has been captured in patents, brands, business systems, customer databases and relationships with partners. In a knowledge-based economy, intellectual capital is likely to be the major asset of many organisations.

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Capabilities

Resources are not very productive on their own. They need organisational capabilities. Organisational capabilities are the skills that a firm employs to transform inputs into outputs. They reflect the ability of the firm in combining assets, people and processes to bring about the desired results. Prahalad and Hamel describe an organisational competence as a "bundle of skills and technologies", which are integrated in people skills and business processes.

Capabilities are, therefore a function of the firm's resources, their application and organisation, internal systems and processes, and firm specific skill sets. Capabilities are rarely unique, and can be acquired by other firms as well in that industry. Some of these capabilities may become "distinctive competencies", when a firm performs them better than its rivals.

Core Competence

Superior performance does not merely come from resources alone because they can be imitated or traded. Superior performance comes by the way in which the resources are deployed to create competences in the organisation's activities. For example, the knowledge of an individual will not improve an organisation's performance unless he or she is allowed to work on particular tasks which exploit that knowledge. Although an organisation will need to achieve a threshold level of competence in all of the activities and processes, only some will become core competences.

Core competence refers to that set of distinctive competencies that provide a firm with a sustainable source of competitive advantage. Core competencies emerge over time, and reflect the firm's ability to deploy different resources and capabilities in a variety of contexts to gain and sustain competitive advantage.

Core competences are activities or processes that are critically required by an organisation to achieve competitive advantage. They create and sustain the ability to meet the critical success factors of particular customer groups better than their competitors in ways that are difficult to imitate. In order to achieve this advantage, core competences must fulfill the following criteria.

It must be:

1. an activity or process that provides customer value in the product or service features.
2. an activity or process that is significantly better than competitors.
3. an activity or process that is difficult for competitors to imitate.

Task Enlist at least five types of resources that all organisations have.

An organisation uses different types of resources and exhibits a certain type of organisational capabilities to leverage those resources to bring about a competitive advantage, as shown in Figure 6.3.

It is important to emphasize that resources by themselves do not yield a competitive advantage. Those resources need to be integrated into value creating activities. Thus the central theme of RBV is that competitive advantage is created and sustained through the bundling of several resources in unique combinations. Thus,

1. Competence is something an organisation is good at doing.
2. Core competence is a proficiently performed internal activity.

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3. Distinctive competence is an activity that a company performs better than its rivals.
4. Distinctive competencies become the basis for competitive advantage.

Figure 6.3: Creation of Competitive Advantage

Barney, in his VRIO framework of analysis, suggests four questions to evaluate a firm's key resources.

1. ***Value:*** Does it provide competitive advantage?
2. ***Rareness:*** Do other competitors possess it?
3. ***Imitability:*** Is it costly for others to imitate?
4. ***Organisation:*** Is the firm organised to exploit the resource?

If the answer to these questions is "yes" for a particular resource, that resource is considered a strength and a distinctive competence.

Using Resources to Gain Competitive Advantage: Grant proposes a five-step resource based approach to strategy analysis.

1. Identify and classify the firm's resources in terms of strengths and weaknesses.
2. Combine the firm's strengths into specific capabilities.
3. Appraise the profit potential of these resources and capabilities.
4. Select the strategy that best exploits the firm's resources and capabilities relative to external opportunities.
5. Identify resource gaps and invest in overcoming weaknesses.

6.3.2 Strategic Importance of Resources

Johnson and Sholes (2002) explain the strategic importance of resources with the concept of 'strategic capability'. According to them, strategic capability is the ability of an organisation to put its resources and capabilities to the best advantage so as to enable it to gain competitive advantage. There are three type of resources:

Available Resources

Strategic capability depends on the resources available to an organisation because it is the resources used in the activities of the organisation that create competences. As already explained

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above, resources can be typically grouped under four headings: Physical resources, human resources, financial resources and intellectual capital.

Threshold Resources

A set of basic resources are needed by a firm for its existence and survival in the marketplace. These resources are called 'threshold resources'. But this threshold tends to increase with time. So, a firm needs to continuously improve this threshold resource base just to stay in business.

Figure 6.4: Resources, Competences and Competitive Advantage

	Same as competitors' or easy to imitate	Better than competitors' and difficult to imitate*
RESOURCES	Threshold resources	Unique resources
COMPETENCES	Threshold competences	Core competences

*Provides the basis to outperform competitors or demonstratably provide better value for money

Unique Resources

Unique resources are those resources that are critically required to achieve competitive advantage. They are better than competitors' resources and are difficult to imitate. The ability of an organisation to meet the critical success factors in a particular market segment depends on these unique resources. To illustrate unique resources, Johnson and Sholes quote the example of some libraries having unique collection of books, which contain knowledge not available elsewhere, and the example of retail stores located in prime locations, which can charge higher than average prices. Similarly, some organisations have patented products or services that are unique, which give them advantage.

Caution For service organisations, unique resources may be particularly talented individuals – such as surgeons or teachers or lawyers. But they may leave the organisation or poached by a rival. So, trying to sustain long-term advantage only through unique resources may be very difficult.

6.3.3 Critical Success Factors

Critical Success Factors (CSFs) are defined as the resources, skills and attributes of an organisation that are essential to deliver success in the market place. CSFs are also called "Key Success Factors" (KSFs) or "Strategic Factors". They are the key factors which are critical for organisational success and survival.

Critical success factors will vary from one industry to another. For example, in the perfume and cosmetics industry, the critical success factors include branding, product distribution and product performance, but are unlikely to include low labour costs, which is a very important CSF for steel companies. CSFs can be used to identify elements of the environment that are particularly worth exploring.

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It is very important to identify the CSFs for a particular industry. Many elements relate not only to the *environment* but also to the *resources* of organisations in the industry. To identify the CSFs in an industry, it is therefore useful to examine the type of resources and the way they are employed in the industry and then use this information to analyze the environment outside the organisation. Hence CSFs require an exploration of the resources and skills of the industry before they can be applied to the environment.

Importance of Critical Success Factors

The Japanese strategist Kenichi Ohamae, the former head of the management consultants Mc Kinsey, in Japan, has suggested that the CSFs (or key success factors, as he calls them) are likely to deliver the company's objectives. He argues that, when resources of capital, labour and time are scarce, it is important that they should be concentrated on the key activities of the firm, that is, those activities that are considered most important to the delivery of whatever the organisation regards as success.

Ohamae treats CSFs as a basic business strategy for competing wisely in any industry. He suggests identifying the CSFs in an industry or business and then to "inject resources into the most important business functions." The aim is to invest in the parts of the company that matter most for its success.

Rockart (1979) has applied the CSFs approach to several organisations through a three step process for determining CSFs. These steps are:

1. ***Generate CSFs*** (asking, What does it take to be successful in business?)
2. ***Convert CSFs into objectives*** (asking, "What should the organisation's goals and objectives be with respect to CSFs)
3. ***Set Performance standards*** (asking "How will we know whether the organisation has been successful in this factor?")

Rockart has also identified four major sources of CSFs:

1. ***Structure of the industry:*** Some CSFs are specific to the structure of the industry. For example, the extent of service support expected by the customers. Automobile companies have to invest in building a national network of authorized service stations to ensure service delivery to their customers.
2. ***Competitive strategy, industry position and geographic location:*** CSFs also arise from the above factors. For example, the large pool of English-speaking manpower makes India an attractive location for outsourcing the BPO needs of American and British firms.
3. ***Environmental factors:*** CSFs may also arise out of the general/business environment of a firm, like the deregulation of Indian Industry. With the deregulation of telecommunications industry, many private companies had opportunities of growth.
4. ***Temporal factors:*** Certain short-term organisational developments like sudden loss of critical manpower (like the charismatic CEO) or break-up of the family owned business, may necessitate CSFs like "appointment of a new CEO" or "rebuilding the company image". Temporarily such CSFs would remain CSFs till the time they are achieved.

6.4 Benchmarking

Benchmarking is the process of comparing the business processes and performance metrics including cost, cycle time, productivity, or quality to another that is widely considered to be an industry standard benchmark or best practice. Essentially, benchmarking provides a snapshot of the performance of a business and helps one understand where one is in relation to a particular

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standard. The result is often a business case and "Burning Platform" for making changes in order to make improvements.

Also referred to as "best practice benchmarking" or "process benchmarking", it is a process used in management and particularly strategic management, in which organisations evaluate various aspects of their processes in relation to best practice companies' processes, usually within a peer group defined for the purposes of comparison. This then allows organisations to develop plans on how to make improvements or adapt specific best practices, usually with the aim of increasing some aspect of performance. Benchmarking may be a one-off event, but is often treated as a continuous process in which organisations continually seek to improve their practices.

Types of Benchmarking

Benchmarking can be of following types:

1. ***Process benchmarking:*** the initiating firm focuses its observation and investigation of business processes with a goal of identifying and observing the best practices from one or more benchmark firms. Activity analysis will be required where the objective is to benchmark cost and efficiency; increasingly applied to back-office processes where outsourcing may be a consideration.
2. ***Financial benchmarking:*** performing a financial analysis and comparing the results in an effort to assess your overall competitiveness and productivity.
3. ***Benchmarking from an investor perspective:*** extending the benchmarking universe to also compare to peer companies that can be considered alternative investment opportunities from the perspective of an investor.
4. ***Performance benchmarking:*** allows the initiator firm to assess their competitive position by comparing products and services with those of target firms.
5. ***Product benchmarking:*** the process of designing new products or upgrades to current ones. This process can sometimes involve reverse engineering which is taking apart competitors products to find strengths and weaknesses.
6. ***Strategic benchmarking:*** involves observing how others compete. This type is usually not industry specific, meaning it is best to look at other industries.
7. ***Functional benchmarking:*** a company will focus its benchmarking on a single function in order to improve the operation of that particular function. Complex functions such as Human Resources, Finance and Accounting and Information and Communication Technology are unlikely to be directly comparable in cost and efficiency terms and may need to be disaggregated into processes to make valid comparison.
8. ***Best-in-class benchmarking:*** involves studying the leading competitor or the company that best carries out a specific function.
9. ***Operational benchmarking:*** embraces everything from staffing and productivity to office flow and analysis of procedures performed.

There is no single benchmarking process that has been universally adopted. The wide appeal and acceptance of benchmarking has led to various benchmarking methodologies emerging. The first book on benchmarking, written by Kaiser Associates, offered a 7-step approach. Robert Camp (who wrote one of the earliest books on benchmarking in 1989) developed a 12-stage approach to benchmarking.

Notes

The 12 stage methodology consisted of:

1. Select subject ahead
2. Define the process
3. Identify potential partners
4. Identify data sources
5. Collect data and select partners
6. Determine the gap
7. Establish process differences
8. Target future performance
9. Communicate
10. Adjust goal
11. Implement
12. Review/recalibrate.

The following is an example of a typical benchmarking methodology:

1. ***Identify your problem areas:*** Because benchmarking can be applied to any business process or function, a range of research techniques may be required. They include: informal conversations with customers, employees, or suppliers; exploratory research techniques such as focus groups; or in-depth marketing research, quantitative research, surveys, questionnaires, re-engineering analysis, process mapping, quality control variance reports, or financial ratio analysis. Before embarking on comparison with other organisations it is essential that one knows one's own organisation's function, processes; base lining performance provides a point against which improvement effort can be measured.
2. ***Identify other industries that have similar processes:*** For instance if one were interested in improving hand offs in addiction treatment he/she would try to identify other fields that also have hand off challenges. These could include air traffic control, cell phone switching between towers, transfer of patients from surgery to recovery rooms.
3. ***Identify organisations that are leaders in these areas:*** Look for the very best in any industry and in any country. Consult customers, suppliers, financial analysts, trade associations, and magazines to determine which companies are worthy of study.
4. ***Survey companies for measures and practices:*** Companies target specific business processes using detailed surveys of measures and practices used to identify business process alternatives and leading companies. Surveys are typically masked to protect confidential data by neutral associations and consultants.
5. ***Visit the "best practice" companies to identify leading edge practices:*** Companies typically agree to mutually exchange information beneficial to all parties in a benchmarking group and share the results within the group.
6. ***Implement new and improved business practices:*** Take the leading edge practices and develop implementation plans which include identification of specific opportunities, funding the project and selling the ideas to the organisation for the purpose of gaining demonstrated value from the process.

Notes

Caselet

XEROX – Benchmarking Story

The history of Xerox goes back to 1938, when Chester Carlson, a patent attorney and part-time inventor, made the first xerographic image in the US. Carlson struggled for over five years to sell the invention, as many companies did not believe there was a market for it. Finally, in 1944, the Battelle Memorial Institute in Columbus, Ohio, contracted with Carlson to refine his new process, which Carlson called 'electrophotography.' Three years later, The Haloid Company, maker of photographic paper, approached Battelle and obtained a license to develop and market a copying machine based on Carlson's technology.

Haloid later obtained all rights to Carlson's invention and registered the 'Xerox' trademark in 1948. Buoyed by the success of Xerox copiers, Haloid changed its name to Haloid Xerox Inc in 1958, and to The Xerox Corporation in 1961. Xerox was listed on the New York Stock Exchange in 1961 and on the Chicago Stock Exchange in 1990. It is also traded on the Boston, Cincinnati, Pacific Coast, Philadelphia, London and Switzerland exchanges. The strong demand for Xerox's products led the company from strength to strength and revenues soared from $37 millions in 1960 to $268 millions in 1965.

Throughout the 1960s, Xerox grew by acquiring many companies, including University Microfilms, Micro-Systems, Electro-Optical Systems, Basic Systems and Ginn and Company. In 1962, Fuji Xerox Co. Ltd. was launched as a joint venture of Xerox and Fuji Photo Film.

Xerox acquired a majority stake (51.2%) in Rank Xerox in 1969. During the late 1960s and the early 1970s, Xerox diversified into the information technology business by acquiring Scientific Data Systems (makers of time-sharing and scientific computers), Daconics (which made shared logic and word processing systems using minicomputers), and Vesetec (producers of electrostatic printers and plotters).

In 1969, it set up a corporate R&D facility, the Palo Alto Research Center (PARC), to develop technology in-house. In the 1970s, Xerox focused on introducing new and more efficient models to retain its share of the reprographic market and cope with competition from the US and Japanese companies. While the company's revenues increased from $ 698 millions in 1966 to $ 4.4 billions in 1976, profits increased five-fold from $ 83 millions in 1966 to $ 407 millions in 1977. As Xerox grew rapidly, a variety of controls and procedures were instituted and the number of management layers was increased during the 1970s. This, however, slowed down decision-making and resulted in major delays in product development.

In the early 1980s, Xerox found itself increasingly vulnerable to intense competition from both the US and Japanese competitors. According to analysts, Xerox's management failed to give the company strategic direction. It ignored new entrants (Ricoh, Canon, and Sevin) who were consolidating their positions in the lower-end market and in niche segments. The company's operating cost (and therefore, the prices of its products) was high and its products were of relatively inferior quality in comparison to its competitors. Xerox also suffered from its highly centralized decision-making processes. As a result of this, return on assets fell to less than 8% and market share in copiers came down sharply from 86% in 1974 to just 17% in 1984. Between 1980 and 1984, Xerox's profits decreased from $ 1.15 billions to $ 290 millions.

Contd...

Notes

In 1982, David T. Kearns (Kearns) took over as the CEO. He discovered that the average manufacturing cost of copiers in Japanese companies was 40-50% of that of Xerox. As a result, Japanese companies were able to undercut Xerox's prices effortlessly. Kearns quickly began emphasizing reduction of manufacturing costs and gave new thrust to quality control by launching a program that was popularly referred to as 'Leadership Through Quality.' As part of this quality program, Xerox implemented the benchmarking program. These initiatives played a major role in pulling Xerox out of trouble in the years to come. The company even went on to become one of the best examples of the successful implementation of benchmarking.

Source: www.icmrindia.org

6.5 Summary

- Culture is a powerful component of an organisation's success, laying the tracks for strategy to roll out on.
- It is the foundation for profit, productivity and progress. While it can accelerate getting to the next level of performance, it can just as easily act as drag.
- Culture-strategy Fit is a leading organisational culture consulting firm conducting ground breaking culture diagnosis and change projects to help organisations leverage their culture to drive strategy and performance.
- It involves specifying the objective of the business venture or project and identifying the internal and external factors that are favorable and unfavorable to achieving that objective.
- A value chain is a chain of activities.
- Products pass through all activities of the chain in order and at each activity the product gains some value.
- The chain of activities gives the products more added value than the sum of added values of all activities.
- It is important not to mix the concept of the value chain with the costs occurring throughout the activities.
- Benchmarking is an improvement tool whereby a company measures its performance or process against other companies' best practices, determines how those companies achieved their performance levels.
- Benchmarking uses the information to improve its own performance.

6.6 Keywords

Assimilation: The acquired firm willingly surrenders its culture and adopts the culture of the acquiring company.

Benchmarking: The concept of discovering what is the best performance being achieved, whether in your company, by a competitor, or by an entirely different industry.

Cultural Fit: Compatibility of culture with other arenas.

Deculturation involves imposition of the acquiring firm's culture forcefully on the acquired firm.

Notes

Integration involves merging the two cultures in such a way that separate cultures of both firms are preserved in the resulting culture.

Value Chain: Value chain is 'a string of companies working together to satisfy market demands.'

6.7 Self Assessment

Fill in the blanks:

1. An organisation's ..... can exert a powerful influence on the behaviour of all employees.
2. An optimal culture is one that best supports the ..... and ..... of the company.
3. A culture grounded in ....., ... and ..... norms that match what is needed for good strategy implementation.
4. An important part of managing the strategy implementation process is establishing and nurturing a good 'fit' between ..... and .....
5. When implementing a new strategy, a company should take time to assess .....
6. Once a strategy is established, it is difficult to .....
7. Changing a company's culture to align it with ..... is one of the toughest management tasks.
8. Changing culture requires both ..... actions and ..... actions.
9. Leaders must emphasize ..... values through internal company communications.
10. The greater the gap between the cultures of the two firms, the ..... the executives in the acquired firm quit their jobs.

6.8 Review Questions

1. As a strategy manager, what would you do if you find that the culture of your organisation is in conflict with company's direction and performance targets?
2. "Organisation does not have a "best" or a "worst" culture". Substantiate.
3. To be a good manager, one must expertly use symbols, role models, and ceremonial occasions to achieve the strategy culture fit. Why/why not?
4. "Integration of culture remains atop challenge in majority of mergers and acquisitions". Why?
5. Explain the rationale behind benchmarking with the help of suitable examples.
6. Do you think that each activity in the value chain can contribute to a firm's relative cost position and create a basis for differentiation? Why/why not?
7. Explain the concept of value chain with the help of figure and suitable examples.
8. Conduct a value chain analysis for a computer system manufacturing company.
9. "Resources alone can't do any good for a company. " Elucidate
10. Discuss the organizational resources from a strategic point of view.

Notes

Answers: Self Assessment

1.	culture	2.	mission, strategy
3.	values, practices, behavioural	4.	culture, strategy
5.	strategy-culture compatibility	6.	change
7.	strategy	8.	symbolic, substantive
9.	dominant	10.	faster

6.9 Further Readings

Books

AA. Thompson and AJ. Strickland, *Strategic Management*, Business Publications, Texas, 1984.

Francis Cherunilam, *Strategic Management*, Himalaya Publishing Home, Mumbai, 1998.

Johnson Gerry and Sholes Kevan, *Exploring Corporate Strategy*, 6th Edition, Pearson Education Ltd., 2002.

Michael Porter, *Competitive Advantage*, Free Press, New York.

Online links

humanresources.about.com/.../organisationalculture/.../culture

www.isixsigma.com/me/benchmarking

Unit 7: Corporate Level Strategies

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Objectives

After studying this unit, you will be able to:

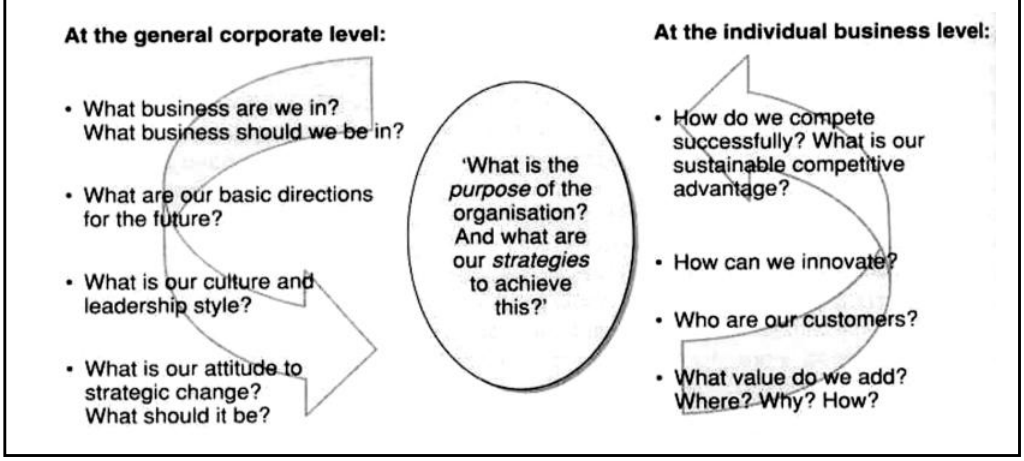
- Discuss the expansion strategies: concentration, integration and diversification
- Explain the retrenchment and combination strategies
- State the concept of internationalisation
- Describe the concept of cooperation and restructuring

Notes

Introduction

Corporate strategy is primarily about the choice of direction for the corporation as a whole. The basic purpose of a corporate strategy is to add value to the individual businesses in it. A corporate strategy involves decisions relating to the choice of businesses, allocation of resources among different businesses, transferring skills and capabilities from one set of businesses to others, and managing and nurturing a portfolio of businesses in such a way as to obtain synergies among product lines and business units, so that the corporate whole is greater than the sum of its individual business units. The essence of a corporate strategy vis-a-vis a business-level strategy is summarized in Figure 7.1.

Figure 7.1



Managers at the corporate level act on behalf of shareholders and provide strategic guidance to business units. In these circumstances, a key question that arises is to what extent and how might the corporate level add value to what the businesses do; or at least how it might avoid destroying value.

Corporate strategy is thus concerned with two basic issues:

1. What businesses should a firm compete in?
2. How can these businesses be coordinated and managed so that they create "Synergy."

Notes Synergy means that the whole is greater than the sum of its parts. In organisational terms, synergy means that as separate departments within an organisation co-operate and interact, they become more productive than if each were to act in isolation. In strategic management, the corporate parent has to create synergy among the separate business units by effectively coordinating their activities, so that the corporate whole is greater than the sum of the independent units. Synergy is said to exist for a multi-divisional corporation if the return on investment (ROI) of each division is greater than what the return would be if each division were an independent business.

According to Goold and Campbell, synergy can take place in one of the six forms:

1. ***Shared Know-how:*** Combined units often benefit from sharing knowledge and skills. This is also called a leveraging of core competencies.

Contd...

Notes

2. ***Coordinated Strategies:*** Alligning the business strategies of two or more business units may provide a company with synergy by reducing competition, and developing a coordinated response to common competitors.
3. ***Shared Tangible Resources:*** Combined units can sometimes save money by sharing resources, such as a common manufacturing facility or R&D lab.
4. ***Economies of Scale or Scope:*** Coordinating the flow of products or services of one unit with that of another unit can reduce inventory, increase capacity utilization and improve market access.
5. ***Pooled Negotiating Power:*** Combined units can combine their purchasing to gain bargaining power over common suppliers to reduce costs and improve quality. The same can be done with common distributors.
6. ***New Business Creation:*** Exchanging knowledge and skills can facilitate new products or services by combining the separate activities in a new unit or by establishing joint ventures among internal business units.

7.1 Expansion Strategies

Growth strategies are the most widely pursued corporate strategies. Companies that do business in expanding industries must grow to survive. A company can grow internally by expanding its operations or it can grow externally through mergers, acquisitions, joint ventures or strategic alliances.

Reasons for Pursuing Growth Strategies

Firms generally pursue growth strategies for the following reasons:

1. ***To obtain economies of scale:*** Growth helps firms to achieve large-scale operations, whereby fixed costs can be spread over a large volume of production.
2. ***To attract merit:*** Talented people prefer to work in firms with growth.
3. ***To increase profits:*** In the long run, growth is necessary for increasing profits of the organisation, especially in the turbulent and hyper–competitive environment.
4. ***To become a market leader:*** Growth allows firms to reach leadership positions in the market. Companies such as Reliance Industries, TISCO etc. reached commanding heights due to growth strategies.
5. ***To fulfill natural urge:*** A healthy firm normally has a natural urge for growth. Growth opportunities provide great stimulus to such urge. Further, in a dynamic world characterized by the growth of many firms around it, a firm would have a natural urge for growth.
6. ***To ensure survival:*** Sometimes, growth is essential for survival. In some cases, a firm may not be able to survive unless it has critical minimum level of business. Further, if a firm does not grow when competitors are growing, it may undermine its competitiveness.

Categories of Growth Strategies

Growth strategies can be divided into three broad categories:

1. Intensive Strategies
2. Integration Strategies
3. Diversification Strategies

Notes

Concentration Strategies

Without moving outside the organisation's current range of products or services, it may be possible to attract customers by intensive advertising, and by realigning the product and market options available to the organisation. These strategies are generally referred to as intensification or concentration strategies. By intensifying its efforts, the firm will be able to increase its sales and market share of the current product-line faster. This is probably the most successful internal growth strategy for firms whose products or services are in the final stages of the product life cycle. Most of the approaches of intensive strategies deal with product-market realignments.

Thus, there are three important intensive strategies:

1. Market penetration
2. Market development
3. Product development

1. ***Market penetration:*** Market penetration seeks to increase market share for existing products in the existing markets through greater marketing efforts. This includes activities like increasing the sales force, increasing promotional effort, giving incentives etc. Market penetration is generally achieved through the following three major approaches:

   (a) *Increasing sales to the current customers:* This can be done through:

   (i) Increasing the size of the purchase

   (ii) Advertising other uses

   (iii) Giving price incentives for increased use

   For example, if customers of toothpaste who brush once a day are convinced to brush twice a day, the sales of the product to the current consumers might almost double.

   (b) *Attracting competitor's customers:* If the firm succeeds in making the customers to switch from the competitor's brands to the firm's brands, while maintaining its existing customers intact, there will be an increase in the firm's sales. This can be done through:

   (i) Increasing promotional effort

   (ii) Establishing sharper brand differentiation

   (iii) Offering price cuts

   (c) *Attracting non-users to buy the product:* If there are a significant number of non-users of a product who could be made users of the product, there will be an opportunity to increase market share. This can be done through:

   (i) Inducing trial use through sampling, price incentives etc.

   (ii) Advertising new uses

Notes In India, there is a very large rural market for cosmetics, which can be tapped through this approach. This strategy will be effective when:

1. Current markets are not saturated
2. Usage rate of present customers is low
3. Economies of scale can bring down the costs
4. Market shares of major competitors are declining while total sales are increasing

Notes

2. ***Market Development:*** Market development seeks to increase market share by selling the present products in new markets. This can be achieved through the following approaches:

   (a) *By entering new geographic markets:* A company, which has been confined to some part of a country, may expand to other parts and foreign markets. Thus, market development can be achieved through:

      (i) Regional expansion

      (ii) National expansion

      (iii) International expansion

Example: Nirma, which was confined to local markets or some parts of the country in the beginning, later expanded to the regional market and then to the national market.

   (b) *By entering new market segments:* This can be achieved through:

      (i) Developing product versions to appeal to other segments

      (ii) Entering other channels of distribution

      (iii) Advertising in other media

Example: Hindustan Lever entered the low price detergent segment by introducing a low-priced detergent called "Wheel" to compete with "Nirma". This strategy will be effective when:

(i) New untapped or unsaturated markets exist

(ii) New channels of distribution are available

(iii) The firm has excess production capacity

(iv) The firm's industry is becoming rapidly global

(v) The firm has resources for expanded operations

3. ***Product Development:*** Product development seeks to increase the market share by developing new or improved products for present markets.

   This can be achieved through:

   (a) Developing new product features

   (b) Developing quality variations

   (c) Developing additional models and sizes (product proliferation)

Example: Hindustan Lever keeps on adding new brands or improved versions of consumer products from time to time to maintain its market share. This strategy will be effective when:

(a) The firm's products are in maturity stage

(b) The firm witnesses one of the rapid technological developments in the industry

(c) The firm is in a high growth industry

(d) Competitors bring out improved quality products from time to time

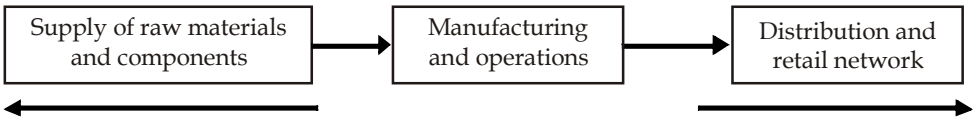
(e) The firm has strong R&D capabilities.

Notes

Integrative Strategies

Integration basically means combining activities relating to the present activity of a firm. Such a combination can be done on the basis of the industry value chain. A company performs a number of activities to transform an input to output. These activities include right from the procurement of raw materials to the production of finished goods and their marketing and distribution to the ultimate consumers. These activities are also called value chain activities; the value chain activities of an industry are shown in Figure 7.2. So, a firm that adopts integration may move forward or backward the industry value chain.

Figure 7.2: Industry Value Chain



Expanding the firm's range of activities backward into the sources of supply and/or forward into the distribution channels is called "Vertical Integration". Thus, if a manufacturer invests in facilities to produce raw materials or component parts that it formerly purchased from outside suppliers, it remains in the same industry, but its scope of operations extend to two stages of the industry value chain. Similarly, if a manufacturer opens a chain of retail outlets to market its products directly to consumers, it remains in the same industry, but its scope of operations extend from manufacturing to retailing. Viewed from a broader angle, the firm's own value chain activities are often closely linked to the value chain activities of the suppliers and distributors. Suppliers' value chain is important because the costs, performance features and quality of the inputs influence a firm's own costs and product differentiation capabilities. Anything the firm does to lower costs or improve quality of its inputs, will enhance its own competitiveness in the market. Similarly, the costs and margins paid to distributors and retailers become a part of the price the consumers pay. Besides, the activities of distributors and retailers affect consumers' satisfaction.

Vertical integration can be:

1. ***Full integration:*** participating in all stages of the industry value chain.
2. ***Partial integration:*** participating in selected stages of the industry value chain.

A firm can pursue vertical integration by starting its own operations or by acquiring a company already performing the activities it wants to bring in house. Thus, integration is basically of two types:

1. Vertical integration and
2. Horizontal integration

Vertical Integration

As already explained above, vertical integration involves gaining ownership or increased control over suppliers or distributors. Vertical integration is of two types:

1. ***Backward Integration:*** Backward integration involves gaining ownership or increased control of a firm's suppliers. For example, a manufacturer of finished products may take over the business of a supplier who manufactures raw materials, component parts and other inputs. Brooke Bond's acquisition of tea plantations is an example of backward integration.

Notes

Backward Integration increases the dependability of the supply and quality of raw materials used as production inputs. This strategy is generally adopted when:

(a) Present suppliers are unreliable, too costly or cannot meet the firm's needs.

(b) The firm's industry is growing rapidly.

(c) The number of suppliers is small, but the number of competitors is large.

(d) Stable prices are important to stabilize cost of raw materials.

(e) Present suppliers are getting high profit margins.

(f) The firm has both capital and human resources to manage the new business.

2. ***Forward Integration:*** Forward integration involves gaining ownership or increased control over distributors or retailers. For example, textile firms like Reliance, Bombay Dyeing, JK Mills (Raymond's) etc. have resorted to forward integration by opening their own showrooms.

   Forward Integration is generally adopted when:

   (a) The present distributors are expensive, or unreliable or incapable of meeting the firm's needs.

   (b) The availability of quality distributors is limited.

   (c) The firm's industry is growing and will continue to grow.

   (d) The advantages of stable production are high.

   (e) Present distributors or retailers have high profit margins.

   (f) The firm has both the capital and human resources needed to manage the new business.

Advantages of Vertical Integration: The following are the advantages of vertical integration:

1. A secure supply of raw materials or distribution channels.
2. Control over raw materials and other inputs required for production or distribution channels.
3. Access to new business opportunities and technologies.
4. Elimination of need to deal with a wide variety of suppliers and distributors.

Risks

1. Increased costs, expenses and capital requirements.
2. Loss of flexibility in investments.
3. Problems associated with unbalanced facilities or unfulfilled demand.
4. Additional administrative costs associated with managing a more complex set of activities.

Caution Sometimes, half-hearted commitment of wholesalers and retailers frustrate a company's attempt to boost sales and market share. In such an event, forward integration is the best strategy.

Notes

Disadvantages of Vertical Integration: The following are the disadvantages of vertical integration

1. It boosts the firm's capital investment.
2. It increases business risk.
3. It denies financial resources to more worthwhile pursuits.
4. It locks a firm into relying on its own in-house sources of supply.
5. It poses all kinds of capacity-matching problems.
6. It calls for radically different skills and capabilities, which may be lacked by the manufacturer.
7. Outsourcing of component parts may be cheaper and less complicated than in-house manufacturing.

Most of the world's automakers, despite their expertise in automobile technology and manufacturing, strongly feel that purchasing many of their key parts and components from manufacturing specialists result in:

1. Higher quality
2. Lower costs
3. Greater design flexibility

So, they feel that vertical integration option is not preferable.

Weighing the Pros and Cons of Vertical Integration: All in all, vertical integration strategy can have both strengths and weaknesses. The choice depends on:

1. Whether vertical integration can enhance the performance of the organisation in ways that lower costs, build expertise or increase differentiation.
2. Whether vertical integrations impact on costs, flexibility, response times and administrative costs of coordinating more activities, are more justified.
3. Whether vertical integration substantially enhances a company's competitiveness.

If there are no solid benefits, vertical integration will not be an attractive strategic option. In many cases, companies prefer to focus on a narrow scope of activities and rely on outsiders to perform the remaining activities.

In today's world of close working relationships with suppliers and distributors and with efficient supply chain management systems, very few firms can make a case for backward integration just for the purposes of ensuring a reliable supply of raw materials or components, or to reduce production costs.

Guidelines for Vertical Integration: The guidelines for vertical integration are as follows:

1. If the performance of suppliers or distributors is satisfactory, it is not appropriate to take over these activities.
2. Highly fluctuating sales or demand for the products of the organisation can either strain resources (when demand is high) or result in unutilized capacity (when demand is low). The cycle of "boom and bust" is not conducive to integration.
3. The strategy of vertical integration may be viable if there is a likelihood of expansion of capacity in the near future.

Notes

Task Give examples of vertical integration and assess the validity and feasibility of those integrations.

Horizontal Integration

Horizontal integration is a strategy of seeking ownership or increased control over a firm's competitors. Some authors prefer to call this as horizontal diversification. By whichever name it is called, this strategy generally involves the acquisition, merger or takeover of one or more similar firms operating at the same stage of the industry value chain.

Recent acquisition of Arcelor by Mittal Steels and the acquisition of Corus by Tata Steel are good examples of horizontal integration.

The most important advantage of horizontal integration is that it generally eliminates or reduces competition. Other advantages are:

1. It yields access to new markets.
2. It provides economies of scale.
3. It allows transfer of resources and capabilities.

When horizontal integration is appropriate

Horizontal integration is an appropriate strategy when:

1. A firm competes in a growing industry.
2. Increased economies of scale provide a major competitive advantage.
3. A firm has both the capital and human talent needed to successfully manage an expanded organisation.
4. Competitors are faltering due to lack of managerial expertise or resources, which the firm has.

It should be noted that horizontal integration might not be an appropriate strategy if competitors are doing poorly due to an overall decline in industry sales.

Some increased risks are associated with both types of integration. For horizontally integrated firms, the risk comes from increased commitment to one type of business. For vertically integrated firms, the risk comes from shortage of managers with appropriate skills or expertise to manage the expanded activities. If there is much more potential profit in downstream or upstream activities, it is better to go in for vertical integration.

Diversification Strategies

Diversification is the process of adding new businesses to the existing businesses of the company. In other words, diversification adds new products or markets to the existing ones. A diversified company is one that has two or more distinct businesses. The diversification strategy is concerned with achieving a greater market from a greater range of products in order to maximize profits. From the risk point of view, companies attempt to spread their risk by diversifying into several products or industries.

Example: An air-conditioning company may add room-heaters in its present product lines, or a company producing cameras may branch off into the manufacturing of copying machines.

Notes

Diversification can be achieved through a variety of ways:

1. Through mergers and acquisitions.
2. Through joint ventures and strategic alliances.
3. Through starting up a new unit (internal development)

Thus, the first concern in diversifying is what new industries to get into and whether to enter by starting a new business unit or by acquiring a company already in the industry or by forming a joint venture or strategic alliance with another company. A company can diversify narrowly into a few industries or broadly into many industries. The ultimate objective of diversification is to build shareholder value i.e., increasing value of the firm's stock.

Reasons for Diversification: The important reasons for a company diversifying their business are:

1. ***Saturation or decline of the current business:*** If the company is faced with diminishing market opportunities and stagnating sales in its principal business, it may become necessary to enter new businesses to achieve growth.
2. ***Better opportunities:*** Even when the current business provides scope for further growth, there may be better opportunities in new lines of business. A firm in a "sunset industry" may be tempted to enter a "sunrise industry."
3. ***Sharing of resources and strengths:*** Diversification enables companies to leverage existing competencies and capabilities by expanding into businesses where these resources become valuable competitive assets. By sharing production facilities, technological capabilities, managerial expertise, distribution channels, sales force, financial resources etc., synergy can be obtained.
4. ***New avenues for reducing costs:*** Diversifying into closely related businesses opens new avenues for reducing costs.
5. ***Technologies and products:*** By expanding into industries, the company can obtain new technologies and products, which can complement its present businesses.
6. ***Use of brand name:*** Through diversification, the company can transfer its powerful and well-known brand name to the products of other businesses.
7. ***Risk minimization:*** The big risk of a single-business firm is having all its eggs in one industry basket. If the market is eroded by the appearance of new technologies, new products or fast–changing consumer preferences, then a company's prospects can quickly diminish.

Example: Digital cameras have diminished markets for film and film processing; CD and DVD technology has replaced cassette tapes and floppy disks and mobile phones are dominating landline phones. Thus, there are substantial risks to single-business companies, and diversification into other businesses minimizes this risk. But diversification itself can become risky.

Risks of Diversification: Diversification has several risks. They are:

1. There is no guarantee that the firm will succeed in the new business. In fact, many diversifications have been failures.
2. If the new lines of business result in huge losses, that adversely affects the main business of the company.

Notes

3. Diversification may sometimes result in neglect of the old business.

4. Diversification may invite retaliatory moves by competitors, which may adversely affect even the old businesses.

Types of Diversification: Broadly, there are two types of diversification:

1. Concentric diversification.

2. Conglomerate diversification.

1. ***Concentric Diversification:*** Adding a new, but related business is called concentric diversification. It involves acquisition of businesses that are related to the acquiring firm in terms of technology, markets or products. The selected new business has compatibility with the firm's current business.

   The ideal concentric diversification occurs when the combined profits increase the strengths and opportunities and decrease the weaknesses and threats. Thus, the acquiring firm searches for new businesses whose products, markets, distribution channels and technologies are similar to its own, and whose acquisition results in "Synergy''. This is possible with related diversification because companies strive to enter product markets that share resources and capabilities with their existing business units.

   Diversification must create value for shareholders. But this is not always the case. Acquiring firms typically pay premiums when they acquire a target firm. Besides, the risks and uncertainties are high. Why do firms still go in for diversification? The answer, in one word, is "Synergy".

   In related diversification, synergy comes from businesses sharing tangible and intangible resources. Additionally, firms can enhance their 'market power' through pooled negotiating power. There are other advantages of concentric diversification.

   Advantages

   (a) Increases the firm's stock value.

   (b) Increases the growth rate of the firm.

   (c) Better use of funds than ploughing them back into internal growth.

   (d) Improves the stability of earnings and sales.

   (e) Balances the product line when the life cycle of the current products has peaked.

   (f) Helps to acquire a needed resource quickly (e.g. technology or innovative management etc.)

   (g) Achieves tax savings.

   (h) Increases efficiency and profitability through synergy.

   (i) Reduces risk.

2. ***Conglomerate diversification:*** Adding a new, but unrelated business is called conglomerate diversification. The new business will have no relationship to the company's technology, products or markets. For example, ITC which is basically a cigarette manufacturer, has diversified into hotels, edible oils, financial services etc. Similarly, Reliance Industries, which is basically a textile manufacturer, has diversified into petro chemicals, telecommunications, retailing etc.

   Unlike concentric diversification, conglomerate diversification does not result in much of synergy. The main objective is profit motive. But it has important advantages.

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Advantages

(a) Business risk is scattered over diverse industries.

(b) Financial resources are invested in industries that offer the best profit prospects.

(c) Buying distressed businesses at a low price can enhance shareholder wealth.

(d) Company profitability can be more stable in economic upswings and downswings.

Disadvantages

(a) It is difficult to manage different businesses effectively.

(b) The new business may not provide any competitive advantage if it has no strategic-fits

The differences between concentric and conglomerate diversification are summarized below:

Table 7.1: Differences between Concentric and Conglomerate Diversifications

Sl. No	Concentric Diversification	Conglomerate Diversification
1.	The company diversifies into businesses *related* to the existing businesses.	The company diversifies into businesses that are *unrelated* to the existing businesses.
2.	There is *commonality* in markets, products or technology.	*No commonality* in markets, products or technology.
3.	The main objective is to increase shareholder value through *"synergy"*, which is achieved through sharing of skills, resources and capabilities.	The main objective is to increase shareholder value through *profit maximization*.
4.	Less risky.	More risky.

Caselet

Diversification brings Success for ITC

For ITC Ltd., 2007-08 continued to be year of quiet growth. Just more launches in its relatively new segment of non-cigarettes fast-moving consumer goods, and solid growth. As in the past few years, ITC's non-cigarettes businesses continued to grow at a scorching pace, accounting for a bigger share of overall revenues. "The non-cigarette portfolio grew by 37.6% during 2006-07 and accounted during that year for 52.3% of the company's net turnover," an ITC spokesman said. In fact, over the first three quarters of 2007-08, ITC's non-cigarette FMCG businesses have grown by 48% on the same period last year, "Indicating that its plans for increasing market share and standing are succeeding".

The branded packaged foods business continued to expand rapidly, with the focus on snacks range Bingo. The biscuit category continued its growth momentum with the 'Sunfeast' range of biscuits launching 'Coconut' and 'Nice' variants and the addition of 'Sunfeast BenneVita Flaxseed' biscuits. Aashirvaad atta and kitchen ingredients retained their top slots at the national level, with the spices category adding an organic range. In the confectionery category, which grew by 38% in the third quarter, ITC cited AC Nielsen data to claim market leader status in throat lozenges. Instant mixes and pasta powered the sales of its ready-to-eat foods under the Kitchens of India and Aashirvaad brands.

In Lifestyle apparel, ITC launched Miss Players' fashion wear for young women to complement its range for men.

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Overall, the biscuit category grew by 58% during the last quarter, ready-to-eat foods under the Kitchens of India and Aashirvaad brands by 63%, and the lifestyle business by 26%.

For the industry, the most significant initiative to watch was ITC's foray into premium personal care products with its Fiama Di Wills range of shampoos, conditioners, shower gels, and soaps. In the popular segment, ITC has launched a range of soaps and shampoos under the brand name Superia.

Ravi Naware, chief executive of ITC's foods business, was quoted recently as saying that the business will make a positive contribution to ITC's bottomline in the next two to three years.

In hotels, ITC's Fortune Park brand was making the news during the year, with a rapid rollout of first class business hotels.

In the agri-business segment, the e-choupal network is trying out a pilot in retailing fresh fruits and vegetables. The e-choupals have already specialised in feeding ITC high quality wheat and potato, among other commodities, grown by farmers with help from the e-choupal.

Source: Financial Express, Article by Somnath Dasgupta

Diversification into both Related and Unrelated Businesses: Some companies may diversify into both related and unrelated businesses. The actual practice varies from company to company. There are three types of enterprises in this respect:

1. ***Dominant business enterprises:*** In such enterprises, one major "core" business accounts for 50 to 80 per cent of total revenues and the remaining comes from small related and unrelated businesses, e.g. TISCO.
2. ***Narrowly diversified enterprise:*** These are enterprises that are diversified around a few (two to five) related or unrelated businesses e.g. BPL.
3. ***Broadly diversified enterprises:*** These enterprises are diversified around a wide-ranging collection of related and unrelated businesses e.g. ITC, Reliance Industries.

Means to Achieve Integration or Diversification: Profitable growth is one of the prime objectives of any business firm. Growth can be achieved internally or externally. Internal growth in assets, sales and profits takes place when the firm introduces a new product or increases the capacity for the existing products through setting up a new plant. Increasing the capacities through internal growth takes time and involves lot of risk. Alternatively, business firms can suddenly increase their growth rate by acquisitions, mergers, etc. These strategies are often referred to as cooperation strategies.

As already mentioned, growth especially by way of integration or diversification can be achieved through four basic means:

1. Mergers and acquisitions
2. Joint ventures
3. Strategic alliances
4. Internal development

With the opening up of the Indian economy, business firms have the freedom to expand, diversify and modernize the operations and set up new undertakings. Market forces continue to play the role and experienced entrepreneurs always remain in search of opportunities to take over units and to expand their operations. So the free economic environment plays a very important role in accelerating the merger and acquisition activities.

Notes

Task Give examples of companies that have recently opted for diversification into unrelated businesses. Can you find out the reasons behind their diversification?

7.2 Retrenchment Strategies

They are the last resort strategies. A company may pursue retrenchment strategies when it has a weak competitive position in some or all of its product lines resulting in poor performance – sales are down and profits are dwindling. In an attempt to eliminate the weaknesses that are dragging the company down, management may follow one or more of the following retrenchment strategies.

1. Turnaround
2. Divestment
3. Bankruptcy
4. Liquidation

7.2.1 Turnaround Strategy

A firm is said to be sick when it faces a severe cash crunch or a consistent downtrend in its operating profits. Such firms become insolvent unless appropriate internal and external actions are taken to change the financial picture of the firm. This process of recovery is called "turnaround strategy".

Any successful turnaround strategy consists of three inter-related phases:

1. The first phase is the diagnosis of impending trouble. Many authors and research studies have indicated distinct early warning signals of corporate sickness.
2. The second phase involves analyzing the causes of sickness to restore the firm on its profit track. These measures are of both short-term and long-term nature.
3. The third and final phase involves implementation of change process and its monitoring.

When Turnaround becomes Necessary

Do companies turn sick overnight and qualify as potential candidates for turnaround or do they become sick slowly which can be stopped by timely corrective action? Obviously, the latter is true in most of the cases. But the reality is also that companies becoming sick often do not themselves recognize this fact, and fail to take timely action to remedy the situation.

Despite the fact that factors that lead to sickness may vary from company to company, there are some common signals which herald the onset of sickness. John M Harris has listed a dozen danger signals of impending sickness.

1. ***Decreasing market share:*** This is the most significant symptom of a major sickness. A company which is losing its market share to competition needs to sit up and take careful note. Regular monitoring of market share helps companies to keep a tag on their performance in the market vis-à-vis their competitors. Any indication of declining market share should trigger off immediate corrective action.

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2. ***Decreasing constant rupee sales:*** Sales figures, to be meaningful, should be adjusted for inflation. If constant rupee sales figures are showing a declining trend, then this is a danger signal to watch out.

3. ***Decreasing profitability:*** Profit figures are a good indication of a company's health. Care must be taken to interpret the profit figures correctly, so as to avoid any misjudgments. Decreasing profitability can show up as smaller profits in absolute terms or lower profits per rupee of sales or decreasing return on investment or smaller profit margins.

4. ***Increasing dependence on debt:*** A company overly reliant on debt soon gets into a tight corner with very few options left. A substantial rise in the amount of debt, a lopsided debt-to-equity ratio and a lowered corporate credit rating may cause banks and other financial institutions to impose restrictions and become reluctant to lend money. Once financial institutions are hesitant to lend money, the company's rating on the stock market also slides down and it becomes very difficult for the company to raise funds from the public too.

5. ***Restricted dividend policies:*** Dividends frequently missed or restricted dividends signal danger. Often, such companies may have earlier paid substantially higher proportion of earnings as dividends when in fact they should have been reinvesting in the business. Current inability to pay dividends is an indication of the gravity of the situation.

6. ***Failure to reinvest sufficiently in the business:*** For a company to stay competitive and keep on the fast growth track, it is essential to reinvest adequate amounts in plant, equipment and maintenance. When a business is growing, the combination of new investments and reinvestments often warrants borrowing. Companies which fail to recognize this fact and try to finance growth with only their internal funds are applying brakes in the path of growth.

7. ***Diversification at the expense of the core business:*** It is a well-observed fact that once companies reach a particular level of maturity in the existing business, they start looking for diversification. Often this is done at the cost of the core business, which then starts to deteriorate and decline. Diversification in new ventures should be sought as a supplement and not as a substitute for the primary core business.

8. ***Lack of planning:*** In many companies, particularly those built by individual entrepreneurs, the concept of planning is generally lacking. This can often result in major setbacks as limited thought or planning go into the actions and their consequences.

9. ***Inflexible chief executives:*** A chief executive who is unwilling to listen to fresh ideas from others is a signal of impending bad news. Even if the CEO recognises the danger signals, his unwillingness to accept any proposal from his subordinates further blocks the path towards recovery.

10. ***Management succession problems:*** When nearly all the top managers are in their mid-fifties, there may be a serious vacuum at the second line of command. As these older managers retire or leave because of perception of decreasing opportunities, there is bound to be serious management crisis.

11. ***Unquestioning boards of directors:*** Directors, who have family, social or business ties with the chief executive or have served very long on the board, may no longer be objective in their judgment. Thus, these directors serve limited purpose in terms of questioning or cautioning the CEO about his actions.

12. ***A management team unwilling to learn from its competitors:*** Companies in decline often adopt a closed attitude and are not willing to learn anything from their competitors. Companies which have survived tough competitive times continuously analyse their competitors' moves.

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Types of Turnaround Strategies

Slater has classified the turnaround strategies into two broad categories. These are strategic turnaround and operating turnaround. Whether a sick business needs strategic or operating turn-around can be ascertained by analysing the current strategic and operating health of the business. The operating turnarounds are easier to carry out and can be applied only when there are average to strong strategic strengths (product-market relationship) in the business.

The strategic turnaround choices may involve either a new way to compete existing business or entering an altogether new business. Entering a new business as a turnaround strategy can be approached through the process of product portfolio management. The strategic turnaround focuses either on increasing the market share in a given product-market framework or by shifting the product-market relationship in a new direction by re-positioning.

The operating turnaround strategies are of four types. These are:

1. Revenue-increasing strategies
2. Cost-cutting strategies
3. Asset-reduction strategies
4. Combination strategies

The focus of all these choices is on short-term profit. Thus, if a sick firm is operating much below its break-even, it must take steps to reduce the levels of fixed cost and help in reducing the total costs of the firm. In real life, it is always a difficult choice to identify the assets which can be sold without affecting the productivity of the business. To identify saleable assets, the firm may have to keep in mind its strategic move in the next two to three years. The turnaround strategies appropriate under different circumstances are:

If the sick firm is operating substantially but not extremely below its break-even point, then the most appropriate turnaround strategy is the one which generates extra revenues. These may be in the form of price reduction to increase sales, stimulating product demand through promotional efforts or sometimes by introducing scaled down versions of the main products of the firm. The increased quantities of product sales not only result in higher sales but also reduce the per unit cost, thus leading to higher operating profits.

If the firm is operating closer but below break-even point then the turnaround strategy calls for application of combination strategies. Under combination strategies cost-reducing, revenue generating and asset-reduction actions are pursued simultaneously in an integrated and balanced manner. The combination strategies have a direct favourable impact on cash flows as well as on profits.

If the firm is operating around break-even point, it usually needs cost-reduction strategies, since cost-reduction actions are easily carried out as compared to revenue generating actions, the former is usually preferred for quick short-term profit increases.

Slater has, however, linked the choice of turnaround strategies to the causes of decline. The recommended choice of strategies includes change in management and organisational processes, improved financial controls, growth via acquisition and new financial strategies.

Closely associated to the choice of turnaround strategy is the concept of turnaround process. We will focus on this aspect in the next section.

Turnaround Process

The process of turning a sick company into a profitable one is rather complex and difficult. It is complex because a successful turnaround strategy demands corrective actions in many deficient areas of the firm. It is necessary that all these actions are integrated and do not contradict each other.

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The turnaround process is difficult because it involves perceptual and attitudinal changes at all levels as far as employees are concerned. These human change processes tend to become very sensitive when the firm is in a crisis situation. Therefore, many a time, a change in the leadership or even an active intervention from outside is suggested for bringing about such changes in the organisation.

As soon as the parameters of corporate performance are indicative of unsatisfactory corporate performance, it becomes necessary to immediately tighten the controls within the organisation. Effective controls have a positive impact on cost-reduction, that is, profit improvement and also on the net cash-flows of the firm. But this tightening of the financial and administrative control do not guarantee a stable turnaround process. In fact, controls coupled with poor quality image of the product may hasten the process of corporate failure. So while the controls are being effected, it is necessary that the strategic posture of the company may also be overhauled. This involves major changes in the product-mix, customer-mix and the pattern of resources deployment in the company. These two stages of change further need to be complemented by changes in top management and many organisational processes. If these changes produce early results which are satisfactory, then for long-term effects it is necessary to reinforce these changes.

Prahlad and Thomas have presented ten propositions for turning around sick units. These propositions are:

1. Revival of a sick unit requires the formulation and implementation of a new strategy.
2. Localising problems and sequencing the corrective actions helps in the revival of the sick unit.
3. The successful implementation of the turnaround strategy requires appropriate organisation structure, a participative type of decision making environment, effective administrative and budgetary controls, training, performance evaluation, career progression and rewards.
4. The turnaround strategy must focus on profit generation and profits must be regarded as a legitimate goal.
5. The acceptance and the commitment of managers and employees of the organisation towards revival measures must be high if not total. Openness in management processes helps in gaining commitment and thus facilitates the implementation process.
6. Openness in the change process leads to confidence in the top management and its strategy.
7. Understanding of technical processes and problem-solving attitude in overcoming technical snags is essential for turning around sick companies.
8. Consultants can play a vital role in objective analysis of problems as well as in implementing innovative changes.
9. The active support given to the chief executive by the appointing authorities is critical for the implementation of turnaround strategy.
10. Leadership provides the focus for action in sick units.

Thus, from these propositions, it is evident that in any turnaround process, the important issues are strategy, the management process, the technical competence and the leadership.

7.2.2 Divestment

Selling a division or part of an organisation is called divestiture. This strategy is often used to raise capital for further strategic acquisitions or investments. Divestiture is generally used as a

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part of turnaround strategy to get rid of businesses that are unprofitable, that require too much capital or that do not fit well with the firm's other activities.

Divestiture is an appropriate strategy to be pursued under the following circumstances:

1. When a business cannot be turned around
2. When a business needs more resources than the company can provide
3. When a business is responsible for a firm's overall poor performance
4. When a business is a misfit with the rest of the organisation
5. When a large amount of cash is required quickly
6. When government's legal actions threaten the existence of a business.

Reasons for Divestitures

1. ***Poor fit of a division:*** When the parent company feels that a particular division within the company cannot be managed profitably, it may think of selling the division to another company. This does not mean the division itself is unprofitable. The other firm with greater expertise in the line of business could manage the division more profitably. This means the division can be managed better by someone else than the selling company.
2. ***Reverse synergy:*** Synergy refers to additional gains that can be derived when two firms combine. When synergy exists, the combined entity is worth more than the sum of the parts valued separately. In other words, 2 + 2 = 5. Reverse synergy exists when the parts are worth more separately than they are within the parent company's corporate structure. In other words, 2 + 2 = 3. In such a case, an outside bidder might be able to pay more for a division than what the division is worth to the parent company.
3. ***Poor performance:*** Companies may want to divest divisions when they are not sufficiently profitable. The division may earn a rate of return, which is less than the cost of capital of the parent company. A division may turn out to be unprofitable due to various reasons such as increase in the material and labour cost, decline in the demand etc.
4. ***Capital market factors:*** A divestiture may also take place because the post divestiture firm, as well as the divested division, has greater access to capital markets. The combined capital structure may not help the company to attract the capital from the investors. Some investors are looking at steel companies and others may be looking for cement companies. These two groups of investors are not interested in investing in combined company, with cement and steel businesses due to the cyclical nature of businesses. So each group of investors are interested in stand-alone cement or steel companies. So divestitures may provide greater access to capital markets for the two firms as separate companies rather than the combined corporation.
5. ***Cash flow factors:*** Selling a division results in immediate cash inflows. The companies that are under financial distress or in insolvency may be forced to sell profitable and valuable divisions to tide over the crisis.
6. ***To release the managerial talent:*** Sometime the management may be overburdened with the management of the conglomerate leading to inefficiency. So they sell one or more divisions of the company. After the divestiture, the existing management can concentrate on the remaining businesses and can conduct the business more efficiently.
7. ***To correct the mistakes committed in investment decisions:*** Many companies in India diversified into unrelated areas during the pre-liberalization period. Afterwards they realised that such a diversification into unrelated areas was a big mistake. To correct the mistake committed earlier, they had to go for divestiture. This is because they moved into product market areas with which they had less familiarity than their existing activities.

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8. ***To realise profit from the sale of profitable divisions:*** This type of divestiture occurs when a firm acquires under-performing businesses, makes it profitable and then sells it to other companies. The parent company may repeat this process to make profit out of it.

9. ***To reduce the debt burden:*** Many companies sell their assets or divisions to reduce their debt and bring the balance in the capital structure of the firm.

10. ***To help to finance new acquisitions:*** Companies may sell less profitable divisions and buy more profitable divisions in order to increase the profitability of the company as a whole.

Types of Divestitures

1. ***Spin-off:*** It is a kind of demerger when an existing parent company distributes on a pro-rata basis the shares of the new company to the shareholders of the parent company free of cost. There is no money transaction, subsidiary's assets are not revalued, and transaction is treated as stock dividend. Both the companies exist and carry on their businesses independently after spin-off. During spin-off, a new company comes into existence. The shareholders of the parent company become the shareholders of the new company spun-off.

   The motivations for a spin-off are similar to that of divestitures.

   (a) *Involuntary Spin-off:* When faced with an adverse regulatory ruling, a firm may be forced to spin-off to comply with the legal formalities.

   (b) *Defensive Spin-off:* Defensive spin-off is a takeover defence. Company may choose to spin-off divisions to make it less attractive to the bidder.

   (c) *Tax consequences of Spin-off:* Shares allotted to the shareholders during spin-off is not taxed as capital gain or as dividend.

   Example: ITC has spun-off hotel business from the company and formed ITC Hotels Ltd.

2. ***Sell-off:*** It is a form of restructuring, where a firm sells a division to another company. When the business unit is sold, payment is received generally in the form of cash or securities.

   When the firm decides to sell a poorly performing division, this asset goes to another owner, who presumably values it more highly because he can use the asset more advantageously than the seller. The seller receives cash in the place of asset. So the firm can use this cash more efficiently than it was utilising the asset that was sold. The firm can also get premium for the assets because the buyer can more advantageously use such assets.

   Sell-off generally have positive impact on the market price of shares of both the buyer and seller companies. So sell-offs are beneficial for the shareholders of both the companies.

3. ***Voluntary corporate liquidation or bust-ups:*** It is also known as complete sell-off. The companies normally go for voluntary liquidation because they create value to the shareholders. The firm may have a higher value in liquidation than the current market value. Here the firm sells its assets/divisions to multiple parties which may result in a higher value being realised than if they had to be sold as a whole. Through a series of spin-offs or sell-offs a company may go ultimately for liquidation.

4. ***Equity carveouts:*** It is a different type of divestiture and different form of spin-off and sell-off. It resembles Initial Public Offering (IPO) of some portion of equity stock of a wholly owned subsidiary by the parent company.

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The parent company may sell a 100% interest in subsidiary company or it may choose to remain in the subsidiary's line of business by selling only a partial interest (shares) and keeping the remaining percentage of ownership. After the sale of shares to the public, the subsidiary company's shares will be listed and traded separately in the capital market. The parent company receives cash from the sale of shares of the subsidiary company. The parent company may still control the company by holding controlling interest in the subsidiary.

Many firms look to equity carveouts as a means of reducing their exposure to a riskier line of business. They also help to raise funds for the parent company.

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Spin-offs vs. Equity Carveouts

The following are the differences between the spin-offs and equity carveouts:

1. In case of spin-off, there is no new set of shareholders. The same shareholders in the parent company become shareholders in the spun-off company.

   In case of equity carveouts, there will be new shareholders as shares are sold to the public.

2. In case of spin-off, there is no cash inflow to the parent company. The shareholders of the parent company are allotted free shares in the new company.

   In case of equity carveouts, as the shares of the subsidiary company are sold to the public, this results in cash inflow to the parent company.

3. In case of spin-off, there is a formation of a new company.

In case of equity carveouts, there is no new company that comes into existence. Here the shares of a subsidiary company are now offered to the public for sale.

5. ***Leveraged buyouts (LBO's):*** A leveraged buyout is an acquisition of a company in which the acquisition is substantially financed through debt. Debt typically forms 70-90% of the purchase price. Much of the debt may be secured by the assets of the company (asset based lending). Firms with assets that have a high collateral value can more easily obtain such loans. So LBOs are generally found in capital intensive industries. Debt is obtained on the basis of company's future earnings potential.

   In LBOs, a buyer generally looks for a company with high growth rate and good market share. The company should be profitable and the demand for the product should be known and stable, so that the earnings can be forecasted. The company should have low debt and its liquidity position should be very good. Low operating risk of such companies allows the acquisition with high degree of financial leverage and risk.

   The lender is prepared to lend even if the company is highly leveraged because he has full confidence in the abilities of buyer to fully utilise the potential of the business and convert it into an enormous value. He also charges high rate of interest for the loan as it involves high risk.

7.2.3 Bankruptcy

This is a form of defensive strategy. It allows organisations to file a petition in the court for legal protection to the firm, in case the firm is not in a position to pay its debts. The court decides the claims on the company and settles the corporation's obligations.

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7.2.4 Liquidation

Liquidation occurs when an entire company is dissolved and its assets are sold. It is a strategy of the last resort. When there are no buyers for a business which wants to be sold, the company may be wound up and its assets may be sold to satisfy debt obligations.

Liquidation becomes the inevitable strategy under the following circumstances:

1. When an organisation has pursued both turnaround strategy and divestiture strategy, but failed.
2. When an organisation's only alternative is bankruptcy. A company can legally declare bankruptcy first and then wind up the company to raise needed funds to pay debts.
3. When the shareholders of a company can minimize their losses by selling the assets of a business.

Case Study

Tracking the Turnaround of Indian Railways

It's a turnaround story that has not only amazed management experts but also caught the attention of premier global business schools like Harvard and Wharton - the dramatic return to profitability for the 154-year-old Indian Railways, among the world's largest railroad networks.

In February, when Railway Minister Lalu Prasad presented India's railway budget for the 2007-08 fiscal, its most striking aspect was the ₹ 215 billions ($4.5 billions) surplus he announced for the organisation that employs 1.5 millions people and boasts a 63,332-kilometer network that ferries 14 millions passengers daily in 9,000 trains (4,000 more for cargo) from 6,947 stations.

"The railways are poised to create history," exulted Lalu Prasad, one of India's most colourful politicians, during his 116-minute speech, referring to the highest-ever surplus - akin to profits for companies - which the Indian Railways was projected to post for the fiscal year ended March 31.

"This is the same railway that defaulted on the payment of dividend and whose fund balances had dipped to ₹3.59 billions ($80 millions) in 2001," said the minister to the amazement of industry honchos and experts who were listening attentively to the speech.

In fact, he not only said that the surplus would increase next fiscal but also belied speculation over freight and upper class fare hikes that had once been a regular feature for the railways to bridge deficits. In fact, he even announced an across-the-board cut in tariffs and rolled out plans for 40 new trains, extended the run of 23 and increased the frequencies of 14 others.

All this only left experts gasping. They wondered what had caused such a sharp turnaround in the organisation from being the backbone of the Indian economy to being termed a "white elephant" headed towards bankruptcy by a government-appointed expert group.

"Today Indian Railways is on the verge of a financial crisis. To put it bluntly, the 'business as usual, low growth' will rapidly drive it to fatal bankruptcy, and in 16 years, the Government of India will be saddled with additional financial liability," said the report presented in July 2001.

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This was, indeed, alarming for the Indian Railways, which since the commencement of its first journey on April 16, 1853, has come to reflect the pluralistic character of the country with many unique features such as having the world's largest as well as the smallest stations, the oldest running locomotive and a separate budget since 1924.

But from 2005, the signs of change were visible and became well entrenched by 2007.

"The railways' renaissance has been engineered by simple entrepreneurial practices, which have evoked the admiration of internationally renowned institutions and companies alike," said a report by KPMG, which also conducted an international conference on railways in New Delhi last month.

"The railways are now working like a private sector corporation. This is great news for India. We wish other public services, especially in the social sector, like education and health would follow suit," Habil Khorakiwala, president of an apex industry group, the Federation of Indian Chambers of Commerce and Industry (FICCI), said.

"The turnaround is not hype because the net revenues have increased sharply," said Prof. G. Raghuram, who has thoroughly examined the performance of the Indian Railways as a case study for the premier Indian Institute of Management at Ahmedabad, one of India's best-known business schools.

"By increasing the axle-loading of wagons (which increases freight traffic) and, combining it with a market-oriented approach, Lalu Prasad has contributed to the success of Indian Railways," Raghuram added.

Lalu Prasad attributed the transformation almost entirely to improved efficiency that was even able to withstand increased competition from budget carriers that were offering to fly passengers for the cost of a second-class air-conditioned fare of the railways.

"Over the past 30 months, freight volumes have grown by 10 percent. Similarly, growth in passenger volumes has been doubled," he explained to a group of 130 students from Harvard and Wharton a few months ago, while delivering a lecture on the transformation of Indian Railways.

"On the supply side, increase in load coupled with reduction in turnaround time of wagons from seven to five days has contributed to an incremental loading capacity," the minister said in the rather simplistic explanation.

With financial parameters back on track, the Indian Railways now has set itself ambitious targets in areas such as refurbishment of stations, passenger amenities, better coaches and new freight corridors as it approaches the 11th Five Year Plan that begins April 1.

And says KPMG: "Indian Railways is in a dynamic phase of growth with new initiatives planned to capitalise on the existing gains and moving steadier and closer to the larger objective of offering world-class services in both freight and passenger transportation."

Questions

1. Do you think that railways desperately needed a change? Why?
2. What factors were responsible for its turnaround?

Source: http://indiainteracts.in/columnist/2007/07/21/Tracking-the-Indian-Railways-turnaround saga/

Notes

7.3 Combination Strategies

A company can pursue a combination of two or more corporate strategies simultaneously. But a combination strategy can be exceptionally risky if carried too far. No organisation can afford to pursue all the strategies that might benefit the firm. Difficult decisions must be made. Priorities must be established. Organisations like individuals have limited resources, so organisations must choose among alternative strategies.

In large diversified companies, a combination strategy is commonly employed when different divisions pursue different strategies. Also, organisations struggling to survive may employ a combination of several defensive strategies.

7.4 Internationalisation

When the focus of a business is its domestic operations, but a portion of its activities are outside the home country, it is called an "International Company". In other words, an international company is one that is primarily based in a single country but that acquires some meaningful share of its resources or revenues from other countries. For example, a small company engaged in exporting some of its products beyond its home country, is called "international" in its operations.

Internationalisation involves creating an international division and exporting the products through that division. The firm really focuses on the domestic market, and exports what is demanded abroad. All control is retained at home office regarding product and marketing strategies. As a firm becomes more successful abroad, it might set up manufacturing and marketing facilities in the foreign country, and allow a certain degree of customization. Country units are allowed to make some minor adaptations to products to suit local needs. But they have far less independence and autonomy compared to multi-domestic companies. All sources of core competencies are centralized.

The majority of large US multinationals pursued the international strategy in the decades following World War II. These companies centralized R&D and product development but established manufacturing facilities as well as marketing divisions abroad. Companies such as Mc Donald's and Kellogg's are examples of firms that followed such a strategy in the beginning. Although these companies do make some local adaptations, they are of a very limited nature. With increasing pressure to reduce costs due to global competition, especially from low-cost countries, the use of this strategy has become limited.

The disadvantages of this strategy are:

1. By concentrating most of its activities in one location, it fails to take advantage of the benefit of an optimally distributed value chain.
2. It is susceptible to higher levels of currency risks, because the company is too closely associated with a single country and increase in the value of currency may suddenly make the product unattractive abroad.

Exporting

This means selling the products in other countries through an agent or a distributor. This choice offers avenues for larger firms to begin their international expansion with a minimum investment. There are merits and demerits.

Notes

Merits

1. Less expensive
2. No need to set up manufacturing facilities abroad

Demerits

1. Not suitable for bulky, perishable or fragile goods
2. Import duties make the product expensive
3. High transportation costs
4. Cannot avail lower production costs in host country

7.5 Cooperation Strategies

Cooperative strategies such as strategic alliance and joint ventures are a logical and timely response to intense and rapid changes in economic activity, technology and globalisation. Apart from alliances between the firms operating within the same country, cross border alliances have also become increasingly popular these days. Alliances generally come in three basic types- joint ventures, strategic alliance, and consortia.

7.5.1 Joint Ventures

In a joint venture, two firms contribute equity to form a new venture, typically in the host country to develop new products or build a manufacturing facility or set up a sales and distribution network (Eg. Maruti Suzuki). The commonly cited advantages are:

1. Improvement of efficiency
2. Access to knowledge
3. Dealing with political risk factors
4. Collusions may restrict competition

Merits

1. Two partners bring complementary expertise to the new venture
2. Both parties share capital and risks.
3. Helps to meet host country regulations

Demerits

1. Two partners may fail to get along
2. The firm has to share profits with the partner
3. Host country culture may pose problems

7.5.2 Strategic Alliances

This is a collaborative partnership between two or more firms to pursue a common goal. Each partner in an alliance brings knowledge or resources to the partnership. Such an alliance is generally formed to access a critical capability not possessed in-house.

Example: Boeing and Airbus formed a strategic alliance to develop a bigger aircraft.

Merits and demerits are same as joint ventures, which are also a form of strategic alliance.

Notes

7.5.3 Consortia

Consortia are defined as large interlocking relationships, cross holdings and equity stakes between businesses of an industry. There could be two forms of consortia:

1. ***Multipartner Consortia:*** These are multi-partner alliances intended to share an underlying technology. One of the most important European based consortiums to date is Air Bus Industries. Airbus brings together four European aerospace firms from Britain, France, Germany and Spain
2. ***Cross-holding Consortia:*** These include large Japanese Keiretsus (Sumitomo, Mitsubishi, and Mitsui) and Korean Chaebols (Daewoo, LG, Hyundai, and Samsung). Two important features of cross-holding consortia are building long-term focus and gaining technological critical mass among affiliated member companies.

7.6 Restructuring

Restructuring is another means by which the corporate office can add substantial value to a business. Here, the corporate office tries to find either poorly performing business units with unrealized potential or businesses on the threshold of significant, positive change. The parent intervenes, often selling off the whole or part of the businesses, changing the management, reducing payroll and unnecessary expenses, changing strategies, and infusing the business with new technologies, processes, reward systems, and so forth. When the restructuring is complete, the company can either "sell high" and capture the added value or keep the business in the corporate family and enjoy the financial and competitive benefits of the enhanced performance.

For the restructuring strategy to work, the corporate office must have insights to detect businesses competing in industries with a high potential for transformation. Additionally, of course, they must have the requisite skills and resources to turn the businesses around, even if they may be in new and unfamiliar industries.

Restructuring can involve changes in assets, capital structure or management.

1. ***Assets restructuring*** involves the sale of unproductive assets, or even whole lines of businesses, that are peripheral. In some cases, it may even involve acquisitions that strengthen the core businesses.
2. ***Capital restructuring*** involves changing the debt-equity mix or the mix between different classes of debt or equity.
3. ***Management restructuring*** involves changes in the composition of top management team, organisational structure, and reporting relationships. Tight financial control, rewards based strictly on meeting performance goals, reduction in the number of middle-level managers are common steps in management restructuring. In some cases, parental restructuring may even result in changes in strategy as well as infusion of new technologies and processes.

7.7 Summary

- Strategy is the direction and scope of an organisation over the long-term.
- Strategies achieve advantages for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations.
- Strategies exist at several levels in any organisation – ranging from the overall business through to individuals working in it.

Notes

- Growth strategies are the most widely pursued corporate strategies.
- Without moving outside the organisation's current range of products or services, it may be possible to attract customers by intensive advertising, and by realigning the product and market options available to the organisation. These strategies are generally referred to as intensification or concentration strategies.
- There are three important intensive strategies, viz. Market penetration, Market development and Product development.
- Integration basically means combining activities relating to the present activity of a firm.
- Integration is basically of two types, viz. vertical integration and horizontal integration.
- Diversification is the process of adding new businesses to the existing businesses of the company.
- A company may pursue defense strategies when it has a weak competitive position in some or all of its product lines resulting in poor performance.
- Retrenchment strategies are last resort strategies. Companies can use any of the four retrenchment strategies- turnaround, divestment, bankruptcy and liquidation.
- Firms can take the international route by exporting a part of their produce to other nations or by outsourcing a small chunk of their work outside.
- Cooperative strategies such as strategic alliance and joint ventures are a logical and timely response to intense and rapid changes in economic activity, technology and globalisation.
- Restructuring is another means by which the corporate office can add substantial value to a business. Restructuring can involve changes in assets, capital structure or management.

7.8 Keywords

Backward Integration: Gaining ownership or increased control of a firm's suppliers.

Corporate Strategy: primarily about the choice of direction for the corporation as a whole

Diversification: process of adding new businesses to the existing businesses of the company

Horizontal Integration: The strategy of seeking ownership or increased control over a firm's competitors.

Integration: Integration basically means combining activities relating to the present activity of a firm.

Intensive Strategy: firms intensify their efforts to boost sales and grow market share

Market Development: seeks to increase market share by selling the present products in new markets

Market Penetration: seeks to increase market share for existing products in the existing markets through greater marketing efforts.

Vertical Integration: Expanding the firm's range of activities backward into the sources of supply and/or forward into the distribution channels.

Notes

7.9 Self Assessment

Fill in the blanks:

1. The customer ..... defines the value proposition that the organisation will apply to satisfy customers.
2. The ..... focuses on all the activities and key processes required in order for the company to excel at providing the value expected by the customers.
3. The ..... and ..... is the foundation of any strategy and focuses on the intangible assets of an organisation.
4. ..... strategy implies continuing the current activities of the firm without any significant change in direction.
5. A ..... strategy is a decision to do nothing new.
6. ..... strategies are the most widely pursued corporate strategies.
7. ..... seeks to increase market share for existing products in the existing markets.
8. Market ..... seeks to increase market share by selling the present products in new markets.
9. ..... seeks to increase the market share by developing new or improved products for present markets.
10. ..... increases the dependability of the supply and quality of raw materials.
11. ..... involves gaining ownership or increased control over distributors or retailers.
12. ..... is the process of adding new businesses to the existing businesses of the company.
13. By expanding into ....., the company can obtain new technologies and products, which can complement its present businesses.
14. Competition as a reason of corporate ..... occurs in the form of product and/or price competition.

7.10 Review Questions

1. If a firm succeeds in making the customers to switch from the competitor's brands to the firm's brands, while maintaining its existing customers intact, there will be an increase in the firm's sales. Why/why not?
2. Explain the concept of product development. Under what conditions, do you think it is feasible?
3. As a manager, in which situations would you apply vertical integration and why?
4. "Horizontal integration eliminates or reduces competition". Comment
5. Discuss the concept of last resort strategies. Under what conditions should they be applied?
6. "A firm is sick!" What do you mean by this statement? How can you prevent this sickness?
7. Do you think that the turnaround process is difficult? Why/why not?
8. Suppose you are the business head of a firm which is in deep financial trouble and is losing customers because of lack of proper services. In such a situation, what will you do and how would you justify your actions?

Notes

9. Is using a combination of strategies better than using a single strategy? Justify your answer
10. Discuss the ways in which a firm can expand. Give suitable examples.

Answers: Self Assessment

1.	perspective	2.	internal process
3.	innovation, learning perspective	4.	Stability
5.	no change	6.	Growth
7.	Market penetration	8.	development
9.	Product development	10.	Backward integration
11.	Forward integration	12.	Diversification
13.	industries	14.	decline

7.11 Further Readings

Books

Adapted from Pearce JA and Robinson RB, *Strategic Management*, McGraw Hill, NY, 2000.

W. Chan Kim and Renee Mauborgne, *Blue Ocean Strategy*, Harvard Business School Press, 2005.

Wheelen Thomas L, David Hunger J, Krish Rangarajan, *Concepts in Strategic Management and Business Policy*, New Delhi, Pearson Education, 2006.

Online links

www.1000ventures.com/.../im_diversification_strategies

www.balancedscorecard.org/.../AbouttheBalancedScorecard

www.marketingteacher.com/.../lesson_generic_strategies.

www.netmba.com/strategy/turnaround

Unit 8: Business Level Strategies

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Objectives

After studying this unit, you will be able to:

- Define industry structure
- Describe the positioning of firm
- Discuss the generic strategies
- Identify the business tactics

Introduction

Each business should have its own business strategy. A business strategy is basically a competitive strategy and is concerned more with how a business competes successfully in the chosen market. The strategic decisions at business-level revolve around choice of products and markets, meeting the needs of customers, protecting market share, gaining advantage over competitors, exploiting or creating new opportunities and earning profit at the business unit level. In short, a business strategy outlines the competitive posture of its operations in the industry.

Business strategy is guided by the direction set by the corporate strategy. It takes the cue from the priorities set by the corporate strategy. It translates the direction and intent generated at the corporate level into objectives and strategies for individual business units.

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Example: A multi-business corporation like ITC assigns priorities in its corporate strategy to its various businesses like cigarettes, vegetable oils, hotels, agro-based products, financial services etc. The business strategies of these units are formulated in accordance with those priorities. Business-level decisions also help bridge decisions at the corporate level and functional levels.

8.1 Industry Structure

An industry is a collection of firms offering goods or services that are close substitutes of each other. Alternatively, an industry consists of firms that directly compete with each other. For the purpose of industry analysis, an industry can be defined rather broadly (the beverage industry) or more precisely (the carbonated soft drink industry). How one defines and circumscribes an industry depends on the kinds of analysis to be performed. In "industry analysis", it is generally better to define an industry as precisely as possible.

Example: In discussing companies like Coca-Cola and Pepsi, one would want to define the boundaries of the "carbonated soft drink industry" rather than that of the "beverage industry".

The term "industry structure" refers to the number and size distribution of firms in an industry. The number of firms in an industry may run into hundreds or thousands. The existence of a large number of firms in an industry reduces opportunities for coordination among firms in the industry. Hence, generally speaking, the level of competition in an industry rises with the number of firms in the industry. The size distribution of firms in an industry is important from the perspective of both business policy and public policy.

Industry structure consists of four elements:

(a) Concentration

(b) Economies of scale

(c) Product differentiation

(d) Barriers to entry.

(a) ***Concentration:*** It means the extent to which industry sales are dominated by only a few firms. In a highly concentrated industry, i.e. an industry whose sales are dominated by a handful of firms, the intensity of competition declines over time. High concentration serves as a barrier to entry into an industry, because it enables the firms to hold large market shares to achieve significant economies of scale.

(b) ***Economies of Scale:*** This is an important determinant of competition in an industry. Firms that enjoy economies of scale can charge lower prices than their competitors, because of their savings in per unit cost of production. They also can create barriers to entry by reducing their prices temporarily or permanently to deter new firms from entering the industry.

(c) ***Product differentiation:*** Real perceived differentiation often intensifies competition among existing firms.

(d) ***Barriers to entry:*** Barriers to entry are the obstacles that a firm must overcome to enter an industry, and the competition from new entrants depends mostly on entry barriers.

These features determine the strength of the competitive forces operating in the industry. Trends affecting industry structure are important considerations in strategy formulation.

Notes

8.2 Positioning of the Firm

When starting a new firm or launching new product, a prime strategic decision is to identify the target audience. But even though a useful segment has been identified, this does not in itself resolve the organisation's strategy. The competitive position within the segment then needs to be explored, because only this will show how the organisation will compete within the segment. Competitive positioning is thus the choice of differential advantage that the product or services will posses against its competitors. Competitive positioning allows an organisation to compete and survive in a market place or in a segment of a market place. To develop positioning, it is useful to follow a two-stage process-first identify the segment gaps, second identify positioning within segments.

Identification of Segment Gaps and their Competitive Positioning Implications

From a strategy viewpoint, the most useful strategy analysis often emerges by exploring where there are gaps in the segments of an industry. The starting point for such work is to map out the current segmentation position and then place companies and their products into the segments; it should then become clear where segments exist that are not served or are poorly served by current products.

Identifying the Positioning within the Segment

From a strategy perspective, some gaps may be more attractive than others. For example, they may have limited competition or poorly supported products. In addition, some gaps may possess a clear advantage in terms of competitive positioning. Others may not.

The process of developing positioning runs as follows:

1. ***Perceptual mapping:*** In-depth qualitative research on actual and prospective customers on the way they make their decisions in the market place, e.g. strong versus weak, cheap versus expensive, modern versus traditional.
2. ***Positioning:*** Brands or products are then placed on the map using the research dimensions.
3. ***Options development:*** Take existing and new products and use their existing strengths and weaknesses to devise possible new positions on the map.
4. ***Testing:*** First with simple statements with customers, then at a later stage in the marketplace.

It will be evident that this is essentially a process, involving experimentation with actual and potential customers.

Task Find out the positioning statements of major Indian banks.

8.3 Generic Strategies

Generic strategies were first outlined in two books from Michael Porter of Harvard Business School. These were "Competitive Strategy" in 1980 and "Competitive Advantage'' in 1985. The second book contained a small modification of the concept. The original version is explored here.

Michael Porter made the bold claim that there are only three fundamental strategies that any business can undertake. During the 1980s, they were regarded as being at the forefront of

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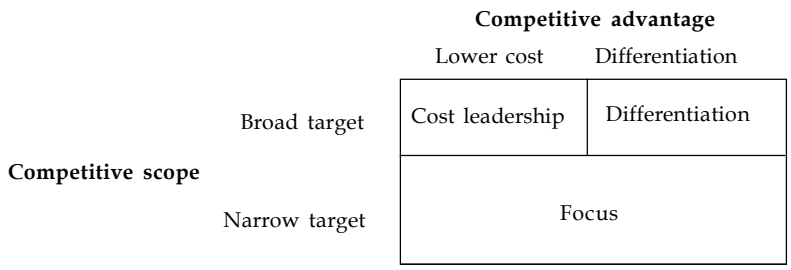
strategic thinking. Arguably, they still have a contribution to make in the new century in the development of strategic options.

Professor Porter argued that the three basic strategies open to any business are:

1. Cost leadership
2. Differentiation
3. Focus.

Each of these generic strategies has the potential to overcome the five forces of competition and allow the firm to outperform rivals within the same industry. These are called 'generic' because they can be used in a variety of situations, across diverse industries at various stages of development.

Figure 8.1: Generic Strategic Options



Source: M. E. Porter (1985), Competitive Advantage, The Free Press, New York, Michael Porter.

Cost Leadership

Cost leadership is a strategy whereby a firm aims to deliver its product or service at a price lower than that of its competitors. Overall cost leadership is achieved by the firm by maintaining the lowest costs of production and distribution within an industry and offering "no-frills" products. This strategy requires economies of scale in production and close attention to efficiency and operating costs. The firm places a lot of emphasis on minimizing direct input and overhead costs, by offering no-frills products.

Example: Deccan Airways, Timex, Nirma.

A cost leadership strategy is likely to work better where the product is standardized, competition is based mainly on price and consumers can switch easily between different suppliers. However, a low cost base will not in itself bring competitive advantage. The product must be perceived as comparable or acceptable by consumers. Firms pursuing this strategy must be effective in engineering, purchasing, manufacturing, and physical distribution. Marketing can be considered as less important, as the consumer is familiar with the product attributes.

Notes An important feature of cost leadership is the effect of the experience curve, in which the unit cost of manufacturing a product or delivering a service falls as experience increases. In the same way that a person learning to knit or play the piano improves with practice, so the unit cost of value added to a standard product declines by a constant percentage (typically 20 to 30%) each time cumulative output doubles (Grant, 2002). This allows firms to set initial low selling prices in the knowledge that margins will increase

Contd...

Notes

as costs fall. The rate of travel down the cost experience curve is a crucial aspect of staying ahead of the competition in an undifferentiated market and underlines the importance of market share if high volumes are not sold, the cost advantage is lost. Examples of products and services that are produced much more cheaply now are semiconductors, watches, cars, and travel reservations (on the Internet).

Having a low cost position also gives a company a defence against rivals. Its lower costs allow it to continue to earn profits during times of heavy competition. Its high market share means that it will have high bargaining power relative to its suppliers. Its low price also serves as a barrier to entry because few new entrants will be able to match the leader's cost advantage. As a result, cost leaders are likely to earn above average profits on investment.

Companies that want to be successful by following a cost leadership strategy must maintain constant efforts aimed at lowering their costs (relative to competitor's costs) and creating value for customers. Cost leadership requires:

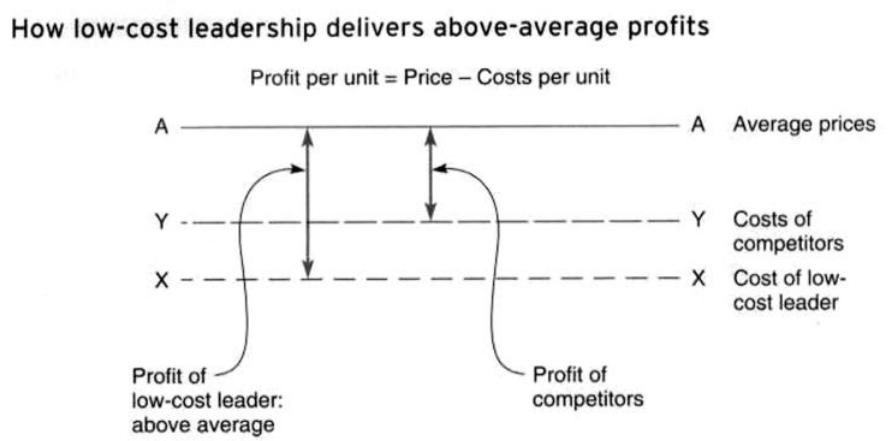
1. Aggressive construction of efficient scale facilities
2. Vigorous pursuit of cost reductions from experience
3. Tight cost and overhead control
4. Avoidance of marginal customer accounts
5. Cost minimization in all activities in the firm's value chain, such as R&D, services, sales force, advertising etc.

Implementing and maintaining a cost leadership strategy means that a company must consider its value chain of primary and secondary activities and effectively link those activities with critical focus on efficiency and cost reduction. For example, McDonald's Restaurants achieved low costs through standardised products, centralised buying of supplies for a whole country and so on.

How Low-cost Leadership Delivers Above-average Profits?

The profit advantage gained from low-cost leadership derives from the assertion that low-cost leaders should be able to sell their products in the market place at around the average price of the market–see line A-A in Figure 8.2. If such products are not perceived as comparable or their performance is not acceptable to buyers, a cost leader will be forced to discount prices below competition in order to gain sales.

Figure 8.2



Notes

Compared with the low-cost leader, competitors will have higher costs - see line Y-Y in the Figure 8.2. After successful completion of this strategy option, the costs of the lowest-cost producer will be lower by than those of other competitors–'see line X-X in the Figure 8.2.

This will deliver above-average profits to the low-cost leader.

To follow this strategy option, an organisation will place the emphasis on cost reduction at every point in its processes. It should be noted that cost leadership does not necessarily imply a low price. The company could charge an average price and reinvest the extra profits generated.

Differentiation Strategy

Differentiation consists of offering a product or service that is perceived as unique or distinctive by the customer. This allows firms to command a premium price or to retain buyer loyalty because customers will pay more for what they regard as a better product. A differentiation strategy can be more profitable than a cost leadership strategy because of the premium price.

Products can be differentiated in a number of ways so that they stand apart from standardized products:

1. Superior quality
2. Special or unique features
3. More responsive customer service
4. New technologies
5. Dealer network.

Example: Hero Honda, Nike athletic shoes, Sony, Asian Paints, Mercedes-Benz, BMW etc.

Nokia achieves differentiation through the individual design of its product, while Sony achieves it by offering superior reliability, service and technology. Mercedes-Benz differentiates by stressing a distinctive product service image, while Coca Cola differentiates by building a widely recognized brand. This strategy is often supported by high spending on advertising and promotion to sustain the brand identity.

McDonald's is differentiated by its brand name and its 'Big Mac' and 'Ronald McDonald' products and imagery. In order to differentiate a product, Porter argued that it is necessary for the producer to incur extra costs, for example, to advertise a brand and thus differentiate it.

The form of differentiation varies from industry to industry. In construction industry, equipment durability, spare parts availability and service will feature, while in cosmetics, differentiation is based on sophistication and exclusivity. Differentiation is aimed at the broad mass market. It is a viable strategy for earning above average profits because the resulting brand loyalty lowers customers' sensitivity to price. Buyer loyalty also serves as an entry barrier because new entrants must develop their own distinctive competence to differentiate their products in some way to achieve buyer loyalty.

It is essential for the success of this strategy that the premium price for the differentiated product must exceed the cost of differentiation. For successfully carrying out the differentiation strategy, the following are required:

1. Creative flair
2. Engineering skills
3. R&D capabilities

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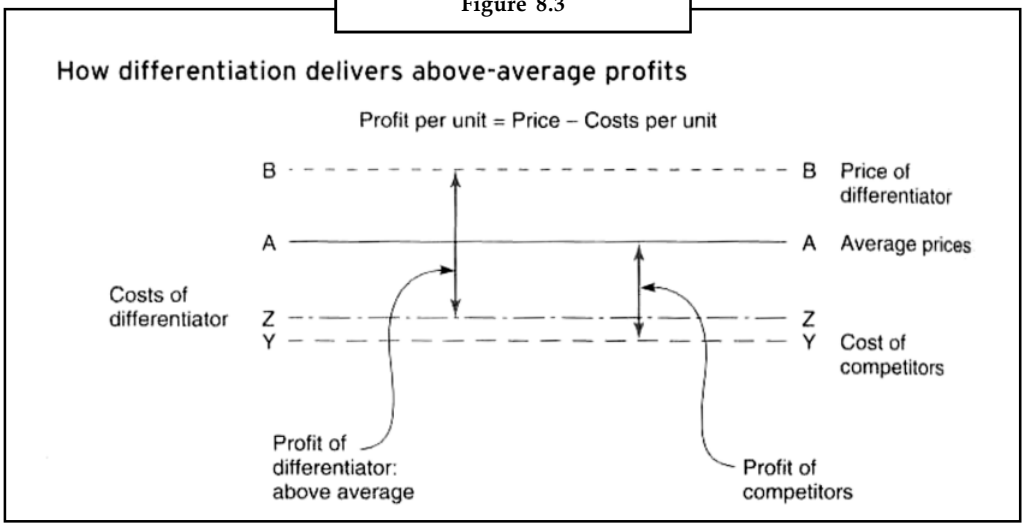
4. Innovative marketing capabilities
5. Motivation for innovation
6. Corporate reputation for quality or technological capabilities.

How Differentiation Delivers Above-average Profits?

Figure 8.3



This is explained in Figure 8.3. As seen from the exhibit, Differentiated product costs will be higher than those of competitors – see line Z-Z. The producer of the differentiated product then derives an advantage from its pricing: with its uniquely differentiated product it is able to charge a premium price, i.e. one that is higher than its competitors – see line B-B in the Figure 8.3. This will deliver above average profits to the company following differentiation strategy.

However, there are two problems associated with differentiation strategies:

1. It is difficult to estimate whether the extra costs incurred in differentiation can be recovered from the customer by charging a higher price.
2. The successful differentiation may attract competitors to copy the differentiated product and enter the market segment.

Neither of the above problems is insurmountable but they do weaken the attractiveness of this option.

Focus Strategy

A focus strategy occurs when a firm focuses on a specific niche in the market place and develops its competitive advantage by offering products especially developed for that niche. It targets a specific consumer group (e.g. teenagers, babies, old people etc.) or a specific geographic market (urban areas, rural areas etc.).

Hence, the focus strategy selects a segment or group of segments in the industry and tailors its strategy to serve them to the exclusion of others. By optimizing its strategy, for the targets, the focuser seeks to achieve competitive advantage in its target segments, even though it does not possess a competitive advantage overall.

Notes

As Porter observes, while the low cost and differentiation strategies are aimed at achieving their objectives industry-wide, the entire focus strategy is built around serving a particular target very well.

Sometimes, according to Porter, neither a low-cost leadership strategy nor a differentiation strategy is possible for an organisation across the broad range of the market.

Example: The costs of achieving low-cost leadership may require substantial funds which are not available.

Equally, the costs of differentiation, while serving the mass market of customers, may be too high. If the differentiation involves quality, it may not be credible to offer high quality and cheap products under the same brand name. So a new brand name has to be developed and supported. For these and related reasons, it may be better to adopt a focus strategy.

The focus strategy has two variants:

1. ***Cost focus:*** A firm seeks to achieve low cost position in its target segment only.
2. ***Differentiation focus:*** A firm seeks to differentiate its products in its target segment only.

The essence of focus strategy is the exploitation of a narrow target's differences from the balance of the industry. Focus builds competitive advantage through high specialization and concentration of resources in a given niche. A focus strategy can serve the needs of a niche segment (a) by identifying gaps not covered by existing players, and (b) by developing superior skills or efficiency while serving such narrow segments. By targeting a small, specialized group of buyers it should be possible to earn higher than average profits, either by charging a premium price for exceptional quality or by a cheap and cheerful low priced product. In the global car market, Rolls Royce and Ferrari are clearly niche players. They have only a minute percentage of the market world-wide. Their niche is premium product and premium price.

The focus strategy rests on the premise that the firm is able to serve its narrow strategic target more effectively and efficiently than competitors who are competing more broadly. As a result, the firm achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target, or both. Even though the focus strategy does not achieve low cost or differentiation industry-wide, it does so in its narrow market target.

The focus strategy requires for its success the same common factors, as are required for the success of cost leadership and differentiation, except that they are directed at the particular target market. In the Indian context, examples of focus strategy are Ayur Herbal Brand, Anjali Kitchenware, Anchor toothpaste, T-series Cassettes etc.

There are, however, some problems with the focus strategy:

1. By definition, the niche is small and may not be large enough to justify attention.
2. Cost focus may be difficult if economies of scale are important in an industry such as the car industry.
3. The niche is clearly specialist in nature and may disappear over time.

None of these problems is insurmountable. Many small and medium-sized companies have found that this is the most useful strategy to explore.

8.3.1 Risks in Competitive Strategies

No one competitive strategy is guaranteed for success. Some companies that have successfully implemented one of Porters' competitive strategies have found that they could not sustain the strategy. Each of these generic strategies has its own risks.

Notes

1. ***Risks of cost leadership:***

   (a) Cost leadership may not be sustained

      (i) If competitors imitate

      (ii) If technology changes

      (iii) If other bases for cost leadership erode.

   (b) Proximity in differentiation is lost.

   (c) Cost focusers achieve even lower costs in segments.

   Proximity in differentiation means that companies that choose cost leadership strategy must offer relatively standardized products with features or characteristics that are acceptable to customers. In other words, the company must offer a minimum level of differentiation–at the lowest competitive price. If this minimum level of differentiation is lost, then the strategy of cost leadership will fail.

2. ***Risks of differentiation:***

   (a) Differentiation may not be sustained

      (i) If competitors imitate.

      (ii) If features of differentiation become less important to buyers.

   (b) Cost proximity is lost.

   (c) Firms that follow focus strategy may achieve even greater differentiation in segments.

   (d) Dilution of brand identification through product-line.

   A company following a differentiation strategy must ensure that the higher price it charges for its higher quality is not priced too far above the competition, otherwise customers will not see the extra quality as worth the extra cost. In other words, if the price differential between the standardized and differentiated product is too high, the risk is that the company provides a greater level of uniqueness than the customers are willing to pay for.

3. ***Risks of Focus:*** The competitive risks of focus strategy are similar to those previously noted for cost leadership and differentiation strategies, with the following additions:

   (a) Focus strategy is not sustained if competitors imitate it.

   (b) The target segment may become structurally unattractive.

      (i) if structure erodes.

      (ii) if demand disappears.

   (c) Competitors may successfully focus on an even smaller segment of the market, out focusing the focuser, or focus only on the most profitable slice of the focuser's chosen segment.

   (d) An industry-wide competitor may recognize the attractiveness of the segment served by the focuser and mobilize its superior resources to better serve the segment's need.

   (e) Preferences and needs of the narrow segment may become more similar to the broad market, reducing or eliminating the advantage of focusing.

Notes

Stuck-in-the Middle

Professor Porter concluded his analysis of what he termed the main generic strategies by suggesting that there are real dangers for the firm that engages in severed generic strategies but fails to achieve any of them. He therefore emphasized the importance of clear positioning i.e., either follow cost leadership or differentiation. He called firms that do not have clear strategic positioning and which make choices that include a few elements of different strategies (i.e. some elements of differentiation and some elements of cost leadership) as firms stuck–in-the-middle. He suggested that such firms do not develop successful competitive advantage. But this concept of stuck-in-the–middle has been an issue of debate.

Several commentators, such as Kay, Stopford and Baden-Fuller and Miller now reject this aspect of the analysis. They point to several empirical examples of successful firms that have adopted more than one generic strategy.

As was pointed out above, there is now useful empirical evidence that some companies do pursue differentiation and low-cost strategies at the same time. They use their low costs to provide greater differentiation and then reinvest the profits to lower their costs even further.

Example: Benetton (Italy), Toyota (Japan) and BMW (Germany)

Did u know? **What are Hybrid Strategies?**

Hybrid strategies include a combination of generic strategies, for example, simultaneous pursuing of both low cost leadership and differentiation strategy. Research has found that such hybrid strategies have contributed to competitive advantage in some situations. For example, successful implementation of differentiation strategy may result in increased sales volume and as sales volume increases costs drop due to economies of scale. Thus successful differentiators can also be the lowest cost producers in an industry.

Porter (1994) later offered some clarification: "A company cannot completely ignore quality and differentiation in the presence of cost advantages, and vice-versa. Progress can be made against both types of advantage simultaneously." However, he notes that these are trade–offs between the two and that companies should "maintain a clear commitment to superiority in one of them".

8.3.2 Critical Assessment of Generic Strategies

The generic business-level strategies discussed above are useful when we view an industry as stable. However, in practice, business environment is dynamic and successful firms need to adapt their strategies to the environmental conditions.

More (2001) notes that each generic strategy gives a company some kind of defence against each of the five competitive forces.

Example: Cost leadership can raise barriers to cope with cost increases form suppliers.

Differentiation based on strong brand loyalty, can create an entry barrier and also insulate the firm from rivalry. But there are risks in this.

Example: Consumer loyalty can falter if the price premium is perceived as too high, and differentiation can be lost through imitation of a product by competitors.

The other risks have already been discussed in the previous sections.

Notes

8.3.3 Comment on Porter's Generic Strategies

Hendry ll and others have set out the problems of the logic and the empirical evidence associated with generic strategies that limit its absolute value. We can summarize them as follows:

Low-cost Leadership

1. If the option is to seek low-cost leadership, then how can more than one company be the low-cost leader? It may be a contradiction in terms to have an option of low-cost leadership.
2. Competitors also have the option to reduce their costs in the long-term, so how can one company hope to maintain its competitive advantage without risk?
3. Low-cost leadership should be associated with cutting costs per unit of production. However, there are limitations to the usefulness of this concept.
4. Low-cost leadership assumes that technology is relatively predictable, if changing. Radical change can so alter the cost positions of actual and potential competitors.
5. Cost reductions only lead to competitive advantage when customers are able to make comparisons. This means that the low-cost leader must also lead price reductions or competitors will be able to catch up, even if this takes some years and is at lower profit margins. But permanent price reductions by the cost leader may have a damaging impact on the market positioning of its product or service that will limit its usefulness.

Differentiation

1. Differentiated products are assumed to be higher priced. This is probably too simplistic. The form of differentiation may not lend itself to higher prices.
2. The company may have the objective of increasing its market share, in which case it may use differentiation for this purpose and match the lower prices of competitors.
3. Porter discusses differentiation as if the form this will take in any market will be immediately obvious. The real problem for strategy options is not to identify the need for differentiation but to work out what form this should take that will be attractive to the customer. Generic strategy options throw no light on this issue whatsoever. They simply make the dubious assumption that once differentiation has been decided on, it is obvious how the product should be differentiated.

Focus

1. The distinction between broad and narrow targets is sometimes unclear. Are they distinguished by size of market? Or by customer type? If the distinction between them is unclear then what benefit is served by focus?
2. For many companies, it is certainly useful to recognise that it would be more productive to pursue a niche strategy, away from the broad markets of the market leaders. That is the easy part of the logic. The difficult part is to identify which niche is likely to prove worthwhile. Generic strategies provide no useful guidance on this at all.
3. As markets fragment and product life cycles become shorter, the concept of broad targets may become increasingly redundant.

Notes

Resource-based View

In an earlier unit, we explored the arguments supporting this view of strategic analysis. They also apply to strategy options and suggest that options based on the uniqueness of the company rather than the characteristics of the industry are likely to prove more useful in developing competitive strategy. The resource-based view does undermine much of Porter's approach.

Fast-moving Markets

In dynamic markets such as those driven by new internet technology, the application of generic strategies will almost certainly miss major new market opportunities. They cannot be identified by the generic strategies approach.

Faced with this veritable onslaught on generic strategies, it might be thought that Professor Porter would gracefully concede that there might be some weaknesses in the concept.

However, Porter hit back in 1996 by drawing a distinction between basic strategy and what he called 'operational effectiveness' – the former is concerned with the key strategic decisions facing any organisation while the latter are more concerned with such issues as TQM, outsourcing, re-engineering and the like. He did not concede any ground but rather extended his approach to explore how companies might use market positioning within the concept of generic strategies.

Given these criticisms, it should not be concluded that the concept of generic strategies has no merit. As part of a broader analysis, it can be a useful tool for generating basic options in strategic analysis. It forces exploration of two important aspects of business strategy: the role of cost reduction and the use of differentiated products in relation to customers and competitors. But it is only a starting point in the development of such options. When the market is growing fast, it may provide no useful routes at all. More generally, the whole approach takes a highly prescriptive view of strategic action.

Case Study

Wal-Mart's Cost Leadership Strategy

On July 2, 1962, Samuel Moore Walton, a merchant with over 15 years of experience in retailing, set up his first discount store in Rogers, a small town in the state of Arkansas, US. The store offered a wide variety of branded merchandise at a competitive price.

During the initial years, Walton focused on establishing new stores in small towns, with an average population of 5,000. These towns were largely neglected by leading retailers like Sears Roebuck & Company, K-Mart and Woolco, which concentrated more on larger towns and big cities. In his efforts to attract people from the rural areas to his stores, Walton introduced the concept of Every Day Low Prices (EDLP).

EDLP promised Wal-Mart's customers a wide variety of high quality, branded and unbranded products at the lowest possible price, offering better value for their money. Wal-Mart's advertisement describing EDLP said,

"Because you work hard for every dollar, you deserve the lowest price we can offer every time you make a purchase. You deserve our Every Day Low Price.

It's not a sale; it's a great price you can count on every day to make your dollar go further at Wal-Mart."

Contd...

Notes

From the very beginning, Walton made efforts to procure products at the lowest prices possible from manufacturers.

He always shared these savings with customers by charging them lower prices, thus giving them the maximum value for their money.

Wal-Mart's products were usually priced 20% lower than those of its competitors. Walton's pricing strategy led to increased loyalty from price-conscious rural customers. It helped the company to generate more profits due to larger volumes. Explaining his pricing strategy, Walton said, "By cutting your price, you can boost your sales to a point where you earn far more at the cheaper retail price than you would have by selling the item at the higher price. In retailer language, you can lower your markup but earn more because of the increased volume." EDLP was extremely attractive to rural customers and emerged as the key contributor to Wal-Mart's growth over the years.

Offering products at EDLP, especially during its early years, when Wal-Mart was not an established retail player, was quite difficult. The company aggressively followed a cost leadership strategy that involved developing economies of scale and making consistent efforts to reduce costs.

The surplus generated was reinvested in building facilities of an efficient scale, purchasing modern business-related equipment and employing the latest technology. The reinvestments made by the company helped it to maintain its cost leadership position.

From the start, Wal-Mart imposed a strict control on its overhead costs. The stores were set up in large buildings, while ensuring that the rent paid was minimal. The company imposed an upper limit for its rent payment at $1.00 per square foot during the late 1960s. Not much emphasis was laid on the interiors of the stores. The company did not invest on standardized ordering programs and on basic facilities to sort and replenish the stock.

In the early 1990s, Wal-Mart started focusing on its Supercenters and Sam's Clubs to fuel growth. Wal-Mart expanded its operations into the Northeast and West of the US by placing a lot of emphasis on the groceries business through its Supercenters. The modus operandi was to first establish discount stores, after which the best performing stores were to be converted into Supercenters.

By 1991, Wal-Mart's mammoth retail network comprised of 1,355 discount stores, 120 Sam's Clubs and three Supercenters being served by 16 distribution centers.

However, at this time, Wal-Mart had yet to enter as many as 23 states in the US. In the early 1990s, it was estimated that the size of the groceries business in the US was three times that of the discount store business. So, Wal-Mart decided to focus on Supercenters to propel its growth. Following Walton's death in 1992, David Glass succeeded him as the CEO of Wal-Mart. Glass viewed food retailing as a key driver to increase revenue growth in the 1990s.

By the beginning of the new millennium, Wal-Mart was one of the world's largest companies, with revenues of $165 billion in fiscal 2000. Wal-Mart's rapid growth continued in the initial years of the new millennium.

While continuing its aggressive expansion in the food business, the company started launching innovative programs to further penetrate the US markets. For instance, in 2001, Wal-Mart launched a program, called 'Store of the community.' Under the program, Wal-Mart began remodeling its discount stores and Supercenters in the US to fulfill the needs of customers they served, in line with what the customers wanted. Explaining the program, Tom Coughlin, President and CEO of Wal-Mart Stores Division, said, "The one-size-fits-all concept simply doesn't work anymore in the retail industry. Customers tell us what they want and it is our responsibility to meet those needs. Our store associates live and work in each store's community and interact with over 100 million customers each week.

Contd...

Notes

Wal-Mart has chalked out an aggressive expansion plan to accelerate its growth in the near future. At the fiscal year ending 2007-08, Wal-Mart achieved a revenue target of $500 billion.

Questions

1. What problems do you think would have been faced by Wal-Mart initially to offer products at cheapest prices?
2. After analysing the above case, do you think every company should aim at cost leadership?

Source: www.icmrindia.org

8.4 Business Tactics

Tactics should work with a firm's strategy and they are the set of requirements need for the plan to take place. A tactic is a device used by the firm for meeting your goals set by your strategy. Strategy and tactics should always be relative to one another because the tactics are the set of actions needed to fulfill your strategy.

1. Tactics are the tools used to achieve goals.
2. Tactics include things like advertising and marketing.
3. Tactics are the steps taken to achieve goals.

Brand Management

One tactic that almost every firm employs is strategic brand management. Firms must find a way to communicate their products and corporate philosophy to potential customers. Over time, a business can establish a reputation that gives its brand name an advantage over the lesser known competitors.

Brand management includes good advertising and public relations to present an image of that is consistent with the mission and vision of the company. A company may also conduct research or poll the general public to learn about how it is perceived and what changes are necessary.

Diversification and Specialisation

Two different business strategies that deal with the scope of a company are diversification and specialisation. A business can diversify by simply expanding its products and services, such as adding a new division, or through merging or acquiring another business.

Specialisation is the opposite of diversification. It refers to narrowing a business's products to focus on a more specific type of product. By focusing limited resources on a smaller product line, a business may hope to improve the quality of its remaining products, or simply divest itself of an unprofitable product.

Research and Development

Some firms use investments into research and development as a major tactic to get ahead of competitors. This is particularly true in the manufacturing field, where new product technologies can save money and produce products that will excite consumers. Smaller businesses may lack the money or in-house talent to invest directly in research and development, but for larger companies the ability to innovate can be the difference between success and failure.

Risk Management

Notes

Managing risk is a tactic that every firm employs in its own way. The simple act of founding a business is itself a risk, since market trends and customer behaviour can be difficult to predict. For an established business, managing risk means making good decisions about where to invest funds and what types of products to focus on.

Task Identify the tactics and strategies used by Nestle Maggi to tackle competition.

Caselet

Brand Repositioning – Maruti Suzuki Wagon R

From 'Feel at home' to 'Inspired Engineering'- Maruti Udyog's premium product in the B segment of the passenger car market, the Wagon R, is undergoing a new brand positioning.

This shift in emphasis, say company officials, is on account of the Multi-Activity Vehicle's tremendous success.

An almost 100 per cent jump in sales in October 2002 over that in October 2001 and a 23 per cent increase in sales for the April-October 2002 period over the same period last year is what has prompted Maruti to go in for this new brand positioning.

According to the company officials, Maruti sold 3,381 units of the Wagon R in October 2002 against 1,680 in October last year — a 101 per cent growth. Likewise, the company sold 17,531 units of the car in April-October 2002 against 14,291 in the same period last year.

Buoyed by the encouraging sales, the officials say, Maruti will shortly launch the new campaign based on the 'Inspired Engineering' theme. It takes on from the earlier campaign that focussed on the 'Feel at home' theme, which helped establish a strong emotional bond with the target consumer, they say.

The new campaign will focus on Wagon R, a uniquely designed product for people who lead interesting lives. The product gels with their lifestyle, reflecting their confidence and multifaceted personality. By sheer excellence of engineering it enables them to be whatever they choose to be — and that is what makes the buyers interested, point out the officials.

According to them, the new positioning "Wagon R — Inspired Engineering" reflects the fact that the car is a piece of unmatched, excellent engineering and that some of the most interesting and discerning people drive it.

"It defied convention and changed the way people looked at a car. It is simply unmatched in performance and comfort. Test-drive one and you'll never settle for anything ordinary again," goes the caption for one of the print advertisements, while another goes like this: "There are some people who tower over the others. They follow their hearts, create their own rules and lead much fuller lives. The Wagon R is for such people. The result of inspired engineering, it defied convention and changed the way people looked at a car..."

According to the officials, the new brand positioning is based on research that showed the Wagon R buyer as being balanced, ambitious, discerning, self-assured and intelligent. At the same time, they have deep-rooted human values. Thus, they lead fuller lives. "Thus the new positioning is in sync with the personality of the buyer and the product," the officials say.

Source: www.thehindubusinessline.com

Notes

8.5 Summary

- Business conditions are always changing, so it's a good practice to periodically step back and take a hard look at the business strategy and analyse its implementation.
- Business Strategy can be defined as a long-term approach to implementing a firm's business plans to achieve its business objectives.
- A business strategy addresses how the firm competes in a market and how it attains and sustains competitive advantage.
- The term "industry structure" refers to the number and size distribution of firms in an industry.
- The competitive position within the segment then needs to be explored, because only this will show how the organisation will compete within the segment.
- Cost Leadership Strategy emphasises efficiency. By producing high volumes of standardised products, the firm hopes to take advantage of economies of scale and experience curve effects.
- The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base.
- Differentiation is aimed at the broad market that involves the creation of a product or services that is perceived throughout its industry as unique. The company or business unit may then charge a premium for its product.
- Focus Strategy concentrates on a select few target markets and is also called a segmentation strategy or niche strategy.

8.6 Keywords

Cost Leadership: A strategy whereby a firm aims to deliver its product or service at a price lower than that of its competitors.

Differentiation: Offering a product or service that is perceived as unique or distinctive by the customer.

Focus Strategy: The strategy in which a firm focuses on a specific niche in the market place and develops its competitive advantage by offering products especially developed for that niche.

Industry: A collection of firms offering goods or services that are close substitutes of each other.

Positioning: Occupying a distinct position in the minds of consumers.

8.7 Self Assessment

Fill in the blanks:

1. .....means the extent to which industry sales are dominated by only a few firms.
2. Competitive positioning gives.....advantage to the firms.
3. .....are the tools used for meeting the goals and objectives as designed by the strategy.
4. A company focuses only the production of ladies shoes. This is an example of.....

Notes

5. Each of these generic strategies has the potential to overcome the ..... of competition.
6. A cost leadership strategy is likely to work better where the product is .....
7. Compared with the low-cost leader, competitors will have ..... costs.
8. The ..... strategy selects a segment or group of segments in the industry and tailors its strategy to serve them to the exclusion of others.
9. If the differentiation involves quality, it may not be credible to offer ..... quality and ..... products under the same brand name.
10. Hybrid strategies include a combination of ..... strategies.

8.8 Review Questions

1. Which industry is Vodafone a part of? Identify the features of that industry and comment on its status in India.
2. Critically analyse the benefits of positioning for a firm.
3. Suppose you are the CEO of a cosmetic firm. Under what situations would you choose a low-cost, differentiation, or speed-based strategy?
4. Illustrate how a firm can pursue both low-cost and differentiation strategies.
5. Identify requirements for business success at different stages of industry evolution.
6. Discuss the good business strategies in fragmented and global industries.
7. "Diversification is a double edged sword". Comment
8. There are many risks in cost leadership strategy. What are they and how would it affect you as a manager?
9. Under what condition(s) do you think would the cost leadership strategy work better?
10. In which situations do you think that the neither a low cost nor a differentiation strategy would be possible for an organisation?
11. Are tactics different from business strategies? Give reasons for your answer.
12. "Business strategy and tactics go hand in hand". Discuss

Answers: Self Assessment

1.	Concentration	2.	Differential
3.	Tactics	4.	Specialisation
5.	Five forces	6.	Standardised
7.	Higher	8.	Focus
9.	High, cheap	10.	Generic

Notes

8.9 Further Readings

Books

Azhar Kazmi, *Strategic Management and Business Policy*- 3rd edition, Tata McGraw Hill

C Appa Rao, B Parvathiswara Rao and K Sivaramakrishna, *Strategic Management and Business Policy-Text and Cases*, Excel Books

David Fred, *Strategic Management: Concepts and Cases*-12th edition, Prentice Hall of India

Online links

www.1000ventures.com/business_guide/sbu

www.economicexpert.com/.../Flanking:marketing:warfare:strategies

www.quickmba.com/strategy/**generic**.shtml

Unit 9: Strategic Analysis and Choice

Notes

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Objectives

After studying this unit, you will be able to:

- Describe the process for strategic choice
- Explain the concept of strategic and industry analysis
- State the concept of corporate portfolio analysis
- Discuss the contingency strategies

Notes

Introduction

Strategic analysis and choice is essentially a decision-making process. This involves generating feasible alternatives, evaluating those alternatives and choosing a specific course of action that could best enable the firm to achieve its mission and objectives.

Alternative strategies do not come from a vacuum. They are derived from the firm's present strategies keeping in view the vision, mission, objectives and also the information gathered from external and internal analysis. They are consistent with or built on past strategies that have worked well.

9.1 Process for Strategic Choice

According to Glueck and Jauch, "strategic choice is the decision to select from among the alternatives considered, the strategy which will best meet the enterprise objectives."

This decision-making process consists of four distinct steps:

1. Focusing on a few alternatives.
2. Considering the selection factors.
3. Evaluating the alternatives.
4. Making the actual choice.

9.1.1 Focusing on a few Alternatives

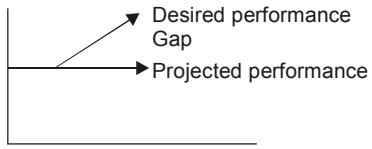
Strategists never consider all feasible options that could benefit the firm because there are innumerable options. So strategists should narrow down the choice to a reasonable number of alternatives. But it is still difficult to tell what that reasonable number is. For deciding on a reasonable number of alternatives, we can make use of the following concepts:

1. Gap analysis
2. Business Definition

Gap Analysis

In gap analysis, a company sets objectives for a future period of time, say three to five years of time, and then works backward to find out where it can reach at the present level of efforts. By analysing the difference between the projected and desired performance, a performance gap could be found as shown in the figure below.

Figure 9.1: Gap Analysis



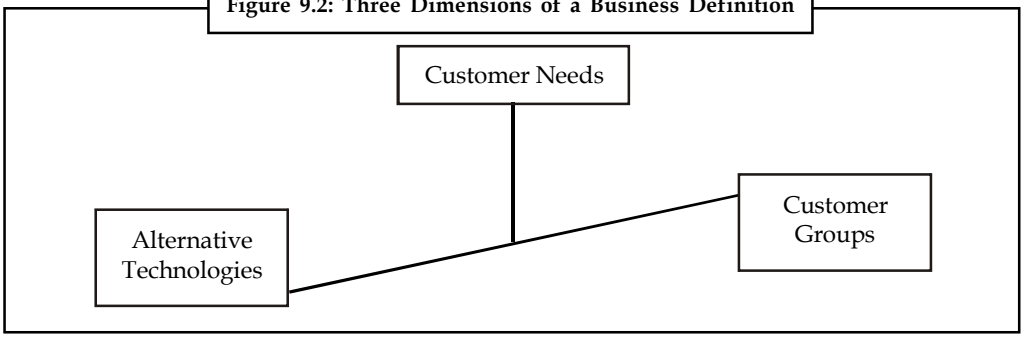
Where the gap is narrow, stability strategies would seem to be a feasible alternative. If the gap is large, expansion strategies are more suitable to be considered. If the gap is large due to past and expected bad performance, retrenchment strategies need to be considered.

Business Definition

Notes

In deciding on what would be a manageable number of alternatives, it is advisable to start with the business definition. Business definition, as discussed earlier, determines the scope of activities that can be undertaken by a firm. It tries to answer three basic questions clearly: (i) who is being satisfied? (ii) what is being satisfied? and (iii) how the need is being satisfied?

Figure 9.2: Three Dimensions of a Business Definition



The three dimensions along which a business is defined help a strategist to chalk out alternatives in a systematic manner.

9.1.2 Considering Selection Factors

The concepts of Gap Analysis and Business definition would help the strategist to identify a few workable alternatives. These must be analysed further against a set of selection criteria.

Selection factors are the criteria against which the alternative strategies are evaluated. These selection factors consist of:

1. Objective factors
2. Subjective factors.

1. ***Objective factors*** are based on analytical techniques such as BCG matrix, GE matrix etc. and are hard facts or data used to facilitate a strategic choice. They are also called rational, normative or prescriptive factors.
2. ***Subjective factors***, on the other hand, are based on one's personal judgment or descriptive factors such as consistency, feasibility, etc. which are discussed in the previous unit.

9.1.3 Evaluating the Alternatives

After narrowing down the alternative strategies to a few alternatives, each alternative has to be evaluated for its suitability to achieve the organisational objectives. Evaluation of strategic alternatives basically involves bringing together the results of the analysis carried out on the basis of objective and subjective criteria.

9.1.4 Making the Actual Choice

An evaluation of alternative strategies leads to a clear assessment of which alternative is most suitable to achieve the organisational goals. The final step, therefore, is to make the actual choice. One or more strategies have to be chosen for implementation. Besides the chosen strategies, some contingency strategies should also be worked out to meet any eventualities. In both the above two steps, a number of portfolio analyses like BCG, nine–cell matrix etc., can be useful.

Notes

9.2 Strategic Analysis

Fred R David has developed a comprehensive strategy formulation and analytical framework which is very useful for strategic analysis and choice. We now discuss the framework briefly.

This framework consists of three stages:

1. Input stage
2. Matching stage
3. Decision stage

The following table summarises the basic information needed at each stage of the analytical framework.

Figure 9.3: Strategy Formulation and Analytical Framework

Stage 1: Input Stage	Stage 2: Matching Stage	Stage 3: Decision Stage
External Factor Evaluation (EFE) matrix Competitive Profile Matrix (CPM) Internal Factor Evaluation (IFE) matrix	SWOT matrix SPACE matrix BCG matrix Internal-External (IE) matrix Grand strategy matrix	Quantitative Strategic Planning Matrix (QSPM)

Input Stage

This stage summarises the basic input information needed to generate alternative strategies. This basic input information relates to the opportunities and threats, strengths and weaknesses as also the competitive profile of the firm. This information can be obtained from the following three matrices:

1. External Factor Evaluation Matrix (EFE Matrix)
2. Internal Factor Evaluation Matrix (IFE Matrix)
3. Competitive Profile Matrix (CPM Matrix)

Making small decisions on the relative importance of external and internal factors allows strategists to generate and evaluate alternative strategies more effectively. Besides, good intuitive judgment is always needed in determining appropriate weights and ratings.

Matching Stage

This stage involves the match between the internal resources and skills and the external opportunities and threats of an organisation. The following matrices can be used for the purpose:

1. SWOT Matrix (Already discussed in unit 5)
2. SPACE Matrix
3. BCG matrix
4. Internal-External Matrix
5. Grand Strategy Matrix

Notes

These tools use the information provided by the input stage and help the strategists to match external opportunities and threats with internal strengths and weaknesses.

Example: If a firm that has an internal weakness of insufficient capacity has to tap an external opportunity caused by the exit of two major foreign competitors from the industry; it may pursue horizontal integration by buying competitor's facilities.

The other matrices are explained in the section "Portfolio Analysis" of this unit.

Decision Stage

The matching techniques discussed above reveal feasible alternative strategies, which need to be examined and appropriate strategies selected for implementation. With the help of techniques like QSPM (Quantitative Strategic Planning Model) the strategies can be prioritised so that the best strategies could be chosen.

QSPM is explained in the "Portfolio Analysis" section of this unit.

9.3 Industry Analysis

The basic purpose of industry analysis is to assess the strengths and weaknesses of a firm relative to its competitors in the industry. It tries to highlight the structural realities of particular industry and the extent of competition within that industry. Through industry analysis, an organisation can find whether the chosen field is attractive or not and assess its own position within the industry.

Importance of Industry Analysis

Macro environment is common to all industries. It remotely affects the industry. It is the structural realities of the specific industry and the nature and intensity of competition unique to that industry that are of special relevance to the firm in formulating strategy.

Caution Industry structure, industry boundaries and industry attractiveness are essential for conducting an environmental survey. With industry and competition analysis, the firm actually gets into the study of proximate environment.

Factors that more directly influence a firm's prospects originate in the environment of its industry. Good industry and competitive analysis is a pre-requisite to good strategy making. A competently done analysis tells a clear, easily understood story about the company's environment needed for shrewdly matching strategy to the company's external situation.

The importance of industry analysis can thus be summarised as follows.

1. Industry – related factors have a more direct impact on the firm than the general environment.
2. An industry's dominant economic characteristics are important because of their implication for crafting strategy.
3. Industry analysis reveals industry attractiveness and its prospects for growth.
4. It helps the firm to identify such aspects as:
   (a) Current size of the industry
   (b) Product offerings

Notes

(c) Relative volumes

(d) Performance of the industry in recent years

(e) Forces that determine competition in the industry.

5. It focuses attention on the firm's competitors.

6. It helps to determine key success factors.

7. A thorough understanding of the industry provides a basis for thinking about appropriate strategies that are open to the firm.

9.4 Corporate Portfolio Analysis

Many companies offer more than one product, and serve more than one customer. They have a portfolio (i.e. a basket) of products. This is a good strategy because a firm which is dependent on one product or customer runs immense risk. Decisions on strategy, therefore, generally involve a range of products in a range of markets.

Portfolio analysis is an analytical tool which views a corporation as a basket or portfolio of products or business units to be managed for the best possible returns, and help a corporate to build a multi-business strategy.

When an organisation has a number of products in its portfolio, it is quite likely that they will be in different stages of development. Some will be relatively new and some much older. Many organisations will not wish to risk having all their products at the same stage of development. It is useful to have some products with limited growth but producing profits steadily, and some products with real growth potential but may still be in the introductory stage. Indeed, the products that are earning steadily may be used to fund the development of those that will provide the growth and profits in the future.

So, the key strategy is to produce a balanced portfolio of products, some with low risk but dull growth and some with high-risk but great potential for growth and profits. This is what we call portfolio analysis.

The aim of portfolio analysis is:

1. To analyse its current business portfolio and decide which business should receive more or less investment.

2. To develop growth strategies for adding new businesses to the portfolio.

3. To decide which business should no longer be retained.

Did u know? Several leading consulting firms developed a number of "portfolio matrices" during the 1970s and 1980s to achieve a better understanding of the competitive position of overall portfolio of businesses, to suggest strategic alternatives of each of the businesses and to identify priorities for allocation of resources. The basis for many of these matrices grew out of the BCG matrix developed by the Boston Consulting Group in the 1970s.

9.4.1 Display Matrices

"Display matrices" are simple frameworks in which products or business units are displayed as a series of investments from which top management expects a profitable return. It charts and characterises different products or businesses in the organisation's portfolio of investments in such a way that top management constantly juggles to ensure the best returns from them.

Notes

As already stated, key purpose of portfolio models is to assist in achieving a balanced portfolio of businesses. This means that portfolio should consist of those businesses whose profitability, growth, cash flow and risk elements would complement each other, and add up to a satisfactory overall corporate performance. Imbalance in portfolio, for example, could be caused either by excessive cash generation with too few growth opportunities or by insufficient cash generation to fund the growth requirements of other businesses in the portfolio.

9.4.2 Balancing the Portfolio

Balancing the portfolio means that the different products or businesses in the portfolio have to be balanced with respect to four basic aspects:

1. ***Profitability:*** The main aim of the portfolio analysis is to maintain the overall profitability of the corporation, even though some of the businesses are loss making. This is ensured through balancing investments.
2. ***Cash flow:*** A growing firm may be profitable, but it will also require additional cash outflows for investment requirements. Mature businesses, though less profitable, do not require much of investments though they may not be net cash generators. Thus, portfolio analysis must balance different businesses, which together must give a comfortable overall cash flow position in harmony with the desired strategy of the company.
3. ***Growth:*** All businesses or products go through the life cycle of introduction, growth, maturity and decline stages. If a company depends on one product alone, it would face problems in the declining stage of the product. It may be too late to start a new product at this stage because of the time lag involved in waiting till it achieves its growth rate. It is therefore better to match different businesses at different stages in their life cycles, to achieve stability which is sometimes called "extended corporate immortality". Thus the balancing of the portfolio implies that though individual businesses grow, mature and decline, yet the company continues to grow.
4. ***Risk:*** Another major objective of portfolio analysis is to reduce the risk due to economic trends and market forces in a country. The aim is to put together diverse businesses with different or even opposite market forces to ensure a stable and smoother financial performance of the overall corporation.

Example: One solution could be to diversify internationally, since markets in different countries are subject to different economic forces. Similarly, in the context of domestic markets, businesses with different seasonal cycles could be combined to ensure a more stable and smooth performance of the overall corporation.

9.4.3 Portfolio and other Analytical Models

Innumerable analytical models have been developed by several leading consulting firms. Some of the best-known models are:

1. BCG matrix
2. GE Nine-cell Matrix
3. Hofer's Product/Market Evolution Matrix
4. Directional Policy Matrix
5. Arthur D Little's Portfolio Matrix
6. Profit Impact of Market Strategy (PIMS) Matrix

Notes

7. SPACE Matrix
8. Quantitative Strategic Planning Matrix (QSPM)

BCG Matrix

The BCG matrix was developed by the Boston Consultancy group in 1970s. It is also called the "Growth share matrix". This is the most popular and the simplest matrix to describe a corporation's portfolio of businesses or products. BCG matrix is based on the premise that majority of the companies carry out multiple business activities in a number of different product-market segments. Together, these different businesses form the business portfolio of the company, which need to be balanced for overall profitability of the company.

To ensure long-term success, a company's business portfolio should consist of both high-growth products in need of cash inputs and low-growth products that generate excess cash.

The BCG matrix helps to determine priorities in a product portfolio. Its basic purpose is to invest where there is growth from which the firm can benefit, and divest those businesses that have low market share and low growth prospects.

Each of the products or business units is plotted on a two-dimensional matrix consisting of

1. Relative market share
2. Market growth rate.

Figure 9.4: The BCG Matrix

High market growth rate	Stars	Question Marks
Low market growth rate	Cash Cows	Dogs
	High relative market share	Low relative market share

Relative Market Share: Relative market share is defined as the ratio of the market share of the concerned product or business unit in the industry divided by the share of the market leader. By this calculation, a relative market share of 1.0 belongs to the market leader.

For example, if market share of 3 businesses A, B, C are

Business		Market share
A	-	10%
B	-	20%
C	-	60%

A's relative market share=10/60=1/6

B's relative market share=20 /60=1/3

C's relative market share=60/20=3

The relative market share reflects the firm's capacity to generate cash. It is assumed that if a business unit enjoys high market share, its cash earnings would be correspondingly higher and vice versa.

Notes

Market Growth Rate: It is the percentage of market growth, that is, the percentage by which sales of a particular product or business unit have increased.

A high growth rate enables the company to expand its operations. It makes it easier for the company to increase its market share and provide the opportunities of profitable investment. The company may plough back its earnings into the business and further increase the rate of return on the investment. Additional cash will necessarily be required to avail of the investment opportunities for growth. On the other hand, low market growth rate indicates stagnation with little scope for expansion and profitable investments may be risky to undertake. Increase in market share in such a situation can be possible only by cutting into the competitor's market price.

Building the BCG Matrix

The stepwise procedure for building the BCG matrix is given below:

1. The various activities of the company are classified into different business units or SBUs
2. The growth rate of the market is determined and plotted on the Y-axis.
3. The assets employed by the company in each of the business units are compiled to determine the relative size of the business unit in relation to the company.
4. The relative market share for different business units is estimated and plotted on the X-axis
5. The position of each business unit or product is plotted on a matrix of market growth rate and relative market share. The size of the business is represented by a circle with a diameter corresponding to the assets invested in the business. The radius of the circle is given by

$$r = \sqrt{p}\ .R^2$$

   where R represents total sales, P represents sales of the business unit as a percentage of the total sales of the company.
6. Depending on its location in the 2 × 2 matrix, a separate strategy has to be developed for each of the units.

It is important not to change the criteria around in order to shift pet projects and products into more favourable groups, thereby defeating the very purpose of the exercise.

Analysis of BCG Matrix

The BCG matrix reflects the contribution of the products or business units to its cash flow. Based on this analysis, the products or business units are classified as:

1. Stars
2. Cash cows
3. Question marks
4. Dogs

Stars (High Growth, High Market Share)

Stars are products that enjoy a relatively high market share in a strongly growing market. They are (potentially) profitable and may grow further to become an important product or category

Notes

for the company. The firm should focus on and invest in these products or business units. The general features of stars are:

1. High growth rate means they need heavy investment
2. High market share means they have economies of scale and generate large amounts of cash
3. But they need more cash than they generate.

The high growth rate will mean that they will need heavy investment and will therefore be cash users. Overall, the general strategy is to take cash from the cash cows to fund stars. Cash may also be invested selectively in some problem children (question marks) to turn them into stars. The other problem children may be milked or even sold to provide funds elsewhere.

Notes Over the time, all growth may slow down and the stars may eventually become cash cows. If they cannot hold market share, they may even become dogs.

Cash Cows (Low Growth, High Market Share)

These are the product areas that have high relative market shares but exist in low-growth markets. The business is mature and it is assumed that lower levels of investment will be required. On this basis, it is therefore likely that they will be able to generate both cash and profits. Such profits could then be transferred to support the stars. The general features of cash cows are:

1. They generate both cash and profits
2. The business is mature and needs lower levels of investment
3. Profits are transferred to support stars/question marks
4. The danger is that cash cows may become under-supported and begin to lose their market.

Although the market is no longer growing, the cash cows may have a relatively high market share and bring in healthy profits. No efforts or investments are necessary to maintain the status quo. Cash cows may however ultimately become dogs if they lose the market share.

Question Marks (High Growth, Low Market Share)

Question marks are also called problem children or wild cats. These are products with low relative market shares in high-growth markets. The high market growth means that considerable investment may still be required and the low market share will mean that such products will have difficulty in generating substantial cash. These businesses are called' question marks because the organisation must decide whether to strengthen them or to sell them.

The general features of question marks are:

1. Their cash needs are high
2. But their cash generation is low
3. Organisation must decide whether to strengthen them or sell them.

Notes

Caution Although their market share is relatively small, the market for question marks is growing rapidly. Investments to create growth may yield big results in the future, though this is far from certain. Further investigation into how and where to invest is advised.

Dogs (Low Growth, Low Market Share)

These are products that have low market shares in low-growth businesses. These products will need low investment but they are unlikely to be major profit earners. In practice, they may actually absorb cash required to hold their position. They are often regarded as unattractive for the long term and recommended for disposal. The general features of dogs are:

1. They are not profit earners
2. They absorb cash
3. They are unattractive and often recommended for disposal.

Turnaround can be one of the strategies to pursue because many dogs have bounced back and become viable and profitable after asset and cost reduction. The suggested strategy is to drop or divest the dogs when they are not profitable. If profitable, do not invest, but make the best out of its current value. This may even mean selling the division's operations.

Task Make an analysis of Maruti Suzuki products on the basis of BCG Matrix.

Strategic Implications

The BCG growth-share matrix links the industry growth characteristic with the company's market share (i.e. competitive strength), and develops a visual display of the company's market involvement, thereby indirectly indicating current resource deployment. The underlying logic is that investment is required for growth while maintaining or building market share. But while doing so, a strong competitive business i.e. a business having high market share operating in an industry with low growth rate will provide surplus cash for deployment elsewhere in the corporation. Thus, growth uses cash whereas market share is a potential source of cash. In terms of BCG classification, the cash position of various types of businesses can be visualized as shown Table 9.1.

Table 9.1: Cash Position of Various Businesses

S.No.	Business Type	Cash Source	Cash Use	Net Cash Balance
1.	Cow	More	Less	Funds available, so milk and deploy
2.	Star	More	More	Build competitive position and grow
3.	Dog	Less	Less	Divest or redeploy proceeds
4.	Question Mark	Less	More	Funds needed to invest selectively to improve competitive position

Thus, in a way, the BCG matrix can be regarded as a pictorial representation of the sources and uses of funds statement. Market share is considered valuable because it is a source of profits. Projects are the fruits of accumulated experience giving rise to cost advantage.

Notes

The model assumes that high market growth of star businesses will ultimately slow down, and stars may become cash cows, permitting the market leader to take cash out of them to invest in other businesses.

However, some of the underlying assumptions of the BCG matrix may not hold good for some businesses.

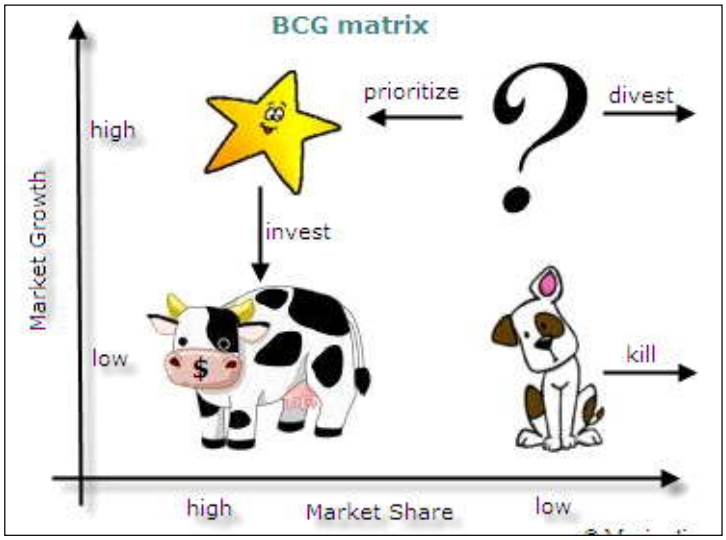
Example: Some electronic appliances and the so-called fashion goods have very short life-cycle, whereas staples like bread have very extended life-cycles. The business may therefore not follow the typical behaviour pattern assumed by the BCG matrix.

Case Study

BCG at Work in PepsiCo

It can be said that PepsiCo products and business portfolio can be divided in four major products or services; each service operates in accordance with its functions along with the products and services in different areas especially made as a distinction of each division. The PepsiCo analysis will be based in assessment of the services offered by the company.

PepsiCo consists of 5 major brands: Gatorade, Quaker, Pepsi products, Frito-Lay and Tropicana. The products that belong to the question mark are Gatorade and also Tropicana. Because of the emergence of different healthy drinks and beverages in the global market, the market share of Tropicana and Gatorade are being threatened. Although these brands are already established in the marketplace, the company still needs to have an effective marketing approach to increase the sale of these brands or brands. Accordingly, question mark category means that these products have a low share of a possible high growth market and may become a star product because of the positive response of the customers.



As can be seen in the figure, the services that fall in star category belong to the Pepsi brands. The star category shows the products with a high share of a gradual growth of market and these products have a tendency to produce high amount of profits. The next category that can be seen in the figure is the cash cows. Herein, the products are considered

Contd...

Notes

to have a high share of a slow growth market. With regards to the PepsiCo, services that can be considered in the cash cows are the Quaker. Lastly, it can be seen that Tropicana, Gatorade and Frito-Lay are products that can be considered in the dogs' category.

It can be said that PepsiCo has been able to market their products and increase their market share and market growth by using different strategies and approaches. The company enhances the market share of their brands by considering different marketing entry modes. Through collaborative venture PepsiCo has been able to se merger and acquisition along with joint venture approach. Furthermore, franchising is another method that PepsiCo used to enhance the market share of the brands of the company. This model has been utilized by PepsiCo in order to expand its business portfolio in other regions in the world. In this manner, the management of PepsiCo considers franchising an existing company in an international market while applying the methods of collaborative venture.

In order to make this foreign operational mode combination a success, PepsiCo consider the most suitable and effective expansion strategy. It can be said that the spread of PepsiCo is truly global. The company has hundreds of brands, which can be found in almost 200 countries and territories around the world.

Questions

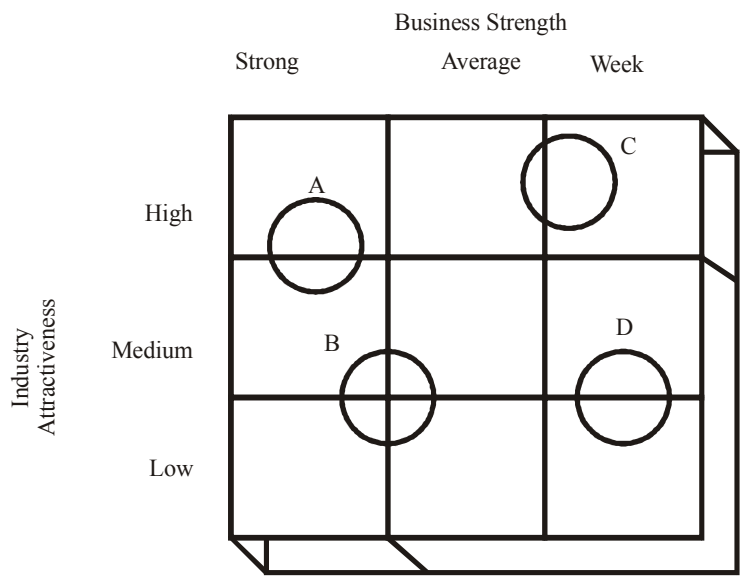
1. Does every company have all the four categories of the BCG matrix?
2. What do you suggest to put the question marks of Pepsi in the Cow category? Will it be feasible for the company? Why/why not?

Source: ivythesis.typepad.com

Ge Nine Cell Matrix

This matrix was developed in 1970s by the General Electric Company with the assistance of the consulting firm, McKinsey & Co., USA. This is also called GE Multifactor Portfolio matrix.

Figure 9.5: GE's Nine Cell Matrix



Notes

The GE matrix has been developed to overcome the obvious limitations of BCG matrix. This matrix consists of nine cells (3 × 3) based on two key variables:

1. Business strength; and
2. Industry attractiveness.

The horizontal axis represents "business strength" and the "vertical axis represents", "industry attractiveness".

The business strength is measured by considering such factors as:

1. Relative market share
2. Profit margins
3. Ability to compete on price and quality
4. Knowledge of customer and market
5. Competitive strengths and weaknesses
6. Technological capacity
7. Calibre of management

Industry attractiveness is measured considering such factors as:

1. Market size and growth rate
2. Industry profit margin
3. Competitive intensity
4. Economies of scale
5. Technology
6. Social, environmental, legal and human aspects

The individual product-lines or business units are plotted as circles. The area of each circle is proportionate to industry sales. The pie within the circles represents the market share of the product line or business unit.

The nine cells of the GE matrix represent various degrees of industry attractiveness (high, medium or low) and business strength (strong, average and weak). After plotting each product line or business unit on the nine cell matrix, strategic choices are made depending on their position in the matrix.

In Figure 9.5, business 'A' has strong business strength and has high industry attractiveness. Such a business has high potential for growth. It deserves expansion strategies through large investments. Business B has strong business strength, but medium/low industry attractiveness. Such a business needs a cautious approach. Business C is weak in business strength though its industry attractiveness is high. Business D is weak in business strength and also low in attractiveness. Broadly considered, the company should build business A, maintain business B and make some hard decisions on what to do with businesses C and D.

Notes

Stoplight Strategy

GE matrix is also called "Stoplight" strategy matrix because the three zones are like green, yellow and red of traffic lights as shown below:

Zone		Strategic Choice
Green		Invest/expand
Yellow		Select /earn
Red		harvest/divest

The strategies are chosen depending on the zone in which the product or business unit happens to fall:

1. If the product falls in the 'green zone', i.e., if the business strength is strong and industry is at least medium in attractiveness, the strategic decision should be to expand, to invest and to grow.
2. If the product falls in the 'yellow zone' i.e. if the business strength is low but industry attractiveness is high, it needs caution and managerial discretion for making the strategic choice.
3. If the product falls in the 'red zone' i.e. the business strength is average or weak and attractiveness is also 'low' or 'medium', the appropriate strategy should be divestment.

Thus, products or business units in the green zone are almost equivalent to "stars" or "cash cows", yellow zone are like 'question marks' and red zone are similar to 'dogs' in the BCG matrix.

Notes

Differences between BCG and GE Matrices

BCG Matrix	GE Matrix
1. BCG matrix consists of four cells	1. GE matrix consists of nine cells
2. The business unit is rated against the following two criteria (i) relative market share (ii) industry growth rate.	2. The business unit is rated against the following criteria (i) business strength (ii) industry attractiveness.
3. The matrix uses single measures to assess growth and market share.	3. The matrix uses multiple measures to assess business strength and industry attractiveness
4. The matrix uses two types of classification i.e. high and low	4. The matrix uses three types of classification (high/medium/low and strong /average /weak).
5. Has many limitations	5. GE matrix overcomes many limitations of BCG and is an improvement over it.

Notes

Critical Assessment of GE Matrix

Merits

The GE matrix is an improvement over BCG matrix in the following respects:

1. It uses 9 cells instead of 4 cells.
2. It considers many variables and does not lead to simplistic conclusions.
3. High/medium/low and strong/average/low classification enables a finer distinction among business portfolios.
4. It uses multiple factors to assess industry attractiveness and business strength, which allow users to select criteria appropriate to their situation.

Shortcomings

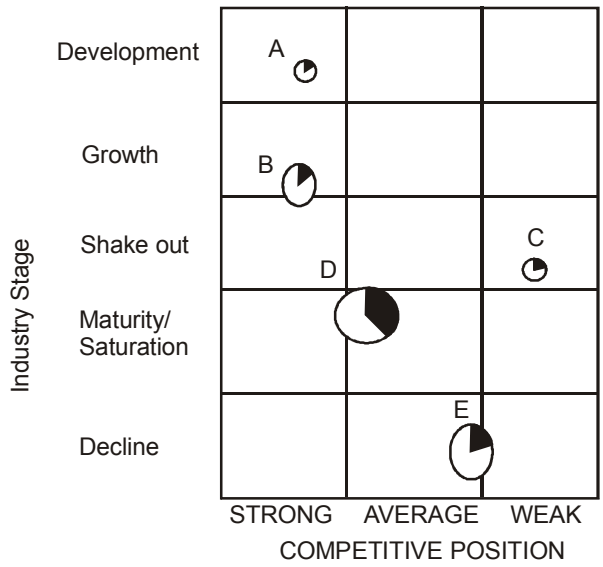
The GE matrix, however, has some shortcomings.

1. It can get quite complicated and cumbersome with the increase in businesses.
2. Though industry attractiveness and business strength appear to be objective, they are in reality subjective judgments that may vary from one person to another.
3. It cannot effectively depict the position of new business units in developing industries.
4. It only provides broad strategic prescriptions rather than specifics of business policy.

Hofer's Product-market Evolution Matrix

Hofer has suggested a three-by-five matrix in which businesses are plotted according to two parameters viz. the firm's business strength (competitive position) and the industry stage in the product-market life cycle. As in the GE nine-cell matrix, circles are plotted to represent the size of the industry while market share is shown as shaded segments.

Figure 9.6: Hofer's Product/Market Evolution Matrix



Notes

Five businesses have been shown in the above Figure 9.6. The key strategies that emerge are briefly explained below.

Business A represents a product/market that has a high potential and deserves expansion strategies through large investments. Business B has a strong competitive position but has a product that is entering the shake-out stage and, therefore, needs a cautious expansion strategy. Business C is probably a 'dog' while D represents a business which can be used for cash generation that could be diverted to A and B. Business E is a potential loser and may be considered for divestment. In this manner, the product/market evolution matrix portrays a company's corporate portfolio with a high level of accuracy and completeness.

Directional Policy Matrix (DPM)

This matrix was developed by Shell Chemicals, UK. It uses two dimensions- viz. "business sector prospects and the "company's competitive capabilities". Business sectors prospects are divided into attractive, average and unattractive; and company's competitive capabilities into strong, average and weak, as shown in the following Figure 9.7. This gives a 9-cell matrix.

Figure 9.7: Directional Policy Matrix

Company's Competitive Capabilities	Business Sector Prospects: Unattractive	Average	Attractive
Weak	1 Divestment	2 Phased withdrawal	3 Double or quit
Average	4 Phased withdrawal	5 Custodial	6 Try Harder
Strong	7 Cash Generation	8 Growth	9 Market Leadership

Based on the two dimensions, businesses fall into Nine quadrants. The strategy to be followed for businesses in each quadrant are explained below.

Divestment

Both competitive capabilities and business prospects of the business units are weak. Loss making units with uncertain cash flows fall in this quadrant. Since the situation is not likely to improve in the near future, these businesses should be divested. The resources released could be put to an alternative use.

Phased Withdrawal

Here the SBU is in an average to weak competitive position in the low growth unattractive business, with very little chance of generating enough cash flows. Gradual withdrawal from such SBUs is the strategy to be followed. The cash released can be invested in more profitable ventures.

Notes

Double or Quit

Though business prospects look attractive here the company's competitive capabilities are weak. Either invest more to exploit the prospects or, if not possible, better "exit" from the SBU.

Phased Withdrawal

Already covered in previous page.

Custodial

Here both competitive capabilities and business prospects are unattractive or average. Bear with the situation with a little bit of help from the other product divisions or get out of the SBU so as to focus more on other attractive businesses.

Try Harder

Here business prospects are attractive, but competitive capabilities are average; strengthen their capabilities with infusion of additional resources.

Cash Generation

Here the SBU has strong competitive capabilities, but its business prospects are unattractive. Its operations can be continued at least for generating cash flows and profits. However, further investments cannot be made in view of unattractive business prospects.

Growth

Here the SBU has strong competitive capabilities, but its business prospects are average. This SBU requires additional infusion of funds. This would help the SBU to grow.

Market Leadership

Here the SBU has strong capabilities, and its business prospects are also attractive. It must receive top priority so that the SBU can retain its market leadership.

Arthur D Little Portfolio Matrix (ADL)

Arthur D Little Company's matrix links the stages of the product life cycle with the business strength. On the vertical axis, businesses are classified with respect to their business strength as weak, tenable, favoured, strong or dominant. Along the horizontal axis, four steps in the product life cycle, i.e. embryonic, growth, mature and decline are marked. This makes a four-by-five matrix as shown in the Figure 9.8.

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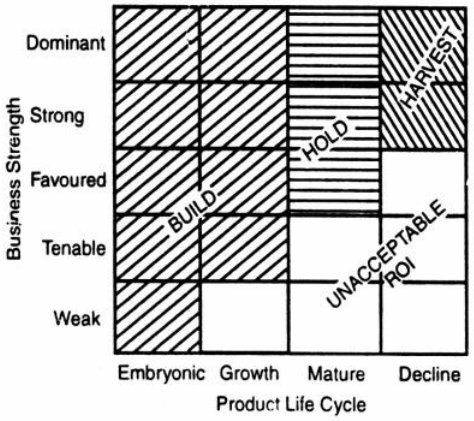
Figure 9.8: Arthur D Little Portfolio Matrix (ADL)



The strategic approach would naturally vary according to the position of the business with respect to its business strength (competitive strength) and the stage in the product life cycle. Thus, the strategy should be to invest in a business which is in embryonic or growth stage provided it has favorable or strong business strength. The "BUILD" strategy is recommended for such a business unit. But "HOLD" strategy is suggested for businesses whose products are in maturity stage even though it has favourable, strong or dominant business strength. For business with products in the decline stage and having a strong or dominant business strength, "HARVEST' strategy is suggested. If the business is in maturity stage, but having weak business strength, "DIVEST" strategy is called for. This is so because any business having weak business strength will have poor return on investment, and hence divestment strategy will be the preferred strategy.

Profit Impact of Market Strategy (PIMS)

PIMS was invented by General Electric in the 1960s to examine which strategic factors most influence cash flows and the investment needs and success. PIMS model is based on analysis of data presented by companies to derive general laws.

Actually, the model uses statistical relationships derived from the past experience of companies. Typically, the Strategic Planning Institute develops an industry characteristic, using multi-dimensional cross sectional regression studies of the profitability of more than 2000 companies. The industry characteristic is compared with performance in the concerned company so as to find the clue to appropriate strategic approaches. The model is characterized by scientific objectivity but it involves analysis of relationship that is based on heterogeneity of business and time periods.

PIMS, of course, has certain inherent drawbacks. It assumes that short-term profitability is the primary goal of the firm. The analysis is based on the historical data and the model does not take note of further changes in the company's external environment.

The model cannot take account of internal-dependencies and potential synergy within organisations. Each firm is examined in isolation.

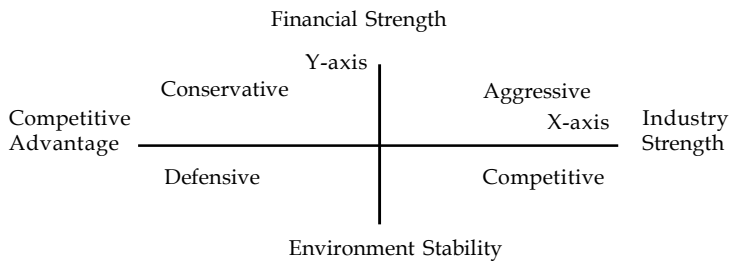
Notes

SPACE Matrix

The Strategic Position and Action Evaluation (SPACE) matrix is another important technique. It reveals which of the following strategies is most appropriate for an organisation:

1. Aggressive strategies
2. Conservative strategies
3. Defensive strategies
4. Competitive strategies

Figure 9.9: The SPACE Matrix



The axes of the space matrix represent two internal dimensions, namely, financial strength and competitive advantage and two external dimensions, namely, environmental stability and industry strengths, as shown in the Figure 9.9.

The directional vector of each profile indicates the type of strategies to pursue: conservative, aggressive, defensive or competitive.

Aggressive Quadrant

When a firm's directional vector falls in the "aggressive quadrant" of the matrix. It is in an excellent position to use its internal strength to:

1. take advantage of external opportunities
2. overcome internal weaknesses
3. avoid or minimize external threats

The firm can adopt any of the aggressive growth strategies like market penetration, market development, product development, backward and forward integration, horizontal integration, concentric and conglomerate diversification or a combination strategy.

Conservative Quadrant

When a firm's directional vector falls in the "conservative quadrant", it means the firm should stay close to its core competencies and not take excessive risks. Conservative strategies include market penetration, market development, product development and concentric diversification.

Defensive Quadrant

When the directional vector falls in the "defensive quadrant", it suggests that the firm should focus on rectifying internal weaknesses and external threats, through defensive strategies. Defensive strategies or retrenchment strategies include turnaround, divestiture, bankruptcy or liquidation.

Notes

Competitive Quadrant

When a directional vector falls in the "competitive quadrant", the firm should follow competitive strategies, which include backward, forward, and horizontal integration, market penetration; market development, product development, joint ventures and strategic alliances.

Task Discuss the space matrix for McDonalds and Wal-Mart.

Quantitative Strategic Planning Matrix (QSPM)

The basic format of QSPM is as follows:

Table 9.2: Basic Format of QSPM

Key Factors	Weight	Strategy 1	Strategy 2	Strategy 3
Key external factors • Economic • Political, legal and governmental • Social, cultural and demographic • Technological • Competitive				
Key internal factors • Management • Marketing • Finance • Production • HR • R&D				

The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on key internal and external success factors. Like other analytical tools, QSPM requires good intuitive judgment.

The six steps required to develop a QSPM are:

Step 1: Make a list of the firm's external opportunities/threats and internal strengths/weaknesses.

Step 2: Assign weights to each key factor.

Step 3: Identify alternative strategies that the organisation wants to pursue.

Step 4: Determine the attractiveness scores. They are numerical values that indicate the relative attractiveness of each strategy in a given set of strategies.

Step 5: Compute the total attractiveness scores, which are obtained by multiplying the weights by the attractiveness scores in each row.

Step 6: Compute the sum total attractiveness scores in each strategy column of QPSM.

The sum total attractiveness scores reveal which strategy is most attractive.

9.5 Contingency Strategies

Strategic choice is made on the basis of certain assumptions and conditions. If the conditions change drastically, the chosen strategies may have to be discarded altogether. If they are not too radical, the strategies may have to be modified suitably. But changes do not occur in a sequential

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order, nor do they give any impending warnings. They surface suddenly leaving deep scars on the faces of managers—if they are unprepared. To be on the safe side, strategists always keep contingency strategies ready. Such contingency strategies are formulated in advance to take care of unknown events and unexpected challengers. As rightly summarised by Peter Drucker, successful managers do not wait for future. They make the future through their proactive planning and advanced preparation. They introduce original action by removing present difficulties, anticipate future problems, change the goals to suit internal and external changes, experiment with creative ideas and take initiative, attempt to shape the future and create a more desirable environment.

The contingencies could come in the form of a labour strike, a downturn in the economy or an overnight change in government policy. Once such scenarios are identified managers could come out with alternative strategies for the firm. Firms using this kind of strategy identify certain trigger points to alert management that a contingency strategy should be pressed into service. When alternative plans are put in place, mid-course corrections could be carried out in a smooth way.

Caselet

TVS-Suzuki: The Third Coming

When the technology partner, Suzuki parted ways with TVS Motors Ltd, the TVS Group had to put all its expansion plans in the back burner and overhaul its product portfolio in the two-wheelers segment. Strict emission norms, too, have made its life somewhat uneasy, forcing the company to abandon the two-stroke technology in favour of the now popular four-stroke technology in motor cycle (VICTOR, Fiero). Though TVS Motors is a late entrant in the 4-stroke motor cycle segment it has been able to recover lost ground in recent years because the group had enough R&D muscle to develop the 4-stroke technology and is purely a power-bike manufacturer. The success of TVS Victor, India's first fully indigenous four-stroke motorcycle, is a shining example of proactive planning and years of hard mental preparation to take care of any eventuality. The important lesson to be learnt from such unexpected events is, quite well known in corporate circles, but worth repeating here: Never rest on past laurels.

Source: Business Today, July 6, 2001; September 10 2001; December 6, 2000

9.6 Summary

- Strategic choice is the decision to select from among the alternatives considered, the strategy which will best meet the enterprise objectives. This decision-making process consists of four distinct steps:
  - Focusing on a few alternatives.
  - Considering the selection factors.
  - Evaluating the alternatives.
  - Making the actual choice.
- Strategic analysis framework consists of three stages: Input stage, Matching stage and Decision stage

Notes

- The basic purpose of industry analysis is to assess the strengths and weaknesses of a firm relative to its competitors in the industry.
- Portfolio analysis is an analytical tool which views a corporation as a basket or portfolio of products or business units to be managed for the best possible returns, and help a corporate to build a multi-business strategy.
- Various matrices are used under this approach.
- Though the portfolio approaches have limitations, but all these limitations can be overcome through effective strategy development and meticulous planning.
- While the core competence concept appealed powerfully to companies disillusioned with diversification, it did not offer any practical guidelines for developing corporate-level strategy.
- Contingency plans are organised and coordinated set of steps to be taken if an emergency or disaster (fire, hurricane, injury, robbery, etc.) strikes.

9.7 Keywords

BCG Matrix: Most popular and the simplest matrix to describe a corporation's portfolio of businesses or products.

Display Matrices: Frameworks in which products or business units are displayed as a series of investments from which top management expects a profitable return.

Market Growth Rate: The percentage of market growth, that is, the percentage by which sales of a particular product or business unit have increased.

Portfolio strategy approach: A method of analysing an organisation's mix of business in terms of both individual and collective contributions to strategic goals.

Relative Market Share: The ratio of the market share of the concerned product or business unit in the industry divided by the share of the market leader.

Strategic Choice: Selection of a strategy that will best meet the firm's objectives.

9.8 Self Assessment

Fill in the blanks:

1. The balancing of the portfolio implies that though individual businesses grow, mature and decline, yet the company continues to .....
2. The GE matrix has been developed to overcome the obvious limitations of .....
3. In GE Matrix, the horizontal axis represents ..... and the vertical axis represents .....
4. GE matrix is also called ..... strategy matrix.
5. Directional Policy Matrix (DPM) was developed by .....
6. Arthur D Little Company's matrix links the stages of the product life cycle with the .....
7. On the vertical axis in Arthur D Little Company's matrix, businesses are classified with respect to their business strength as ....., ..., ..., ... or .....

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8. The axes of the space matrix represent two internal dimensions, namely, ... and .....
9. The axes of the space matrix represent two external dimensions, namely, ... and .....
10. BCG matrix is also called the .....
11. The BCG matrix helps to determine ..... in a product portfolio.
12. A high growth rate enables the company to ..... its operations.

9.9 Review Questions

1. Suppose you are the head of a garments making firm that has just started its operations in India. Discuss the process of strategic choice that you are most likely to follow.
2. Conduct an industry analysis for the Indian automobile industry.
3. Analyse the main advantages of portfolio analysis? Why it is a good option for multi-product organisations?
4. Through examples, prove that some of the underlying assumptions of the BCG matrix may not hold good for some businesses.
5. Compare and contrast the General Electric Grid and the BCG Matrix?
6. Do you think, BCG Matrix has limited application? Justify your answer.
7. Though BCG matrix can be very helpful in forcing decisions in managing a portfolio of products, it cannot be employed as the sole means of determining strategies for a portfolio of products. Do you agree with this statement or not? Why?
8. On the basis of GE Matrix, make an analysis of banking company of your choice.
9. Analyse the main issues which have to be taken care of while formulating a multi business strategy.
10. Do you think it is possible to sustain over a long run without formulating multi business strategy? Why/ why not?

Answers: Self Assessment

1. grow
2. BCG matrix
3. business strength, industry attractiveness
4. Stoplight
5. Shell Chemicals, UK
6. business strength
7. weak, tenable, favoured, strong, dominant
8. financial strength, competitive advantage
9. environmental stability, industry strengths
10. Growth share matrix
11. priorities
12. expand

9.10 Further Readings

Notes

Books

Richard Lynch, *Corporate Strategy*, Prentice Hall, Pearson Education Ltd., UK, 2006.

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Online links

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www.netmba.com/strategy/matrix/bcg

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Unit 10: Strategy Implementation

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Objectives

After studying this unit, you will be able to:

- Explain how strategies are activated
- State the nature and barriers in strategy implementation
- Discuss the model of strategy implementation
- Describe the concept of resource allocation

Introduction

Strategy implementation is the process of putting organisation's various strategies into action by setting annual or short-term objectives, allocating resources, developing programmes, policies, structures, functional strategies etc. Even the best strategic plan will be useless unless it is implemented properly. The strategy implementation is, therefore, the most difficult element of

the strategic management process. This is so because there has to be a "fit" between the strategy and the organisation.

10.1 Activating Strategies

There is no guarantee that a well designed strategy is likely to be approved and implemented automatically. The strategic leader must, therefore, defend the strategy from every angle, communicate how the strategy when implemented would benefit the whole organisation and secure the wholehearted support of employees working at various levels. To keep things on track, he can list out priorities, programme implementation process, budgets, etc. on paper so that nothing is left to chance.

While giving a concrete shape to the strategy, he should also take note of regulatory mechanisms that govern business activity and see that everything is in order. Some of the important things to be kept in mind are listed below:

1. ***Formation of a company:*** This must be in line with provisions of the Companies Act, 1956, covering issues such as formation of a company, its registration, obtaining suitable licenses before commencing operations, raising funds from various sources in accordance with the provisions of SEBI Act, 1992.
2. ***Operations of a company:*** The company must compete in a fair way and earn the profits through legally blessed routes only observing the (a) provisions of competition law; (b) Import/export restrictions, (c) FERA regulations (FEMA regulations, 2000); (d) Patent, trademark, copyright (Indian Patents Act 1995, The Trade and Merchandise Marks Act 1958, The Copyrights Act 1957 etc.) stipulations; (e) Labour Laws (regarding employment of women, children, payment of wages, providing welfare amenities, keeping healthy industrial relations etc.); (f) environmental protection (The Environment Protection Act 1986), (g) pollution control requirements; (h) consumer protection measures etc.
3. ***Winding up operations:*** Even when the company decides to get out of a venture/business, the rules of the game need to be followed scrupulously (whether in offering golden handshake to employees or asking all the employees to quit in one go).

After the institutionalisation of strategy in the above manner, action plans could be formulated. These are basically functional level strategies undertaken at the departmental level and usually deal with operational aspects of a strategy. The action plans, however, must try to translate the overall strategic plan in letter and spirit without any deviations. Issues like who will do what, what kind of support is required at various stages, what kind of privities have to be fixed while implementing active plans, how does a particular active plan contribute to the broad objectives of the strategy etc. must also be carefully looked into. Once the action plans are ready, the strategist must resolve issues relating to allocation of scarce resources over the entire organisation.

10.2 Nature of Strategy Implementation

A successful strategy formulation does not guarantee successful strategy implementation. It affects an organisation from top to bottom; it affects all divisional and functional areas of business. It requires the right alignment between the strategy and various activities, processes within the organisation.

The complexities in the task of implementation arise from a number of organisational adjustments that are required over an extended period of time and the need to match them all to the strategy. Key people need to be added or reassigned, resources have to be mobilised and allocated, functional strategies and policies are to be designed, organisational structure may

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have to be changed, a strategy- supportive culture may have to be developed, reward and incentive plans are to be revised and if necessary, restructuring, re-engineering and redesigning becomes imperative. In short, the difficulties in affecting the organisational adjustments arise from the tasks associated with change. The success of strategy implementation, to a large extent, therefore, depends on the way the task of change management is carried out.

Though both the formulation and implementation are inextricably linked, they can be distinguished as follows (Fred R. David):

Strategy formulation	Strategy implementation
Positioning forces *before* the action.	Managing forces *during* the action.
Focuses on *effectiveness.*	Focuses on *efficiency.*
Primarily an *intellectual* process.	Primarily an *operational* process.
Requires good *intuitive* and *analytical* skills.	Requires *motivation* and *leadership* skills.
Requires coordination among *few individuals*	Requires coordination among *many individuals.*

Implementation moves responsibility from the corporate level to operational levels. This shift in responsibility from strategists to divisional, functional and operational managers may cause implementation problems especially when strategic decisions come as a surprise to middle and lower-level managers. Therefore, strategic decisions must be communicated and understood throughout the organisation. It is also essential that divisional and functional managers be involved as much as possible in strategy formulation activities and, likewise strategists be involved in strategy implementation activities.

Case Study

Cost Reduction Strategy at Bajaj

Bajaj Auto is India's biggest scooter and motorcycle manufacturer, yet it faces intense competition from some of the world's leading scooter and motorcycle manufacturers. This case explores how it was using supplier strategies to reduce its costs and remain competitive.

In 1998, Bajaj Auto – India's biggest scooter and motorcycle manufacturer – was struggling to shake off a strong challenge from Honda, Suzuki and Piaggio in its home market. The family-owned company, which lacks the technological resources of its competitors, had to compensate by watching its expenses. Its aim is to remain the lowest cost producer in the world.

But no matter how hard Bajaj tries to control costs and improve productivity at its plants near Pune, in West India, the incremental savings were meager. This is because most of the costs are incurred before the components enter Bajaj's factory gates. In-house costs make up only about 10 to 12% of the sales price. Advertising and distribution costs account for a further 3 to 4%. By contrast, 'about 65% of the sales price comes from costs outside Bajaj's direct control. This can rise to 75% for new models. Bajaj has recently realised that further big cost savings are more likely to come from its suppliers than from the manufacturing process.

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GM Style Supplier Management

Sanjiv Bajaj is heading an effort to introduce US-style supply chain management, using General Motors as a model. It is a task for which he is well suited. A trained engineer, he went into the finance department because his elder brother, Rajiv, had already been groomed to take over the core manufacturing responsibilities. Engineering expertise helps him to understand where costs can be trimmed. Bajaj, which produces 1.3 million vehicles a year, has about 900 direct tier-1 suppliers. According to the GM model, it should have 80. Many of them are small, low-technology, family-run businesses with poor productivity and slack quality control.

'We need to identify who the good vendors are, reduce the number of vendors and give them a bigger share of the pie,' says Sanjiv Bajaj. Then, he adds, the company will try to negotiate lower prices for higher volumes. As in the case of GM, Bajaj hopes to work with its suppliers to improve 'quality and reliability'. The company aims to help its chosen suppliers invest in new equipment and improve productivity over the long term, bearing in mind 'our future requirements'.

Bajaj has followed GM principles by dividing its suppliers into different categories: those that own specialist knowledge and provide it in the form of proprietary items such as headlamps; those that provide model design parts on the basis of knowledge passed on by Bajaj; those that provide basic nuts and bolts hardware; and non-core product suppliers. It has also set out four issues to be looked at with its suppliers: the 'make-or-buy' decisions that determine which products a customer buys; issues pertinent to each component sector; a vendor rating system; a vendor integration programme to introduce quality control systems used by Bajaj to its suppliers.

Difficulties with Applying US-style Strategy

But this is where the similarity with GM ends. "You can't use textbook theories," says Sanjiv Bajaj. 'In India you have to consider questions like labour and power supply.' Unlike GM, Bajaj cannot afford to rely on only one supplier for a particular part because its operations would be paralysed if that supplier's workers went on strike – a common occurrence in India's highly unionised manufacturing industry. Similarly, having just one supplier would be risky because its output could be disrupted by power shortages, another regular occurrence. It makes sense to have suppliers in different areas, since simultaneous power failures are less likely.

Bajaj also has to wrestle with problems such as India's poor road system, which affects distribution and makes location important. Few Indian suppliers could shoulder the responsibilities GM puts on its US suppliers. There are also issues that relate specifically to components. "Two of our three suppliers of shock absorbers are subsidiaries of competitors," says Sanjiv Bajaj. "Long term this is questionable." The company may opt to build up a third supplier in a relationship of 'interdependence'.

Rationalising the supply chain will take several years. When it is completed, Bajaj will still have far more suppliers than the GM model suggests it should. Sanjiv Bajaj talks of '200, 300 or 400', though he says the company will decide the final figure 'from the bottom up'.

Bajaj hopes this will produce cost savings and quality improvements that will help compete against world-class products in an increasingly discerning market. It remains to be seen whether this will be enough. Bajaj will also have to match Honda and its other rivals in design, engine technology and marketing. But better management of its suppliers, while not guaranteeing success, is likely to be a necessary requirement for it.

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Progress to 2005

By 2005, Bajaj Auto was well established as a major motorcycle manufacturer in India. It had created a major manufacturing facility at its base in Pune. It had developed a strong distribution and service network and an important R&D facility, which had led to the introduction of new Digital Twin Spark Ignition Technology. The company had also become a major exporter of motorcycles in the Asian region and was negotiating to set up a manufacturing facility in Indonesia. Although not mentioned in the case above, the company had an important line of vehicles – Bajaj was the leading company in the Indian three-wheeler market and had a profitable revenue stream from this market segment.

However, Bajaj Auto had lost its market leadership in motor cycles to a rival company, Hero Honda. This was partly as a result of having little success in launching successful models into the fast-growing executive segment of the Indian motor cycle market, where Hero Honda was the market leader. Bajaj was still engaged in a fierce price war with Hero Honda in the standard market segment where low production costs were crucial to profitability. In addition, the original Japanese motorcycle company, Honda, had entered the Indian market in 2004 as a new threat to both Hero Honda and Bajaj.

Finally, Bajaj was so pleased with the overall performance of Mr Rajiv Bajaj that it appointed him as managing director of the group in 2005. He had delivered a major transformation in the group's fortunes over the period from 1998 and was well positioned to take the group forward.

Questions

1. What are the main problems facing Bajaj Auto? To what extent are they related to operations issues?
2. Is it possible or even realistic to employ US-style operations strategies in a country where the suppliers present rather different problems from those experienced in the US?
3. Can you think of any other options to assist Bajaj develop its strategy beyond supply chain issues?
4. What lessons can companies draw from the experience of Bajaj on the application of the strategic issues?

10.3 Barriers and Issues in Strategy Implementation

Management must keep in mind the following key issues that arise in implementing strategy and how empowering systems might relate to such issues.

1. ***Time Horizon:*** Such systems have both long-term and short-term dimensions. For example, rewards like productivity bonus should be based on quantitative measures of performance related to the short-term. On the other hand, it is appropriate to link long-term rewards with qualitative measures and a few relevant quantitative measures.
2. ***Risk Considerations:*** When risk-prone behaviour is desired, qualitative measures of performance may be more beneficial, for example, rewards like bonus or stock options. This is because quantitative measures may lead to risk-averse behaviour to avoid failure rather than risk prone behaviour to achieve results.

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3. ***Bases of Individual Rewards:*** Reward systems should be linked to an individual's capability, effort and job satisfaction. If rewards are geared to only one aspect, it may have a negative effect on performance in other aspects.

4. ***Bases of Group Rewards:*** An important issue in reward systems is whether to have individual rewards or group rewards. Rewarding individuals for effort and performance may be difficult unless the organisational structure permits individual performance to be isolated from that of others. Thus, for example, with respect to managerial contribution to corporate performance, individual rewards may be beneficial and appropriate because individual's contribution is relatively independent of others. On the other hand, if individual's contributions are relatively interdependent, it would be appropriate to adopt schemes based on group performance. Again, rewarding individuals may be necessary where entrepreneurial or creative behaviours are sought to be encouraged. On the contrary, if greater co-operation and team work is sought to be rewarded, group reward schemes would be more desirable.

5. ***Corporate and SBU Perspectives:*** In multi-divisional organisations, reward systems with a balanced approach towards corporate interests and the interests of the Strategic Business Units (SBUs) should be designed, where business units have greater autonomy and independence. Likewise, if the SBUs are not likely to influence corporate performance, unit-based reward schemes would be more beneficial. But in the case of directors and general managers, placed in the units, who have dual responsibility of achieving unit as well as corporate objectives, due care must be taken to design balanced empowering environment.

Task Recently ITC has launched its range of noodles –Sunfeast Yippee. The noodles come in different flavours and shape and they are trying to position the product based on these distinguishing features. Considering that the market is dominated by Nestlé's Maggi, identify the barriers they might face in the implementation of their strategy.

10.4 Model for Strategy Implementation

According to Steiner and Miner, "the implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organisational purposes". Implementation of strategy therefore involves a number of interrelated decisions, choices, and a broad range of activities. It requires an integration of people, structures, processes etc.

Mc Kinsey's 7-S model is good at capturing the importance of all these elements in the implementation of strategy.

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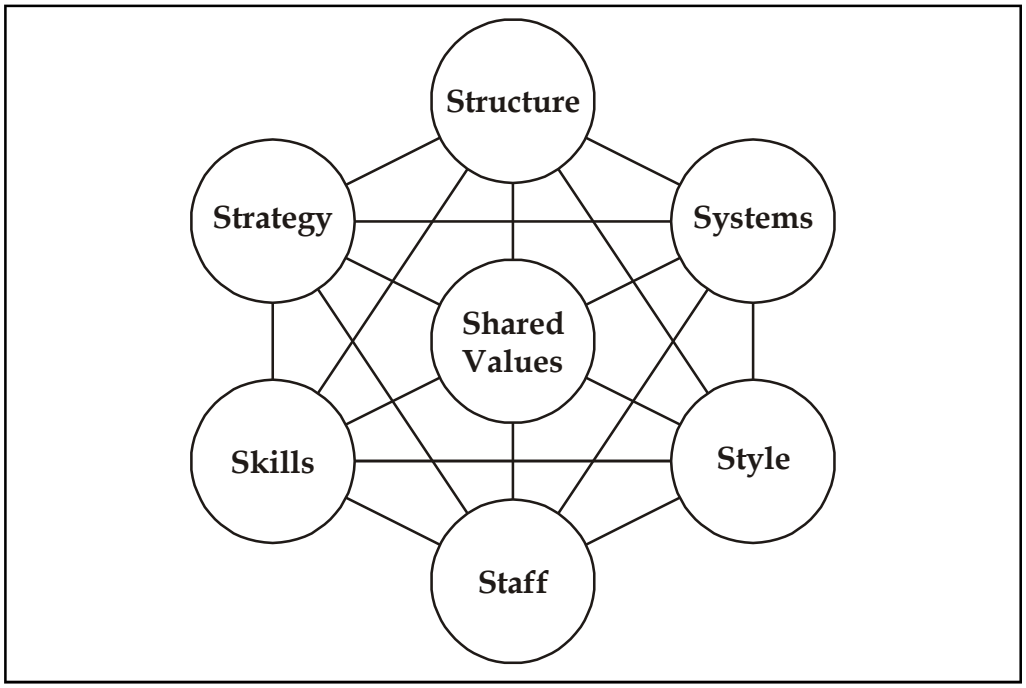
The 7-S framework was developed in 1970s by the well-known consultancy firm, the Mc Kinsey Company of the United States. The 7-S framework is illustrated:



The purpose of the model is to show the *interrelationship* between different elements of an organisation, and the need to bring them together.

7-S Framework

This framework basically deals with organisational change. The main thrust of change is not connected only with the organisation's strategy. It has to be understood by the complex relationships that exist between ***strategy, structure, systems, style, staff, skills*** and ***super-ordinate goals***. These are called the 7-S of the organisation.

The 7-S framework suggests that there are several factors that influence an organisation's ability to change. The variables involved are interconnected so that altering one element may well impact other connected elements. Hence, significant changes cannot be achieved in any variable without making changes in all the variables. There is no starting point or implied hierarchy in the shape of the diagram, so it is not obvious which of the 7 factors would be the driving force in changing a particular organisation at a particular point of time. All the elements are equally important. The critical variables of change could be different across organisations. They could also be different in the same organisation. Fundamentally, the framework makes the point that effective strategy implementation is more than an individual subject, but is coupled with skills, styles, structures, systems, staff and super-ordinate goals.

Super-ordinate Goals: "Super-ordinate goals" mean the "goals of a higher order which express the values, vision and mission that senior management brings to the organisation".

These can be considered as the fundamental ideas around which a business is built. Hence, they represent the main values and aspirations of an organisation. They are the broad notions of future direction. They can be considered to be equivalent to "organisational purposes". For example, the super-ordinate goal of IBM has been "customer service", while that of Hewlett-Packard was "innovative people at all levels in the organisation". When properly articulated, super-ordinate goals can provide a strong basis for organisation's stability in a rapidly changing environment by providing a basic meaning to people working for the organisation.

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Structure: "Structure" means the organisational structure of the company. The design of organisational structure is a critical task of top management. Organisational structure refers to the relatively more durable organisational arrangements and relationships. It prescribes the formal relationships among various positions and activities, communication channels, roles to be performed by various members of an organisation.

Organisational structure performs four major functions:

1. It reduces external uncertainty.
2. It reduces internal uncertainty due to variable, unpredictable and random human behaviour.
3. It provides a wide variety of devices like departmentalization, specialization, division of labour, delegation of authority etc.
4. It helps in coordinating various activities of the organisation and focus on its objectives.

Organisational structure must be designed in accordance with the needs of the strategy. According to Chandler, structure must follow strategy. In other words, changes in strategy must be followed by changes in organisational structure.

According to McKinsey, the relationship between strategy and structure, though important, rarely provides unique structural solutions. Quite often the main problem in strategy relates to its execution.

Systems: "Systems" mean the procedures that make the organisation work. They include the rules, regulations and procedures, both formal and informal, that complement the organisational structure. Systems include production planning and control systems, cost accounting procedures, capital budgeting systems, performance evaluation systems etc. Often, changes in strategy require changes in systems.

Style: "Style" means the way the company conducts its business. Top managers in organisations can use style to bring about change. Organisations differ from each other in their "styles" of working. The style of an organisation, according to the McKinsey framework, becomes evident through the patterns of actions taken by the top management team over a period of time.

Thus, an important part of managing change is establishing and nurturing a good 'fit' between culture and strategy.

Staff: "Staff" refers to the pool of people who need to be developed, challenged and encouraged. It should be ensured that the staff has the potential to contribute to the achievement of goals. Three important aspects about staff are:

1. Selecting meritorious people for specific organisational positions.
2. Developing abilities and skills in them, to take up challenging assignments.
3. Motivating them to give their best to achieve strategic goals.

Skills: "Skills" are the most crucial attributes or capabilities of an organisation. Skills in the 7-S framework can be considered as an equivalent of "distinctive competencies". For example, Hindustan Lever is known for its marketing skills, TELCO for its engineering skills, IBM for its customer service, Du Pont for its research and development skills and Sony for its new product development skills. Skills are developed over a period of time and are a result of a number of factors. Hence, to implement a new strategy, it is necessary to build new skills.

Strategy: "Strategy" is the long-term direction and scope of an organisation. It is the route that the company has chosen to achieve competitive success.

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Alignment of the Framework

Successful implementation of strategy requires the right alignment of different elements within the organisation. The Mc Kinsey consultants call *strategy, structure, and systems* as the *"hard elements"* of the organisation and the other 4 Ss i.e. *style, skills, staff and super-ordinate goals* as the *"soft elements"* of the organisation. The hard elements are more tangible and definite, and so they are often the ones that gain the greater attention, however, the soft elements are equally important, even if they are less easy to measure, assess and plan.

Merits of 7-S Framework

The virtue of 7-S framework is that it highlights some important organisational interconnections and their role in affecting change. It illustrates, in a simple way, that the real task of implementing strategy is one of bringing all 7-Ss into harmony. When the 7-S are in good alignment, an organisation is poised and energized to execute strategy to the best of its ability.

Secondly, the Mc Kinsey's model provides a convenient checklist for judging whether an organisation is ripe for implementing strategy. It also helps in diagnosing why the results emanating from the implementation of a strategy fall short of expectations and therefore, what new 'fits' would be required.

Thirdly, the framework also helps strategists in evaluating their organisations along each of the seven dimensions, thereby identifying organisational strengths and weaknesses.

Finally, Mc Kinsey's 7-S framework is a powerful expository tool. However, it should be remembered that changing the organisational elements is not an easy task. But that should not stop one from striving to bring about change.

Limitations of 7-S Framework

The 7-S framework shows that relationships exist and it provides some limited clues as to what constitutes more effective strategy implementation. Beyond this, however, it is not precise. For example, the framework says little about the how and why of interrelationships. The model is therefore poor at explaining the logic and methodology in developing the links between the elements.

A further weakness is that the framework does not highlight or emphasize other areas that have subsequently been identified as being important for strategy. Those areas are:

1. Innovation
2. Knowledge
3. Customer-driven service
4. Quality

The above elements are equally important for any organisation to succeed.

In spite of the above limitations, the 7-S framework provides a way of examining the organisation and what contributes to its success. It is good at capturing the importance of the links between the various elements. That is why Mc Kinsey consultants used it as a starting point for their search for more detailed interconnections.

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10.5 Resource Allocation

Most strategies need resources to be allocated to them if they are to be implemented successfully. Let us examine some special circumstances that may affect the allocation of resources.

Resource allocation deals with the procurement and commitment of financial, physical and human resources to strategic tasks for achievement of organisational objectives. This involves the process of providing resources to particular business units, divisions, functions etc for the purpose of implementing strategies. All organisations have at least five types of resources:

1. Physical Resources
2. Financial Resources
3. Human Resources
4. Technological Resources
5. Intellectual Resources

These resources may already exist in the organisation or may have to be acquired. Resource allocation decisions are very critical in that they set the operative strategy for the firm. Resource allocation decisions about how much to invest in which areas of business reinforce the strategy and commit the organisation to the chosen strategy.

10.5.1 Importance of Resource Allocation

A company's ability to acquire sufficient resources needed to support new strategic initiatives and steer them to the appropriate organisational units has a major impact on the strategy implementation process. Too little funding arising from constrained financial resources or from sluggish management action slows progress and impedes the efforts of organisational units to execute their part of the strategic plan effectively.

At the same time, too much funding wastes organisational resources and reduces financial performance. Both these extremes emphasize the need for managers to be careful about resource allocation. Resource allocation becomes a critically important exercise when there are major shifts from the past strategies in terms of product/market scope. For example, if the firm's strategy is expansion in one line, withdrawal from another and stability in the rest of the products, then greater resources will have to flow to the first and lesser to the second and the third. Similarly, if the strategy is to develop competitive edge through product development, greater resources will have to be committed to R&D.

Resource allocation is a powerful means of communicating the strategy in the organisation as it gives the signals to all concerned. It will demonstrate what strategy is really in operation.

Resource allocation decisions should be taken judiciously because using a formula approach (i.e. allocating funds as a percentage of sales or profits), may be inappropriate and counter-productive. Care should be taken to see that the resources are not allocated or withdrawn because of easy availability or paucity.

Example: Cutting down R&D budget in view of sudden fall of profitability should be avoided as such expenditure may be most critical for developing future competitive advantage.

The resource allocation decisions are generally linked to the objectives. For example, decision about dividend payment is linked to the ability of the company to attract capital. How to distribute the expected profits among investors, employees and the company's own needs is an important resource allocation decision from the viewpoint of long-term implications of the strategy.

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Notes Broadly, there are three approaches to resource allocation:

1. Top-down approach
2. Bottom-up approach
3. Strategic budgeting

1. ***Top-Down approach:*** In this approach, resources are allocated through a process of segregation down to the operating levels. The Board of Directors, the Managing Director or members of top management typically decide the requirements of each subunit and distribute resources accordingly.
2. ***Bottom-up approach:*** In this approach, resources are distributed through a process of aggregation from the operating level. The operating levels work out the requirements of each subunit and the resources are allocated accordingly.
3. ***Strategic budgeting:*** This approach is a mix of the above two approaches, and involves an interactive form of decision-making between different levels of management.

10.5.2 Managing Resource Conflict

The common approach to resource allocation is through budgetary system. There are however, many other tools, which can be used for this purpose. Some of the important tools used for resource allocation are discussed below:

BCG Matrix

The BCG matrix, which is generally used for portfolio analysis, can also be used as a guideline for resource allocation. The surplus resources from "cash cows" can be reallocated to "stars" or "question marks". In so far as businesses categorized as "dogs" are concerned, with low growth and low market share, they may not need any thrust, and resources can be gradually withdrawn from such businesses and invested in other promising businesses.

The BCG matrix is a useful tool because it impresses upon a portfolio approach to resource allocation. It helps in averting over-investment in any particular type of business and under-investment in promising businesses from the long-term perspective. Despite the utility of the BCG matrix, however, it should be used with care and only as a guideline. It does not provide a concrete measure for making a finer choice, particularly among the businesses of the same nature.

PLC-based Budgeting

Resource allocation can also be linked to different stages of a Product Life Cycle (PLC). A product in introductory and growth stages may require more resources than a product in mature and decline stages.

Zero-based Budgeting (ZBB)

The key differences between ZBB and traditional budgeting is that ZBB requires managers to justify their budget requests in detail from the scratch, without relying on the previous budget allocations. Therefore, instead of taking the last year's budget as the base for projecting the future allocations, ZBB forces the managers to review the objectives and operations afresh and

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justify the budget requests. ZBB is, therefore, a type of budget that requires managers to rejustify the past objectives, projects and budgets and set priorities for the future. It amounts to recalculation of all organisational activities to see which should be eliminated or funded at a reduced or increased level.

Capital Budgeting

Capital Budgeting techniques can be used for long-term commitment of resources, such as capital investments in mergers, acquisitions, joint ventures, and setting up of new plants etc. Various techniques like payback period, net present value, internal rate of return, etc. can be used to find which investments would earn maximum returns.

Operating Budgets

Operating budgets are necessary for more routine resource allocation for conducting operations. There are two types of systems:

1. ***Fixed budgeting system:*** This system commits resources based on activity levels. In this type of budgeting, there may be a tendency to retain the committed resources even if the activity levels are not being achieved, thus depriving other divisions of the resources, which have a better potential.
2. ***Flexible budgeting system:*** This system provides for transfer of funds from one unit to another if a fall is expected in actual activity level in a particular unit, thus ensuring better resource utilization. But this system has the disadvantage of encouraging non-seriousness about budgetary allocations.

Did u know? **What are the different types of routine budgets?**

1. ***Operating budget*** specifies materials, labour, overheads and other costs.
2. ***Financial budget*** projects cash receipts and disbursements.
3. ***Sales budget*** specifies sales revenues and selling, distribution and marketing costs.
4. ***Expenses budget*** projects expenses not carried out in other budgets.

10.5.3 Criteria for Resource Allocation Process

In large, diversified companies, the corporate office plays a major role in allocating resources among various strategies proposed by its operating units or divisions. In many cases, product groups, business units or functional areas may bid for funds to support their strategic proposals.

There are three criteria which can be used when allocating resources.

1. ***Contribution towards fulfillment of organisational objectives:*** At the centre of the organisation, the resource allocation task is to steer resources away from areas that are poor at delivering the organisation's objectives and towards those that are good at delivering the organisation's objectives.
2. ***Support of key strategies:*** In many cases, the problem with resource allocation is that the requests for funds usually exceed the funds normally available. Thus, there needs to be

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some further selection mechanism beyond the delivery of the organisation's mission and objectives. This second criterion relates to two aspects of resource analysis:

(a) *Support of core competencies:* Resources should develop and enhance core competencies which, in turn, help achieve competitive advantage.

(b) *Enhancement of value chain activities:* Resources should assist particularly those activities of the value chain which help the organisation to achieve low cost or differentiation and thereby enhance and sustain competitive advantage of the firm.

(c) *Risk-acceptance level of the organisation:* Clearly, if the risk is higher, there is a lower likelihood that the strategy will be successful. Some organisations will be more comfortable with accepting higher levels of risk than others. So, the criterion in this case needs to be considered in relation to the risk-acceptance level of the organisation.

Caution Sometimes, special circumstances may cause an organisation to amend the criteria for allocation of resources, Those considerations are:

1. ***When major strategic changes are unlikely:*** In this situation, resources may be allocated on the basis of a formula, e.g. marketing funds might be allocated as a percentage of sales based on past history and experience. The major difficulty with such an approach is its arbitrary nature. It may, however, be a useful shortcut.

2. ***When major strategic changes are predicted:*** In this situation, additional resources may be required to respond to an expected competitive initiative. In this case, special negotiation with the corporate office is required for resourcing rather than the adherence to dogmatic criteria.

3. ***When resources are shared between divisions:*** In this situation, the corporate office may seek to enhance its role beyond that of resource allocator. It may need to establish the degree of collaboration and, where the areas disagree, impose a solution.

10.5.4 Factors affecting Resource Allocation

Resource allocation may not necessarily be a purely 'rational' decision-making process. It is also a behavioural and political process involving people who may be motivated by different objectives. Some of the major factors affecting resource allocation are discussed below:

1. ***Objectives of the organisation:*** People motivated by different objectives exercise their influence over the funding of projects. There are two types of objectives. Official (explicit) objectives and operative (implicit) objectives. Allocations of resources are more guided by implicit objectives than explicit objectives. The formal and informal organisations also influence the perception of which projects should be chosen for funding.

2. ***Powerful units:*** Sometimes, powerful SBU heads secure larger allocation of funds than their 'fair share'.

3. ***Dominant strategists:*** The preferences of dominant strategists like the CEO, Directors, SBU heads, etc. are reflected in the way resources are allocated. The divisional and departmental heads know that such preferences matter and try to present their demands in line with them.

4. ***Internal politics:*** Resources are often construed as power, and those units, which manage to secure substantial resources, are perceived as more powerful than others. Internal politics within the organisation to secure more and more resources, affect the process of resource allocation.

Notes

5. ***External influences:*** Apart from internal politics, external influences like government policy, demands of shareholders, financial institutions, community and others, also affect resource allocation. For example, legal requirements may require additional finances in labour welfare and social security, pollution control, safety equipments and energy conservation. The shareholders may expect higher dividends, and resources have to be directed to them. Financial institutions may impose restrictions or require companies to invest in technology up-gradation and R&D. Similarly, the discharge of social responsibilities by the firm requires allocation of sufficient funds. Thus, external influences affect the process of resource allocation.

To sum up, we can say that the 'behavioural' and 'political' considerations are inevitable in a typical organisation, but one must ensure that they do not dominate the 'rational' considerations in allocation of resources. Otherwise, irrational allocation of funds may jeopardize effective implementation of the strategy and lead to problems in achieving the desired strategic change.

Task Find out how Microsoft allocates its human and financial resources into various units.

10.5.5 Difficulties in Resource Allocation

The resource allocation process can sometimes become fairly complex, and may even create several difficulties to the strategists. Some of the difficulties that can create problems are:

1. ***Scarcity of Resources:*** Resources are hard to find. Even if finance is available, the cost of capital could be a constraint. Non-availability of highly skilled people could be another problem.
2. ***Restrictions on Generating Resources:*** Within organisations, the new units which have greater potential for growth in the future, may not be able to generate resources in the short run. Allocation of resources on par with existing SBUs, divisions and departments through the usual budgeting process, will put them at a disadvantage.
3. ***Bloated Demands:*** Unit managers may sometimes submit inflated or overstated demands for funds to guard against any budget-cuts. This subverts the decision process.
4. ***Negative Attitude:*** Units, which do not get the desired allocations, may develop a negative attitude towards the corporate managers. They may work at cross purposes, which may obstruct the implementation of the intended strategy.
5. ***Budget Battles:*** The actual allocation of funds to any unit has a major effect on the work environment of the unit and the career of the manager concerned. If a manager loses the 'budget battle', his subordinates feel that the manager has failed them, and may not cooperate with him.
6. ***Budgetary Process:*** The budgetary process itself can lead to problems if it is not tied to the strategic plans of the firm. If top management fails to communicate the shifts in the strategic plans and the lower levels are unaware of the shifts, any intended strategy is unlikely to succeed .
7. ***New SBUs:*** The budgetary process is tied to the way units and divisions are arranged organisationally. New SBUs can be at a disadvantage if they are unaware of the intricacies of the budget procedures used in their organisations.

To avoid the above difficulties, strategists should pay maximum attention to resource allocation, and 'prioritize' budgeting allocations in the initial stages taking overall objectives into account.

Notes

Many 'budget battles' can be avoided if targets, resource sharing, prioritization, midway revisions etc. are decided in an atmosphere of cooperation and participation, especially at departmental and divisional levels.

Allocating resources to specific divisions and departments alone does not mean successful implementation of the strategy. If major strategic shifts are occurring, the organisation structure is likely to change along with the way resources are allocated.

Caselet

No Fair!

The regular announcements in the Budget for women include the strengthening of the Rashtriya Mahila Kosh for providing micro-credit to poor assetless women, the launching of an integrated scheme for women's empowerment and the starting of a new scheme for women in difficult circumstances such as the widows of Vrindavan, Kashi and others who are destitute or disadvantaged.

However, the actual announcements in the Budget that impact women are more than those announced under the specific women's bracket. Some are positive and some negative. Resources are not fairly allocated for them.

Source: blonnet.com

10.6 Summary

- Most strategies need resources to be allocated to them if they are to be implemented successfully.
- A successful strategy formulation does not guarantee successful strategy implementation. It affects an organisation from top to bottom; it affects all divisional and functional areas of business.
- Implementation of strategy involves a number of interrelated decisions, choices, and a broad range of activities. It requires an integration of people, structures, processes etc.
- Mc Kinsey's 7-S model is good at capturing the importance of all these elements in the implementation of strategy.
- A company's ability to acquire sufficient resources needed to support new strategic initiatives and steer them to the appropriate organisational units has a major impact on the strategy implementation process.

10.7 Keywords

Bottom-up Approach: In this approach, resources are distributed through a process of aggregation from the operating level. The operating levels work out the requirements of each subunit and the resources are allocated accordingly.

Capital Budgeting: used for long-term commitment of resources, such as capital investments in mergers, acquisitions, joint ventures etc.

McKinsey 7-S Model: A model of organisational effectiveness that postulates that there are seven internal factors of an organisation that needs to be aligned and reinforced in order for it to be successful.

Notes

Operating Budget: Necessary for more routine resource allocation for conducting operations.

Top-down Approach: In this approach, resources are allocated through a process of segregation down to the operating levels. The Board of Directors, the Managing Director or members of top management typically decide the requirements of each subunit and distribute resources accordingly.

Zero Based Budgeting: Budget requests in detail from the scratch, without relying on the previous budget allocations.

10.8 Self Assessment

Fill in the blanks:

1. .....are the core values of the company that are evidenced in the corporate culture and the general work ethic.
2. .....represents the competencies of the employees working for the company.
3. Resource allocation deals with the .....and ..... of financial, physical and human resources to strategic tasks.
4. ..... budget specifies materials, labour, overheads and other costs.
5. ..... and 'political' considerations are inevitable in a typical organisation.
6. The common approach to resource allocation is through ..... system.
7. In BCG Matrix, the ..... represent low growth and low market share.
8. ..... budgeting system provides for transfer of funds from one unit to another if a fall is expected in actual activity level in a particular unit.
9. ..... budgeting techniques can be used for long-term commitment of resources.
10. The problem with resource allocation is that the requests for funds usually ..... the funds normally available.

10.9 Review Questions

1. Does a successful strategy formulation guarantee a successful implementation? Why/ why not?
2. "Strategic decisions to be communicated and understood throughout the organisation". Elucidate.
3. Why is it said that using a formula approach in resource allocation may be counterproductive. Discuss with reasons accompanied with examples.
4. "There has to be a "fit" between the strategy and the organisation." Substantiate
5. "Formulation and implementation are inextricably linked". Discuss
6. Bring out the differences between formulation and implementation of strategy.
7. Discuss the relevance of McKinsey's 7-S model in modern business organisations.
8. Critically evaluate the McKinsey's 7-S Model.
9. "Resource allocation is a powerful tool to communicate the strategies of the organisation". Justify

Notes

10. Suppose you are the head of an organisation that produces chocolate chips biscuits. You have a decent amount of money to spend but not as many workers. How will you allocate your resources?

Answers: Self Answers

1.	Super ordinate goals	2.	Skills
3.	Procurement, commitment	4.	Operating
5.	'Behavioural'	6.	Budgetary
7.	"Dogs"	8.	Flexible
9.	Capital	10.	Exceed

10.10 Further Readings

Books

Fred R. David, *Strategic Management – Concepts and Cases*, Pearson Education Inc., 2005.

Hamel F and Prahalad CK, "*Competing for the Future*", Harvard Business School Press, Boston 1994.

Richard Lynch, *Corporate Strategy*, Essex, Pearson Education Ltd, 2006.

Online links

www.businessplanning.ws/.../business-plan-strategy-implementation

www.investorwords.com/4218/resource_allocation

www.themanager.org/Knowledgebase/Strategy/Implementation

Unit 11: Structural Implementation

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Objectives

After studying this unit, you will be able to:

- Describe the types of organisational structures
- Define organisational design and change
- Explain the structures for strategies

Introduction

To implement its strategy successfully a firm must have an appropriate organisational structure. An organisational structure is a set of formal tasks and reporting relationships which provide a framework for control and coordination within the organisation. The visual representation of an organisational structure is called organisational chart. The purpose of an organisational structure is to coordinate and integrate the efforts of employees at all levels – corporate, business and functional levels – so that they work together to achieve the specific set of strategies.

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Organisational structure is a tool that managers use to harness resources for getting things done. It is defined as:

1. The set of formal tasks assigned to individuals and departments.
2. Formal reporting relationships, including lines of authority, responsibility, number of hierarchical levels and span of manager's control.
3. The design of systems to ensure effective coordination of employees across departments.

The set of formal tasks and formal relationships provides a framework for vertical control of the organisation.

There are two different aspects of the organisational structure:

1. Superstructure
2. Infrastructure

1. ***Superstructure:*** This is the highly visible part of the organisational structure. This depicts how people are grouped into different divisions, departments and sections and how they are related to each other. The superstructure also indicates the principal ways in which the organisational operations are integrated and coordinated. By showing their levels, it indicates which groups have relatively more strategic importance.
2. ***Infrastructure:*** This is comparatively less visible part of the organisational structure. It is concerned with issues like delegation of authority, specialization, communication, information systems and procedures. The infrastructure enables the organisation to engage in a number of disparate activities and still keep them coordinated.

The design of organisational structure is a critical task of the top management of an organisation. It is the skeleton of the whole organisation. It provides relatively more durable organisational arrangements and relationships.

Thus an organisational structure fulfils two fundamental and opposing requirements:

1. Division of labour into various tasks
2. Coordination of these tasks to accomplish effective control of an organisation.

However, as an organisation grows and becomes more complex, it needs appropriate changes in its design.

11.1 Basic Principles of Organisational Structure

There are several important principles of organisation, which need to be understood before building an organisation's structure. They are:

1. ***Hierarchy:*** Hierarchy defines who reports to whom and the span of control. Span of control is the number of people reporting to a supervisor. It determines how closely a supervisor can monitor subordinates. Tall structures have many levels in the hierarchy and a narrow span. Communication up and down the hierarchy becomes difficult. Flat structures are horizontally dispersed having fewer levels in the hierarchy. The trend in recent years has been towards flat structures allowing for wider spans of control as a way to facilitate better communication and co-ordination.
2. ***Chain of Command:*** The chain of command is an unbroken line of authority that links all persons in an organisation and shows who reports to whom. It has two underlying principles. Unity of command means that each employee is held accountable to only one supervisor. The scalar principle means a clearly defined line of authority in the organisation. Authority and responsibility for different tasks should be distinct. All persons in the

organisation should know to whom they report as well as the successive management levels all the way to the top.

3. ***Specialization:*** Specialization, sometimes called division of labour, is the degree to which organisational tasks are subdivided into separate jobs. Work can be performed more efficiently if employees are allowed to specialize. This is because an employee in each department performs only the tasks relevant to his specialized function. Despite the apparent advantages of specialization, many organisations are moving away from this principle. With too much specialization, employees are isolated performing only a single, boring job. Many companies are, therefore, enlarging jobs to provide greater challenges or assigning tasks to teams so that employees can rotate among several jobs performed by the team.

4. ***Authority, Responsibility and Delegation:*** Authority is the formal and legitimate right of a manager to make decisions, issue orders, allocate resources and command obedience. Responsibility is the duty to perform the task or activity an employee has been assigned. Accountability means that the people with authority and responsibility are subject to reporting and justifying task outcomes to those above them in the chain of command.

Notes Delegation is the process managers use to transfer authority and responsibility to positions below them in the hierarchy. The principle is that there must be parity between authority and responsibility. It means managers can be made accountable for results only when they are delegated with sufficient authority commensurate with the responsibility.

Most organisations today encourage managers to delegate authority to the lowest possible level to provide maximum flexibility to meet customer needs and adapt to the environment. Managers are encouraged to delegate authority, although they often find it difficult.

5. ***Centralization and Decentralization:*** Centralization and decentralization refer to the level at which decisions are made. Centralization means that decision-making is done at the top levels of the organisation. Decentralization means that decision making is pushed down to the lower levels in the organisation. Centralization helps in better coordination, but too much centralization results in slow response and demotivates people at lower levels. Decentralization relieves the burden on top managers, makes greater use of worker's skills, ensures decision making by well-informed people and permits rapid response to external changes. But it does not mean that every organisation should decentralize. Managers should diagnose the organisational situation and select the decision-making level.

6. ***Formalization:*** Formalization is the extent to which written documentation is used to direct and control employees. Written documentation includes rules, regulations, policies, procedures, job descriptions etc. They are inexpensive ways to coordinate activities. These documents complement the organisational structure by providing descriptions of tasks, responsibilities and authority. The use of rules and regulations is a part of bureaucratic model of organisation.

Caution Although written documentation is intended to be rational and helpful to the organisation, it often creates "red tape" that causes more problems than it solves.

Narrowly defined job descriptions, for example, tend to limit the creativity, flexibility and rapid responses needed in today's knowledge-based organisations. Many organisations today are reducing formalization and bureaucracy.

Notes

7. ***Departmentalization:*** Another fundamental characteristic of organisational structure is departmentalization, which means grouping positions into departments and departments into the total organisation.

Did u know? **What is organisational design?**

The process of designing an organisation's structure to match with its situation is called organisational design. The best design for an organisation is determined by many aspects of its situation, viz. the size, technology, environment and strategy. Managers make choices about how to use the chain of command to group people together to perform their work. The functional, divisional and matrix structures are traditional approaches that rely on the chain of command to define departmental groupings and reporting relationships along the hierarchy. Newer approaches such as teams, networks and virtual organisations have emerged to meet changing organisational needs in an increasingly global, knowledge-based business environment.

Caselet

Reinventing Organisation Design

Organisation design is not a mere exercise in changing structures and processes in a company. Companies must break away from the dogma of structure and process, but focus more on values. Structures are meant only to serve a chosen purpose. What is important is that people are enabled to achieve that chosen purpose. The prime objective of organisation design is to create a business entity around a strong foundation of shared values and goals. The basic criterion is that purpose and values must be reflected in all the activities of the organisation.

The concept of organisation design is simple in theory but highly complex in practice because of two reasons. First, the sheer number and variety of elements that make up an organisation and their inter-relationships are immense. Managing this complexity is a logistical nightmare beyond the wit of majority of managers.

Second, the central factor in any organisation is people; and people defy logic and common sense. Everyone is an individual and expects to be recognised and treated as such. No two persons are similar. Everyone brings to work his/her own attitudes, aspirations, and problems.

Superimposing these two factors – the unpredictable and irrational nature of people, and the complexity associated with the number of elements in an organisation – this overlay presents a phenomenal challenge. As the needs of the individual take on greater importance in the knowledge economy, the difficulty is compounded requiring an altogether different dimension of organisation design. Recognising that organisation design is a process, and not an outcome is important. It is a journey, and not a destination.

Source: thehindubusinessline.com

11.2 Relation between Strategy and Structure

Strategic management posits that the strategy and the organisation structure of the firm must match. In a classic study of large U.S. corporations such as DuPont, General Motors, Sears, and Standard Oil, Alfred Chandler concluded that structure follows strategy. This means that changes

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in corporate strategy lead to changes in organisational structure. He also concluded that organisations follow a pattern of development from one kind of structural arrangement to another as they expand. According to Chandler, these structural changes occur because the old structure was not suitable. Chandler therefore proposed the following as the sequence of what occurs:

1. New strategy is created
2. New administrative problems emerge
3. Economic performance declines
4. New appropriate structure is invented
5. Profit returns to its previous level

Chandler found that in their early years, corporations such as DuPont and General Motors had a centralized functional structure, which was suitable for a limited range of products. As they added new product lines and created their own distribution networks, the old structure became too complex. Therefore, they shifted to a decentralized structure with several autonomous divisions.

11.3 Improving Effectiveness of Traditional Organisational Structures

In the changed times and situations, traditional organisational structure is crumbling under the weight of ever-increasing regulations that drive greater accountability and transparency. Smart companies are on the forefront of building new and improved structures that support and enhance this new compliance environment, and best practices are emerging.

The best structure for an organisation is determined by many aspects of its situation – the technology, size, environment and strategy. Frequently, structures evolve as the organisation moves from one stage of growth to the next. The external and internal environments affect structural design in different ways.

Example: 1. An organisation which faces a stable environment may use functional structure.

2. A volatile environment demands a rapid-response capability, flexibility and quick decision-making. Such demands can be better met by the creation of a divisional or a matrix type of structure.

According to Mintzberg, there are four main characteristics of the environment that influence structure.

Table 11.1: Environmental Types and their Impact on Organisational Structure

Type of Environment	Range	Consequences for Organizational Structure
Rate of change	Static ↔ Dynamic	As rate of change increases, the organization needs to be kept more flexible
Degree of complexity	Simple ↔ Complex	Greater complexity needs more formal co-ordination
Market complexity	Involved in single market involved ↔ in diversified markets	As markets become more diversified, divisionalisation becomes advisable
Competitive situation	Passive ↔ Hostile	Greater hostility probably needs the protection of greater centralisation

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Rate of Change

When the organisation operates in a more dynamic environment, it needs to be able to respond quickly to the rapid changes that occur. In static environments, change is slow and predictable and does not require great sensitivity on the part of the organisation. In dynamic environments, the organisation structure and its people need to be flexible, well co-ordinated and able to respond quickly to outside influences. The dynamic environment implies a more flexible, organic structure.

Degree of Complexity

Some environments can be easily monitored from a few key data movements. Others are highly complex, with many influences that interact in complex ways. One method of simplifying the complexity is to decentralize decisions in that particular area. The complex environment will usually benefit from a decentralized structure.

Market Complexity

Some organisations sell a single product or variations on one product. Others sell ranges of products that are essentially diverse. As markets become more diverse, there is usually a need to divisionalise the organisation as long as synergy or economies of scale are unaffected.

Competitive Situations

With friendly rivals, there is no great need to seek the protection of the centre. In deeply hostile environments, however, extra resources and even legal protection may be needed; these are usually more readily provided by central headquarters. As markets become more hostile, the organisation usually needs to be more centralized.

The effectiveness of traditional organisational structures can be improved by regular revision and development of the skill sets held by the employees. If change is not handled correctly, it can be more devastating than ever before. The management has to identify those employees that are high performers and have the potential to reflect, discover, assess, and act. The management has to instill the new focus of connecting the heads, hearts, and hands of people in the organisation. On big problem may be the problem of strategy implementation. The management as well as the team heads must learn how to motivate others and build an efficient team.

Structural changes are essential to better position the organisation as compared with its competitors, focus on client needs and move forward in development and sustainability programmes. Sometimes reorganisation maybe required to provide a framework for longer-term commitment to organisational objectives and vision.

The management should encourage the entire organisation in general and sub units in particular to put work teams in place to ensure that each sector integrates staff and services into a cohesive, focused business unit. Consultation and participation should be made part and parcel for the programme for the successful development and implementation of organisational goals and objectives.

Each work team should be asked to develop an effective process for discussion of major challenges and opportunities facing the organisation, if possible, over the next decade. Updated strategic plans should be then developed. These plans should form the framework for focusing organisational resources on the most strategic areas by using a staged approach. Updated plans

Notes

should then be implemented by work teams at all levels of management. Work-team objectives must include:

1. Involving all levels of staff in consultation
2. Designing and implementing a process to develop-goals and objectives for the organisation and unit; a strategic process for the next five to ten years
3. Defining and clarifying organisational structures and identifying functions, customers, and service delivery models
4. Identifying changes and staged approaches needed to move from the current situation to what will be required over the next three to five years
5. Identifying and recommending priorities for policy and programme development
6. Incorporating goals for expenditure reduction, service quality improvement, workforce management, accountability, technology, and business process improvement.

11.4 Types of Organisational Structures

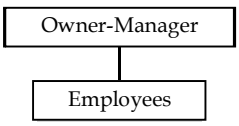
There are seven basic types of organisational structures:

1. Simple structure
2. Functional structure
3. Divisional structure
4. SBU structure
5. Matrix structure
6. Network structure
7. Virtual structure

Let us understand each of them briefly.

1. ***Simple Structure:*** In this structure, the owner-manager controls all activities and makes all the decisions. This structure may be appropriate for small and young organisations. Coordination of tasks is done through direct supervision. There is little specialization of tasks, few rules and regulations and communication is informal.

Figure 11.1: Simple Structure



Example: Small businesses like mom and pop stores, small restaurants etc have a simple organisation structure.

2. ***Functional Structure:*** Functional structures are grouped based on major functions performed. Each function is led by a functional specialist. Functional structures are formed in organisations in which there is a single or closely related products or services.

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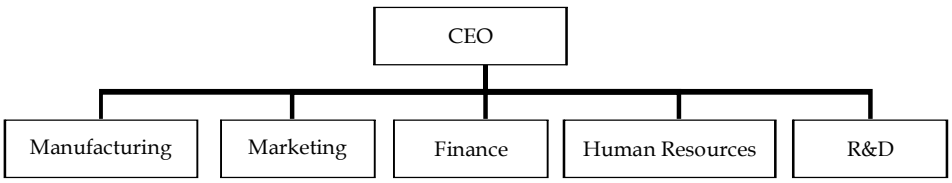
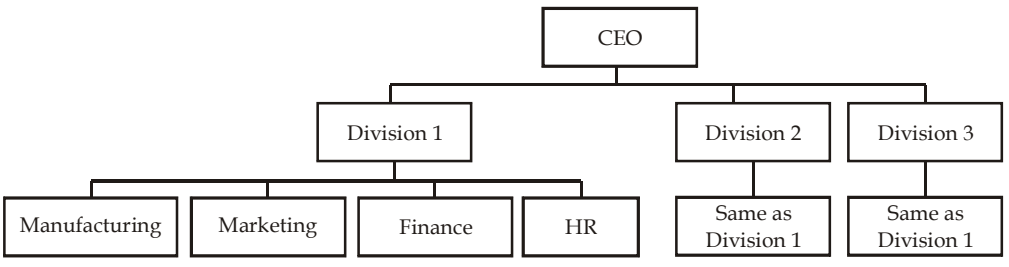
Figure 11.2: Functional Structure



Example: Small business with one product line could start making the components it requires for production of its products instead of procuring it from an external organization. It is not only beneficial for organization but also for employees' faiths.

3. ***Divisional Structure:*** Divisional structures are used by diversified organisations. In a divisional structure, divisions are created as self-contained units with separate functional departments for each division. A division may be organised around geographic area, products, customers etc. The head office determines corporate strategy, allocates resources among divisions and appoints and rewards the heads of these divisions. Each division is responsible for product, market and financial objectives for the division as well as their division's contribution to overall corporate performance.

Figure 11.3: Divisional Structure



Example: Divisions can be categorized from different points of view. One might make distinctions on a geographical basis (a US division and an EU division, for example) or on product/service basis (different products for different customers: households or companies). In another example, an automobile company with a divisional structure might have one division for SUVs, another division for subcompact cars, and another division for sedans.

4. ***Matrix Structure:*** The matrix structure is, in effect, a combination of functional and divisional structures. In this structure, there are functional managers and product or project managers. Employees report to one functional manager and to one or more project managers. For example, a product group wants to develop a new product. For this project it obtains personnel from functional departments like Finance, Production, Marketing, HR, Engineering etc. These personnel work under the product manager for the duration of the project. Thus, they are responsible for two managers – the product manager and the manager of their functional area.

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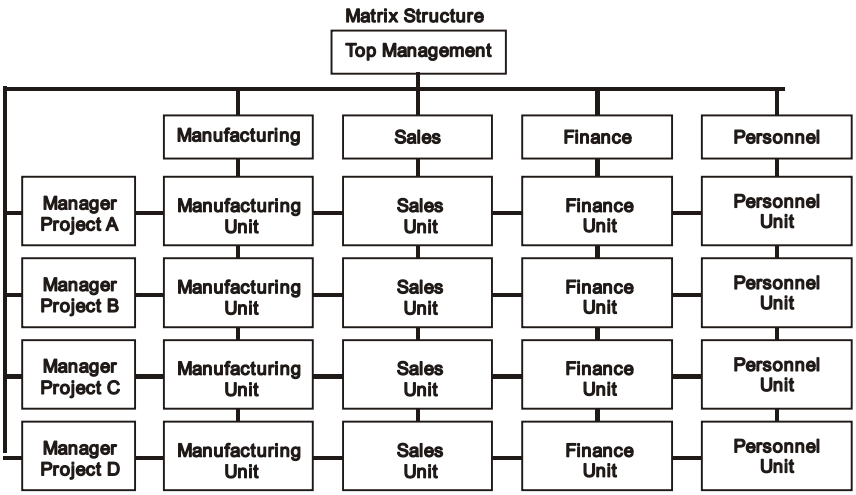
Figure 11.4: Matrix Structure

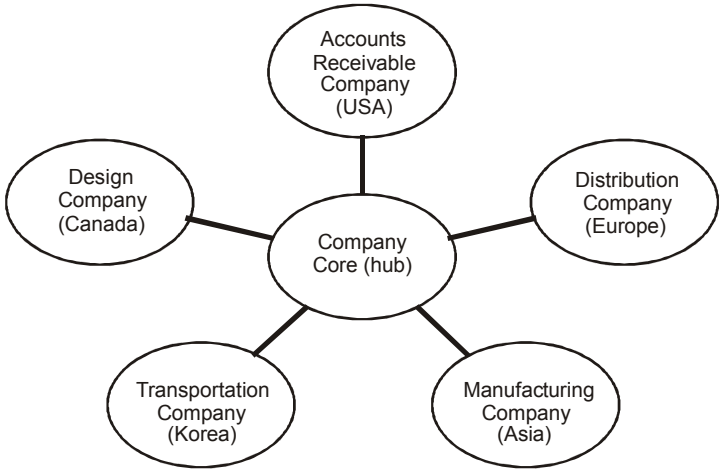


While functional heads have vertical control over the functional managers, the product or project heads have horizontal control over them. Thus, matrix structure provides a dual reporting. The dual lines of authority makes the matrix structure unique. The matrix structure has been used successfully by companies such as IBM, Unilever, Ford Motor Company etc.

Example: Starbucks is one of the numerous large organizations that successfully developed the matrix structure supporting their focused strategy. Its design combines functional and product based divisions, with employees reporting to two heads. Creating a team spirit, the company empowers employees to make their own decisions and train them to develop both hard and soft skills. That makes Starbucks one of the best at customer service.

5. ***Network Structure:*** A network organisation outsources or subcontracts many of its major functions to separate companies and coordinates their activities from a small headquarters. Rather than being housed under one roof, activities like design, manufacturing, marketing, distribution etc. are outsourced to separate organisations that are connected electronically to the central office.

Figure 11.5: Network Structure



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Example: Athletic shoe companies like Nike and Reebok have outsourced manufacturing of their shoes to countries such as China and Indonesia, where labour costs are low. What Nike or Reebok does is the design and marketing of shoes. Networked computer systems and the Internet enable the organisation to exchange data and information. The organisation may be viewed as a hub surrounded by a network of outside specialists.

As may be seen from the above, the core organisation is only a shell with a small headquarters acting as a broker connected to supplier, design, manufacturing etc. organisations.

Example: Hennes and Mauritz(H&M), a famous Swedish retail clothing company, is outsourcing its clothing to a network of 700 suppliers, more than two-thirds of which are based in low-cost Asian countries. Not owning any factories, H&M can be more flexible than many other retailers in lowering its costs, which aligns with its low-cost strategy. The potential management opportunities offered by recent advances in complex networks theory have been demonstrated including applications to product design and development, and innovation problem in markets and industries.

6. ***Virtual Organisation:*** This is an extension of the network structure. In this approach, independent organisations form temporary alliances to exploit specific opportunities, then disband when their objectives are met. The term virtual means "being in effect but not actually so". The virtual organisations consist of a network of independent companies – suppliers, customers or even competitors – linked together to share skills, costs, markets and rewards. The members of a virtual organisation pool and share the knowledge and expertise of each other.

Creating Agile Virtual Organisation: New ways to manage change and to compete in a rapidly changing business world are emerging under the concept of the agile enterprise. Agile organisations can be almost any size or type, but what distinguishes them from their lumbering traditional business counterparts is the ability to read and to react quickly. They can also be virtual, meaning they can reconfigure themselves quickly and temporarily in response to a challenge, which gives them agility, but then dissolve or transmute themselves into something else.

Virtual organisations have been existing throughout history, from the whaling companies of the 19th century through the film studios of the 20th. The virtual organisations have few full-time employees or usually temporarily hire outside specialists to complete a specific project, such as a new software application. These people do not become a part of the organisation, but join together as a separate entity for a specific purpose. Sometimes companies use a virtual approach to harness the talents and energies of the best people for a particular job, rather than trying to develop those capabilities in-house.

Now that serious management tools are beginning to appear, the agile virtual enterprise is no longer just a theoretical possibility. When an organisation uses a virtual approach, the virtual group typically has full authority to make decisions and take actions within certain predetermined boundaries and goals. Most virtual organisations use electronic media for sharing of information and data. Some organisations have redesigned offices to provide temporary space for virtual workers to meet or work on-site.

Notes

Advantages and Disadvantages:

Advantages

(a) It can draw on expertise worldwide.

(b) It is highly flexible and responsive.

(c) It reduces overhead costs.

Disadvantages

(a) Lack of control because the boundaries of a virtual organisation are weak and ambiguous.

(b) Virtual teams place new demands on managers, who have to work with new people, new ideas and new problems.

(c) Virtual organisation poses communication difficulties, and managers may lose motivation.

Example: Computer organizations that have successfully implemented forms of this new structure include Apple Computer and Sun Microsystems. When Apple Computer linked its easy-to-use software with Sony's manufacturing skills in miniaturization, Apple was able to get its product to market quickly and gain a market share in the notebook segment of the PC industry.

Sun Microsystems has been considered another highly decentralized organization comprised of independently operating companies. Sun positions information systems as a top priority, trying to achieve faster and better communication. With numerous "SunTeams," members operate across time, space, and organizations to address critical business issues. Sun managers identify key customer issues and then form teams with the critical skills and knowledge needed to address the issue. This team might include sales people, marketing personnel, finance, and operations from various places around the globe; customers and suppliers may become episodic members as necessary. Weekly meetings may take place via conference calls. Critical to the team's success is the selection of talent from the organization, defining a clear purpose for the team's efforts, and establishing communication links among the team members.

Sun has been working on further development of technologies such as EDI (Electronic Data Interchange) and RFID (Radio Frequency Identification technology). Both EDI and RFID will impact information exchange globally and across numerous industries.

Source: Wikipedia and www.referenceforbusiness.com)

Task Can you name two virtual organisations? Why and how were they formed?

11.5 Modular Organisation

The organisational capabilities to interact with others have been greatly improved as a result of modern information and communications technologies: Nowadays a company can maintain more relationships with more companies at much lower costs than before. The increased business networks require modularization of the products, the processes and the firm in order to be effective. Modular products tend to favor a modular organisation form, as the various units

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involved in the design process of products with interchangeable components are loosely coupled, operate autonomously, and can be easily reconfigured.

The concept of modularity can be applied not only to complex product system design, but also to business system interpretation and design. A modular organisation is one in which different functional components are separated from one another, a technique adopted from software engineering.

A modular organisation is in contrast to a composite organisation in which there is no separation between functions. Modular organisation is also distinct from hierarchical organisation. Modular organisation is chiefly concerned with the horizontal design of a system.

Modularity allows components to be produced separately and used interchangeably in different configurations without compromising system integrity. In modular organisations, coordination tasks are delegated to individual modules (functions, teams, etc.) and coherence is achieved easily through fully specified interfaces. In addition to the reduction of managerial complexity, this structural, hierarchical function-based decomposition results in the localization of the impacts of environmental disturbances within specific modules, increasing the immunity and adaptability of the overall organisation in a turbulent environment.

11.6 Towards Boundaryless Structures

Traditional companies with boundaries, rules, and extensive plans are at a supreme disadvantage in today' globalized world, where technology changes daily and the value chain commands changes of its own. In a traditional company where people are categorized into neatly defined positions with their job descriptions filed in triplicate in the Human Resources department, the way a company plans its business can cause it to sink despite planning because the boundaries can mean lost opportunities, being overtaken by the competition, loss of revenues, or watching its niche slip away because of a new technology, an alteration in the global marketplace, or simply a failure to market its product effectively. When changes occur, they happen too quickly for its organisational processes to meet them; as a result, opportunities are quickly lost, problem situations take over rapidly, and before the company can respond appropriately, it has lost customers, opportunities, and market share. Although that company likely has more than enough talent within its walls to offset all of those disasters, the talent is never put to use, because employees are constrained to operate within the confines of their job descriptions, where only the prescribed talents can be put to good use.

The answer to this dilemma lies in boundaryless organisations. A boundaryless organisation is a contemporary approach to organisational design. It is an organisation that is not defined by, or limited to, the horizontal, vertical, or external boundaries imposed by a predefined structure. This term was coined by former GE chairman Jack Welch because he wanted to eliminate vertical and horizontal boundaries within GE and break down external barriers between the company and its customers and suppliers.

A big question is if all companies become boundaryless? Yes, but not all companies can do it today, because an organisation has to be completely compatible with such a radical methodology. Upper level management has to embrace it wholeheartedly, knowing that their status will essentially vanish in the new organisation, and employees have to be retrained to understand how to operate under the new paradigm. Companies should already be in the process of getting to that point, however, and those that do it first will have the greatest advantage.

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11.7 Structures for Strategies

To understand the logic behind this approach to the development of organisational structures, it is helpful to look at the historical background. As already mentioned, prior to the early 1960s, the US strategist Alfred Chandler studied how some leading US corporations had developed their strategies in the first half of the twentieth century. He then drew some major conclusions from this empirical evidence, the foremost one being that the organisation first needed to develop its strategy and, after this, to devise the organisation structure that delivered that strategy. Chandler drew a clear distinction between devising a strategy and implementing it. He defined strategy as:

"The determination of the basic long-term goals and objective of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals".

The task of developing the strategy took place at the corporate and business levels of the organisation. The job of implementing it then fell to the various functional areas. Chandler's research suggested that, once a strategy had been developed, it was necessary to consider the structure needed to carry it out. A new strategy might require extra resources, or new personnel or equipment which would alter the work of the enterprise.

Changes in Business Environment and Social Values

Table 11.2

Early twentieth century	Early twenty- first century
• Uneducated workers, typically just moved from agricultural work into the cities • Knowledge of simple engineering and technology • The new science of management recognized simple cause-and-effect relationship • Growing, newly industrializing markets and suppliers • Sharp distinctions between management and workers	• Better educated, computer- literate, skilled • Complex, computer-driven, large-scale • Multifaceted and complex nature of management now partially understood • Mix of some mature, cyclical markets and some high-growth, new-technology markets and suppliers • Greater overlap between management and workers in some industrialized countries

To understand why it is no longer appropriate to develop an organisation structure after deciding a strategy, the earlier theory needs to be placed in its historic strategic context. Since Chandler's research in the early twentieth century, the environment has changed substantially. The workplace itself, the relationship between workers and managers, and the skills of employees have all altered substantially. Old organisational structures embedded in past understandings may therefore be suspect. Table 11.2 summarizes how the environment has changed from the early twentieth century to early twenty-first century.

Strategy and Structure are Interlinked

According to modern strategists, strategy and structure are interlinked. It may not be optimal for an organisation to develop its structure after it has developed its strategy. The relationship is more complex in two respects:

1. *Strategy and the structure associated with it may need to develop at the same time in an experimental way* : As the strategy develops, so does the structure. The organisation learns to adapt to its changing environment and to its changing resources, especially if such change is radical.
2. *If the strategy process is emergent, then learning and experimentation involved may need a more open and less formal organisation structure.*

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Managing the Complexity of Strategic Change

Quinn suggests that strategic change may need to proceed incrementally, i.e. in small stages. He called the process "logical incrementalism". The clear implication is that it may not be possible to define the final organisation structure, which may also need to evolve as the strategy moves forward incrementally. He recognizes the importance of informal organisation structures in achieving agreement to strategy shifts. If the argument is correct, it will be evident that any idea of a single, final organisation structure – after deciding on a defined strategy – is dubious.

Criticism of the Strategy – First, Structure- Afterwards Process

1. Structures may be too rigid, hierarchical and bureaucratic to cope with the newer social values and rapidly changing environment.
2. The type of structure is just as important as the business area in developing the organisation's strategy. It is the structure that will restrict, guide and form the strategy.
3. Value chain configurations that favour cost cutting or, alternatively, new market opportunities may also alter the organisation required.
4. The complexity of strategic change needs to be managed, implying that more complex organisational considerations will be involved. Simple configurations such as a move from a functional to a divisional structure are only a starting point in the process.
5. The role of top and middle management in the formulation of strategy may also need to be reassessed: Chandler's view that strategy is decided by the top leadership alone has been challenged. Particularly for new, innovative strategies, middle management and the organisation's culture and structure may be important. The work of the leader in empowering middle management may require a new approach – the organic style of leadership.

The Concept of 'Strategic Fit'

Although it may not be possible to define which comes first, there is a need to ensure that strategy and structure are consistent with each other. For example, Pepsi Co reorganised its North American business to ensure that its strengths in the growing non-carbonated drinks market could be exploited across its full range of drinks. For an organisation to be economically effective, there needs to be a matching process between the organisation's strategy and its structure. This is the concept of strategic fit.

In essence, organisations need to adopt an internally consistent set of practices in order to undertake the proposed strategy effectively. It should be said that such practices will involve more than the organisation's structure. They will also cover such areas as reward systems, information systems and processes, culture, leadership styles, etc.

There is strong empirical evidence, both from Chandler and Senge, that there does need to be a degree of strategic fit between the strategy and the organisation structure.

Although the environment is changing all the time, organisations may only change slowly and not keep pace with external change, which can often be much faster – for example, the introduction of digital technology. It follows that it is unlikely that there will be a perfect fit between the organisation's strategy and its structure. There is some evidence that a minimal degree of fit is needed for an organisation to survive. It has also been suggested that, if the fit is ensured early during the strategic development process, then higher economic performance may result. However, as the environment changes, the strategic fit will also need to change.

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Case Study

Boundarylessness: The Welch Way

Globalization has certainly changed the way that HR does business, enabled by technology advances. HR organizations that embrace globalization opportunities are finding ways to deliver their strategic value in that new environment. So, human capital plans can be presented that take advantage of a global workforce, talent can be identified and aligned with customers, no matter where they may be. Technology offers the capability to maintain contact and information flow to employees--through web sites, e-mails, webinar, video conference and virtual sites such as Second Life.

'Boundarylessness' was developed at General Electric in the late 1980s and early 1990s, and it is one of the cultural elements General Electric credits for its phenomenal success over the last fifteen years. Proponents of boundarylessness believe traditional boundaries between layers of management (vertical boundaries) and divisions between functional areas (horizontal boundaries) have stifled the flow of information and ideas among employees. A boundaryless culture seeks to overcome the limitations imposed by these and other internal corporate divisions.

Jack Welch certainly propelled it into the world's corporate consciousness with his Work-Out program at General Electric in the early 1990s. In 1992, he described boundarylessness this way: GE's diversity creates a huge laboratory of innovation and ideas that reside in each of the businesses, and mining them is both our challenge and an awesome opportunity. Boundaryless behavior is what integrates us and turns this opportunity into reality, creating the real value of a multi-business company -- the big competitive advantage we call Integrated Diversity.

"Boundaryless behavior has become the 'right' behavior at GE, and aligned with this behavior is a rewards system that recognizes the adapter or implementer of an idea as much as its originator. Creating this open, sharing climate magnifies the enormous and unique advantage of a multibusiness GE, as our wide diversity of service and industrial businesses exchange an endless stream of new ideas and best practices"-- This quote ignited my interest in the link between organizational evolution and boundarylessness. Because of its unique position as a "multibusiness" company, General Electric recognized the importance of idea adaptation, or in organizational evolution terms, recombination. By creating an atmosphere where adapting and implementing a good idea from another area of GE or from outside is valued as much as or more than generating the good idea, Jack Welch focused his company on getting the maximum benefit from its diverse and powerful intellectual capital.

"Town meetings," developed at GE as it embraced boundarylessness, are an important tool in creating boundaryless organizations. In a town meeting, employees with a common goal or purpose (serving the same customer, working on the same product or process, etc.) but from different areas and different levels of management come together to discuss new ideas. In the organizational evolution reading of boundarylessness, town meetings are recombination workshops. Groups work for a few days before town meetings to generate and refine new ideas, and the ideas are presented, discussed, and either killed or implemented at the meetings. The town meeting format provides "safe ways" for anyone's ideas to be challenged by anyone else, without regard to position or authority. Town meetings have two purposes. First, of course, is to generate and implement change ideas. Second however, is to educate people on their "real degrees of freedom," to let employees

Contd...

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know what decisions they can make on their own and to encourage them to do so. This creates an atmosphere where change, i.e. recombination, is not only encouraged at town meetings, it is encouraged throughout the organization whenever and wherever it is necessary.

The benefits of globalization are so well known that most businesses would take full advantage of them immediately, if only it were easier to do. Making globalization work demands new types of expertise that traditional organizations often lack. While technology has eliminated a number of barriers to globalization (most notably those involving time and space), many significant barriers still remain, particularly those involving people and the organizations we build around them. The enormous cultural diversity in today's global economy makes evaluating, assessing, recruiting and managing talent a challenge - perhaps the challenge - for transnational companies. There are several key steps companies and their talent leaders can take to meet that challenge and build a global workforce that delivers high performance with high integrity.

Question

Is it possible for all the organisations to follow the GE method?

Source: www.milagrow.in

11.8 Summary

- Organisations are structured in a variety of ways, dependant on their objectives and culture.
- The structure of an organisation will determine the manner in which it operates and it's performance.
- Structure allows the responsibilities for different functions and processes to be clearly allocated to different departments and employees.
- The wrong organisation structure will hinder the success of the business.
- Organisational structures should aim to maximize the efficiency and success of the organisation.
- An effective organisational structure will facilitate working relationships between various sections of the organisation.
- It will retain order and command whilst promoting flexibility and creativity.
- Internal factors such as size, product and skills of the workforce influence the organisational structure.
- As a business expands the chain of command will lengthen and the spans of control will widen.
- The higher the level of skill each employee has the more the business will make use of the matrix structure to maximize these skills across the organisation.

11.9 Keywords

Agile Organisation: A firm that identifies a set of business capabilities central to high profitability operations and then build a virtual organisation around those capabilities.

Chain of Command: an unbroken line of authority that links all persons in an organisation and shows who reports to whom

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Formalization: extent to which written documentation is used to direct and control employees

Hierarchy: defines who reports to whom and the span of control

Infrastructure: concerned with issues like delegation of authority, specialization, communication, information systems and procedures

Modular Organisation: An organisation in which different functional components are separated from one another.

Outsourcing: subcontracting a service with another company or person to do a particular function.

Span of Control: The number of employees that each manager/supervisor is responsible for.

Superstructure: depicts how people are grouped into different divisions, departments and sections and how they are related to each other

Virtual Organisations: consist of a network of independent companies - suppliers, customers or even competitors linked together to share skills, costs, markets and rewards

11.10 Self Assessment

Fill in the blanks:

1. The ..... indicates the principal ways in which the organisational operations are integrated and coordinated.
2. The ..... enables the organisation to engage in a number of disparate activities.
3. ..... means that each employee is held accountable to only one supervisor.
4. ..... means that decision-making is done at the top levels of the organisation.
5. The ..... principle means a clearly defined line of authority in the organisation.
6. ..... is the process managers use to transfer authority and responsibility to positions below them in the hierarchy.
7. The process of designing an organisation's structure to match with its situation is called .....
8. Divisional structures are used by ..... organisations.
9. The ..... structure is, in effect, a combination of functional and divisional structures.
10. A ..... organisation outsources or subcontracts many of its major functions to separate companies.
11. The complex environment will usually benefit from a ..... structure.
12. As markets become more hostile, the organisation usually needs to be ..... centralized.
13. A ..... organisation is an organisation that is not defined by, or limited to, the horizontal, vertical, or external boundaries imposed by a predefined structure.
14. The biggest advantage of an agile virtual organisation is it can draw on ..... worldwide.
15. A modular organisation is in contrast to a ..... organisation.

Notes

11.11 Review Questions

1. In your opinion, what fundamental requirements does an organisational structure fulfill?
2. Do you agree with the statement that work can be performed more efficiently if employees are allowed to specialize? Why/why not?
3. What do you see as the reason behind the recent trend of most organisations encouraging managers to delegate authority to the lowest possible level?
4. In your opinion, which aspects of an organisation determine the best design for it?
5. Compare and contrast the functional and divisional structures?
6. Give example of an organisation that has successfully employed the matrix structure. Analyse its success mantra.
7. Prove that network structure can weaken the employee loyalty.
8. Illustrate the advantages due to which some organisations sell a single product or variations on one product.
9. "Being boundary-less can be the disadvantages for an organisation". Explain
10. Suggest any three advantages of modular organisations.

Answers: Self Assessment

1.	superstructure	2.	infrastructure
3.	Unity of command	4.	Centralization
5.	scalar	6.	Delegation
7.	organisational design	8.	diversified
9.	matrix	10.	network
11.	decentralized	12.	more
13.	boundaryless	14.	expertise
15.	composite		

11.12 Further Readings

Books

Burt R.S., *Structural Holes: The Social Structure of Competition*, Harvard University Press: Cambridge,

Garud R., Kumaraswamy A., Technological and Organisational Designs for Realizing Economies of Substitution, *Strategic Management,* Journal.

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Unit 12: Behavioural Implementation

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Objectives

After studying this unit, you will be able to:

- Explain the concept of stakeholder management
- Describe the concept of strategic leadership
- Discuss the corporate culture and strategic management
- Identify the role of personal values and ethics
- Realise the concept between social responsibility and strategic management

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Introduction

Successful strategy formulation does not at all guarantee successful strategy implementation. It is always more difficult to actually carry out something than to say you are going to do it. Strategy implementation requires support, discipline, motivation and hard work from all managers and employees. Managers should pay careful attention to a number of key issues while executing the strategies. Chief among them are how the organisation should be structured to put its strategy into effect and how such variables as leadership, power and organisational culture should be managed to enable employees to work together while implementing the firm's strategic plans. Organisations in stable, predictable environments often become relatively tall, with many hierarchical levels and narrow spans of control. On the other hand, companies in dynamic, rapidly changing environments usually adopt flat structures with few hierarchical levels and wide spans of control.

12.1 Stakeholders and Strategy

A firm's stakeholders are the individuals, groups, or other organisations that are affected by and also affect the firm's decisions and actions. Depending on the specific firm, stakeholders may include government, employees, shareholders, suppliers, distributors, the media and even the community in which the firm is located among many others.

1. When it comes to corporate mission values stakeholders will maximise the value for all stakeholders, as opposed to shareholders who only maximise the value for themselves.
2. Stakeholders also play a role in the decision making process in a business. Although since employees and customers are included in being stakeholders they too are considered when it comes to decision making.
3. When it comes to accountability it does not just come down to being accountable to themselves. Accountability lies with the customer, suppliers, government, community and employee stakeholders.

Stakeholder Management

An organisation needs to have an effective stakeholder management system in place, which provides a great support in achieving its strategic objectives. It interprets and influences both the external and internal environments and creates positive relationships with stakeholders through the appropriate management of their expectations and agreed objectives. Stakeholder Management is a process and control that must be planned and guided by underlying principles.

Stakeholder Management, within business or projects, prepares a strategy that utilises information or intelligence collected during the following common processes:

1. ***Stakeholder Identification:*** identify the parties, either internal or external to organisation, that are affected by the business. For this purpose, a stakeholder map can be used.
2. ***Stakeholder Analysis:*** identify and acknowledge stakeholder's needs, concerns, wants, authority, common relationships, interfaces, and put this information in line within the Stakeholder Matrix.
3. ***Stakeholder Matrix:*** position the stakeholders on a matrix based on their level of influence, impact or enhancement they may provide to the business or its projects.
4. ***Stakeholder engagement:*** engaging stakeholders does not seek to develop the project/ business requirements, solution or problem creation, or establishing roles and responsibilities. The process focuses on knowing and understanding each other, at the

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Executive level. It gives an opportunity to discuss and agree expectations of communication and, primarily, agree a set of Values and Principles that all stakeholders will abide by.

5. ***Communicating Information:*** expectations are established and agreed for the manner in which communications are managed between stakeholders - who receives communications, when, how and to what level of detail. Protocols may be established including security and confidentiality classifications.

Notes An organisation can follow these basic tips to manage their stakeholders effectively:

1. The organisation must prioritise business and stakeholders' needs. In order to feel like the organisation is still yours without offending or losing big stakeholders that contribute money to keep your company in business, the organisation needs to think strategically and balance out business needs and stakeholders' needs. This means that they have to capture business processes and link them to projects software and capabilities. They will also need to modify their prioritisation as their understanding of the application and stakeholder needs change. They also need to take into consideration the customer needs as well by involving them in the project.
2. The organisation should develop the growth activities around stakeholder needs. By leveraging certain developments or user center designs, an organisation can accept the fact that stakeholder needs will change over time. As you business changes so will the needs of the stakeholders and they will need to also meet their changing needs.
3. The organisation should understand the available assets. By understanding what assets are available to the business, they can also balance asset reuse with stakeholders needs. Some examples of business assets would be legacy applications, reusable components, etc.

12.2 Strategic Leadership

Leadership is the art and process of influencing people so that they will strive willingly and enthusiastically towards achievement of the organisation's purpose. Specific styles of leadership are often associated with specific approaches to the crafting and execution of strategies. The organisation's purpose and strategy do not just drop out of a process of discussion, but are actively directed by an individual with strategic vision, whom we call "strategic leader".

Strategic leadership establishes the firm's direction by developing and communicating a vision of the future and inspiring organisation members to move in that direction. Unlike managerial leadership which is generally concerned with the short-term day-to-day activities, strategic leadership is concerned with determining the firm's strategy, direction, aligning the firm's strategy with its culture, modeling and communicating high ethical standards, and initiating changes in the firm's strategy when necessary. The most successful leadership is not just to define the vision and mission of an organisation in a cold, abstract manner but to communicate trust, enthusiasm and commitment to strategy.

Example: Bill Gates of Microsoft, Akio Morita of Sony, Jack Welch of General Electric, Gianni Agnelli of Fiat, Narayana Murthy of Infosys, are all examples of strategic leaders who have guided and shaped the direction of their companies.

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It is rightly said:

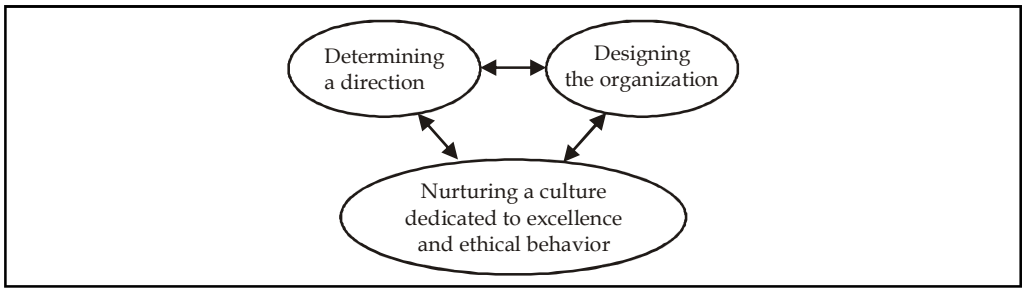
"Visionary leadership inspires the impossible: fiction becomes truth".

Strategic leadership thus enhances prospects for the organisation's long-term success, while at the same time maintaining its short-term financial stability.

12.2.1 Role of a Strategic Leadership

Leaders play a central role in performing six critical and interdependent activities in implementation of strategies:

1. Clarifying strategic intent
2. Setting the direction
3. Building an organisation
4. Shaping organisation culture
5. Creating a learning organisation
6. Instilling ethical behaviour



1. ***Clarifying strategic intent:*** Leaders motivate employees to embrace change by setting forth a clear vision of where the business's strategy needs to take the organisation.
2. ***Setting the Direction:*** Leaders set the direction and scope of the organisation through formulating appropriate corporate and business strategies.
3. ***Building the organisation:*** Since leaders are attempting to embrace change, they are often required to rebuild their organisation to align it with the ever – changing environment and needs of the strategy. And such an effort often involves overcoming resistance to change and addressing problems like the following:
   (a) Ensuring a common understanding about organisational priorities
   (b) Clarifying responsibilities among managers and organisational units
   (c) Empowering managers and pushing authority lower in the organisation
   (d) Uncovering and remedying problems in coordination and communication across the organisation
   (e) Gaining personal commitment from managers to a shared vision
   (f) Keeping closely connected with "what's going on in the organisation".
4. ***Shaping organisational culture:*** Leaders play a key role in developing and sustaining a strategy supportive culture. Leaders know well that the values and beliefs shared throughout their organisation will shape how the work of the organisation is done. And

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when attempting to embrace accelerated change, reshaping their organisation's culture is an activity that occupies considerable time for most leaders.

5. ***Creating a learning organisation:*** Leaders must also play a central role in creating a learning organisation. Learning organisation is one that quickly adapts to change. The five elements central to a learning organisation are:

   (a) Inspiring and motivating people with a mission or purpose

   (b) Empowering people at all levels throughout the organisation

   (c) Accumulating and sharing internal knowledge

   (d) Gathering external information

   (e) Challenging the status quo to stimulate creativity

6. ***Instilling ethical behaviour:*** Ethics may be defined as a system of right and wrong. Business ethics is the application of general ethical standards to commercial enterprises. A leader plays a central role in instilling ethical behaviour in the organisation.

   The ethical orientation of a leader is generally considered to be a key factor in promoting ethical behaviour among employees. Leaders who exhibit high ethical standards become role models for others in the organisation and raise its overall level of ethical behaviour. In essence, ethical behaviour must start with the leader before the employees can be expected to perform accordingly.

12.2.2 Leadership Approaches

Research has found that some leadership approaches are more effective than others for bringing about change in organisation. Three types of leadership that can have a substantial impact are transactional, transformational and charismatic leadership. These types of leadership are briefly explained below:

1. ***Transactional Leadership:*** Transactional leaders clarify the role and task requirements of subordinates, initiate structure, provide appropriate rewards, and try to be considerate to and meet the social needs of subordinates. The transactional leader's ability to satisfy subordinates may improve productivity. Transactional leaders excel at management functions. They are hardworking, tolerant, and fair minded. They take pride in keeping things running smoothly and efficiently. Transactional leaders often stress the impersonal aspects of performance, such as plans, schedules and budgets. They have a sense of commitment to the organisation and conform to organisational norms and values. In short, transactional leaders use the authority of their office to exchange rewards such as pay and status for employees and generally seek to enhance an organisation's performance steadily, but not dramatically. In other words, transactional leadership is important to all organisations, but leading change requires a different approach, viz. transformational leadership.

2. ***Transformational Leadership:*** Transformational leaders have a special ability to bring about *innovation* and *change.* They encourage the followers to question the status quo. They have the ability to lead change in the organisation's mission, strategy, structure and culture as well as promote innovation in products and technologies. Transformational leaders do not rely solely on tangible rules and incentives to control specific transactions with followers. They focus on intangible qualities such as vision, shared values, and ideas to build relationships and find common ground to enlist in the change process.

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3. ***Charismatic and Visionary Leadership:*** Charismatic leadership goes beyond transactional and transformational leadership. Charisma is a "fire that ignites followers' energy and commitment, producing results above and beyond the call of duty". The charismatic leader has the ability to inspire and motivate people to do more than what they would normally do, despite obstacles and personal sacrifice. Followers transcend their own self-interests for the sake of the leader.

   Charismatic leaders are often skilled in the art of visionary leadership. A vision is an attractive, ideal future that is credible yet not readily attainable. Visionary leaders see beyond current realities and help followers believe in a brighter future. They speak to the hearts of their followers, letting them be part of something bigger than themselves. Thus, visionary leaders have a strong vision for the future and can motivate others to help realise it. They have an emotional impact on subordinates because they strongly believe in the vision and can communicate it to others in a way that makes the vision real, personal and meaningful to others.

   When charismatic and visionary leaders respond to organisational problems, they can have a powerful, positive influence on organisational performance.

Task Identify some leaders from the corporate world and comment on their style of leadership.

12.3 Corporate Culture and Strategic Management

A company's culture is manifested in the values and business principles that management preaches and practices.

Example: Culture is manifested in:

1. Corporate stories
2. Attitudes and behaviours of employees
3. Core values
4. Organisation's politics
5. Approaches to people management and problem solving
6. Relationships with stakeholders; and
7. Atmosphere that permeates its work environment

An organisation's culture is similar to an individual's personality. Just as an individual's personality influences the behaviour of an individual, the shared assumptions (beliefs and values) among a firm's members influence the opinions and actions within that firm.

Quite often, the elements of company culture originate with a founder or other early influential leader who articulates the values, beliefs and principles to which the company should adhere. These elements then get incorporated into company policies, a creed or value statement, strategies

and operating practices. Over time, these values and practices become shared by company employees and managers. Culture is thus perpetuated as:

1. New leaders act to reinforce them
2. New employees are encouraged to adopt and follow them
3. Stories of people and events told and retold
4. Organisation members are honoured and rewarded for displaying cultural norms.

12.3.1 Influence of Culture on Behaviour

An organisation's culture can exert a powerful influence on the behaviour of all employees. It can, therefore, strongly affect a company's ability to adopt new strategies. A problem for a strong culture is that a change in mission, objectives, strategies or policies is not likely to be successful if it is in opposition to the culture of the company. Corporate culture has a strong tendency to resist change because its very existence often rests on preserving stable relationships and patterns of behaviour.

Example: The male-dominated Japanese centered corporate culture of the giant Mitsubishi Corporation created problems for the company when it implemented its growth strategy in North America. The alleged sexual harassment of its female employees by male supervisors resulted in lawsuits and a boycott of the company's automobiles by women activists.

There is no one best corporate culture. An optimal culture is one that best supports the mission and strategy of the company. This means that, like structure and leadership, corporate culture should support the strategy. Unless strategy is in complete agreement with the culture, any significant change in strategy should be followed by a change in the organisation's culture. Although corporate cultures can be changed, it may often take long time and requires much effort. A key job of management therefore involves "managing corporate culture". In doing so, management must evaluate what a particular change in strategy means to the corporate culture, assess if a change in culture is needed and decide if an attempt to change culture is worth the likely costs.

12.3.2 Creating Strategy Supportive Culture

Once a strategy is established, it is difficult to change. It is the strategy-maker's responsibility to select a strategy compatible with the organisation's prevailing corporate culture. If it is not possible, once a strategy is chosen, it is the strategy implementer's responsibility to change the corporate culture that hinders effective execution of a chosen strategy.

Changing a Problem Culture

Changing a company's culture to align it with strategy is one of the toughest management tasks. This is because the deeply held values and habits are heavily anchored, and people cling emotionally to the old and familiar. It takes concerted management action over a period of time to root out certain unwanted behaviours and instill behaviours that are more strategy-supportive. Changing culture requires competent leadership at the top. Great power is needed to force major cultural change, to overcome the spring back resistance of entrenched cultures, and great power normally resides only at the top.

Changing a problem culture involves the following four steps:

Step 1: Identify facts of present culture that are strategy – supportive and those that are not.

Step 2: Clearly define desired new behaviours and specify key features of "new" culture.

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Step 3: Talk openly about problems of present culture, and how new behaviours will improve performance.

Step 4: Follow with visible, aggressive actions to modify culture.

Managing Culture Change

As already explained in earlier sections, the culture that an organisation wishes to develop is conveyed through rites, rituals, myths, legends, actions etc. Only with bold leadership and concerted action on many fronts can a company succeed in tackling a major cultural change. Top leadership should play a key role in communicating the need for a cultural change and personally launching actions to prod the culture into better alignment with strategy.

Changing culture requires both (a) Symbolic actions and (b) Substantive actions. They require serious commitment on the part of the top management.

The following measures are helpful in building a strategy supportive culture:

1. ***Emphasise key themes or dominant values:*** Leaders must emphasise dominant values through internal company communications. They must repeat at every opportunity the messages of why cultural change is good for the company.
2. ***Stories and legends:*** Leaders must tell stories, anecdotes and legends in support of basic beliefs. Organisational members must identify with them, and share those beliefs and values.
3. ***Rewards:*** Visibly praising and generously rewarding people who display new cultural norms will slowly change the culture.
4. ***Recruiting and hiring:*** New managers and employees are to be recruited who have the desired cultural values.
5. ***Revising policies and procedures*** in ways that will help the new culture.
6. ***Leading by example:*** If the organisation's strategy involves low-cost leadership, senior management must display in their own actions and decisions, inexpensive decorations in the executive suites, conservative expense accounts and entertainment allowances, lean corporate allowances, few executive perks, and so on.
7. ***Ceremonial events:*** In ceremonial functions, companies must honour individuals and groups who exhibit cultural norms and reward those who achieve strategic milestones.
8. ***Group gatherings:*** Top management must participate in employee training programmes etc. to stress strategic priorities, values, ethical principles and cultural norms.

Every group gathering must be seen as an opportunity to repeat and ingrain values, praise good deeds, reinforce cultural norms and promote changes that assist strategy implementation. Thus, best companies and best executives expertly use symbols, role models, and ceremonial occasions to achieve the strategy-culture fit.

Managing Culture Clash

When merging or acquiring another company, top management must give some consideration to a potential clash of corporate cultures. Integrating cultures is a top challenge to a majority of companies. It is dangerous to assume that the firms can simply be integrated into the same reporting structures. The greater the gap between the cultures of the two firms, the faster executives in the acquired firm quit their jobs, and valuable talent is lost.

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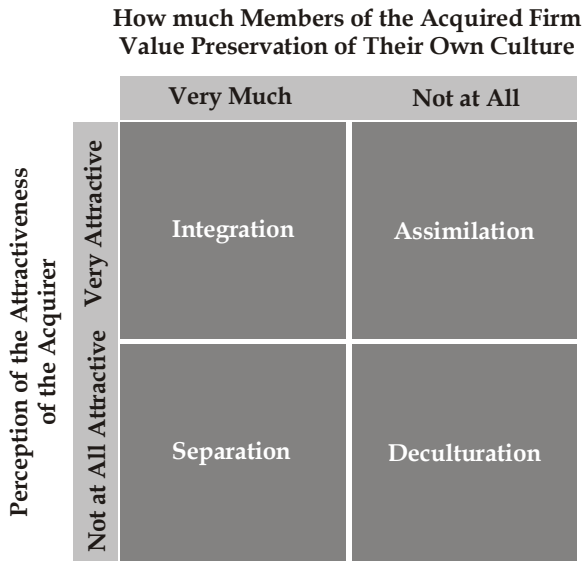
Figure 12.1: Methods of Managing the Culture of an Acquired Firm



There are four general methods of managing two different cultures. They are: (1) Integration (2) Assimilation (3) Separation, and (4) Deculturation.

1. ***Integration*** involves merging the two cultures in such a way that separate cultures of both firms are preserved in the resulting culture.
2. ***Assimilation:*** Here, the acquired firm willingly surrenders its culture and adopts the culture of the acquiring company.
3. ***Separation:*** Here there is a separation of the two companies' cultures. They are structurally separated, without cultural exchange.
4. ***Deculturation:*** This involves imposition of the acquiring firm's culture forcefully on the acquired firm. This often results in much confusion, conflict, resentment and stress.

Example: When AT & T acquired NCR Corporation in 1990 for its computer business, it replaced NCR managers with AT & T Managers, reorganised sales, forced employees to adhere to the AT & T code of values called the "Common Bond" and even changed the name of NCR. The result was that by 1995 AT & T incurred huge losses, and the NCR unit was put up for sale in 1996.

Case Study

Shaping the Culture at NOKIA

Nokia was founded in 1865 when engineer Fredrik Idestam established a mill to manufacture pulp and paper on the Nokia River in Finland. Although Nokia flourished within Finland, the company was not well known to the rest of the world.

In 1985, Ollila joined Nokia and held a variety of key management positions before moving to the helm of affairs in 1992. His leadership played an important role in shaping Nokia's culture and led the company's reinvention as a mobile communications company.

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Nokia's annual meetings, referred to as the 'Nokia way', were used to exchange notes and set priorities. After a brainstorming exercise, top managers defined the company's vision, which was communicated to the lower layers of management through formal presentations.

Nokia's culture was rooted in the Finnish national character-frugal, honest, very direct, serious, with little tolerance for "fooling around"-mixed with a good dose of engineering culture-"can do," pragmatic, and hands-on. The difficulties that Nokia had faced before Ollila became CEO also played their part in shaping the culture.

The most distinctive characteristics of Nokia's organization did not show up on any organization chart. When asked to describe the company's organization structure, Nokia's managers talked about its flexibility, freedom, and the importance of networks, rather than its formal architecture.

While Nokia was not known to pay high compensation, it had been successful in attracting, motivating and retaining quality people because it provided these individuals with plenty of growth opportunities in a challenging environment.

Nokia had introduced various innovations in its people processes to achieve a positive employer image. Nokia believed in providing individuals with a platform for personal growth in a challenging environment. Nokia believed in providing equal opportunities to people and attempted to shape a culture of respect, openness and trust.

As a result, Nokia, is renowned all over the world for its organizational culture. A flat, networked organization along with flexibility and speedy decision-making form the main elements of Nokia's culture. Many analysts attribute the success of Nokia in becoming world's largest maker of cell phones ahead of rivals such as Motorola, Siemens, Samsung, etc., to the culture it follows.

Questions

1. What do you analyse as the most glaring aspect of Nokia's culture that you are least likely to find with many companies?
2. Do you think that Nokia benefited financially from its culture? If yes, how?

Source: www.icmrindia.org

12.4 Personal Values and Ethics

Values, personal values, and core values all refer to the same thing. They are desirable qualities, standards, or principles. Values are a person's driving force and influence their actions and reactions.

Ethics is defined as "the discipline dealing with what is good and bad, and right and wrong, or with moral duty and obligation."

Ethics refers to the moral principles and values that govern the behaviour of a person or group. Ethics helps us in deciding what is good or bad, moral or immoral, fair or unfair in conduct and decision-making. In other words, ethics serve as a **"moral compass"** to guide our actions.

There are many sources for an individual's ethics. These include family background, religious beliefs, community standards and expectations etc.

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12.4.1 Importance of Ethics

There has been a growing interest in corporate ethics over the past several years. This is perhaps because of a spate of recent corporate scandals at such firms as Enron, Tyco, Texaco etc. Without a strong ethical culture, the chances of ethical crises occurring in companies cannot be ruled out. Due to this, companies face enormous costs in terms of financial and reputational loss as well as erosion of human capital and relationships with suppliers, customers, society at large and governmental agencies.

An ethical organisation is driven by ethical values and integrity. Such values shape the search for opportunities, the design of systems and the decision-making processes of the organisation. They provide a common frame of reference that serves as a unifying force across different functions and employee groups. Organisational ethics define what a company is and what it stands for.

The potential benefits of an ethical organisation are many. A strong ethical orientation can have a positive effect on employee commitment and motivation to excel. This is particularly important in today's knowledge-intensive organisations, where human capital is critical in creating value and competitive advantage. An ethically sound organisation can also strengthen its bonds among its suppliers, customers and governmental agencies.

The ethical orientation of a leader is generally considered to be a key factor in promoting ethical behaviour among employees. Leaders who exhibit high ethical standards become role models for others in the organisation and raise its overall ethical behaviour. In essence, ethical behaviour must start with the leader, who plays a central role in instilling ethical behaviour in the organisation.

Caution Some may think that ethics is a question of personal scruples. But ethics is as much an organisational issue as a personal issue. Leaders who fail to provide leadership in establishing proper systems and controls cannot create an ethical organisation. Unethical business practices reflect the values, attitudes and behavioural patterns that define an organisation's operating culture. Thus ethics plays a critical role in organisations.

12.4.2 Approaches to Ethics

When an ethical dilemma arises, there are four approaches to guide our action. These four approaches are:

1. Utilitarian approach
2. Individualism approach
3. Moral – rights approach
4. Justice approach

Utilitarian Approach

According to this approach, moral behaviour is one that produces the greatest good for the greatest number.

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Individualism Approach

According to this approach, acts are moral when they promote the individual's best long-term interests, which ultimately lead to the greater good.

Moral – Rights Approach

According to this approach, the fundamental rights and liberties should be respected in all decisions. Thus, an ethically correct decision is one that best maintains the rights of those people affected by it. Six moral rights should be considered during decision-making:

1. Right of free consent
2. Right of privacy
3. Right of freedom of conscience
4. Right of free speech
5. Right to due process
6. Right to life and safety

To make ethical decisions, managers need to avoid interfering with the rights of others.

Justice Approach

According to this approach, moral decisions must be based on equity, fairness and impartiality. Four types of justices are of concern to managers:

1. ***Distributive justice*** requires that individuals should not be treated differently on the basis of race, sex, religion or national origin. Individuals who are similar should be treated similarly. Thus, men and women should not receive different salaries if they are performing the same job.
2. ***Procedural justice*** requires that rules be administered fairly. Rules should be clearly stated and be consistently and impartially administered.
3. ***Compensatory justice*** requires that individuals should be compensated for the cost of their injuries by the party responsible. Moreover, individuals should not be held responsible for matters over which they have no control.
4. ***Natural duty principle:*** This principle reflects a duty to help others who are in need or danger; duty not to cause unnecessary suffering; and the duty to comply with the just rules of an institution.

12.4.3 Building an Ethical Organisation

A firm must have several key elements before it can become a highly ethical organisation. These elements must be constantly reinforced in order for the firm to be successful:

Role Models

For good or bad, leaders are role models in their organisation. The values as well as the character of leaders become transparent to an organisation's employees through their behaviour. Leaders must take responsibility for ethical lapses within the organisation, which enhances the loyalty and commitment of employees through the organisation.

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Code of Ethics

They are another important element of an ethical organisation. Such mechanisms provide a statement and guidelines for norms and beliefs as well as decision–making. They provide employees with a clear understanding of the ethical standards of the organisation. Many large companies have developed such codes code of conduct.

Reward and Evaluation Systems

An appropriate reward and evaluation system should consider both the outcomes and the means adopted to achieve the organisational goals and objectives. Inappropriate reward systems may cause individuals to commit unethical acts.

Policies and Procedures

Most of the unethical behaviours in organisations could be traced to the absence of policies and procedures to guide behaviour. It is important to carefully develop policies and procedures to guide behaviour so that all employees are encouraged to behave in an ethical manner. However, it is not enough merely to have policies "on the books". Rather, they must be effectively communicated, enforced and monitored. The company should also follow sound corporate governance practices.

Ethics Training

The purpose of ethic training is to encourage ethical behaviour. Companies should provide appropriate training in ethical standards. It enables managers to align ethical behaviour with organisational goals.

Ethics Audit

Companies should undertake periodic audits to ensure that proper ethical standards are being followed by all deportments of the organisation.

Chief Ethics Officer

Some large corporations appoint a senior officer with the exclusive responsibility of overseeing the ethical conduct of employees. He functions like a watchdog on ethics.

Ethics Committee

An ethics committee establishes polices regarding ethical conduct and resolves major ethical dilemmas faced by the employees of an organisation. Ethics committee performs such functions as organisation of regular meetings to discuss ethical issues, identifying possible violations of the code, enforcing the code, rewarding ethical behaviour etc.

Ethics Hotline

This is a special telephone line that enables employees to bypass the proper channel for reporting their ethical dilemmas and problems. The line is usually handled by an executive also investigates the matter and helps resolve the problems of the concerned employees.

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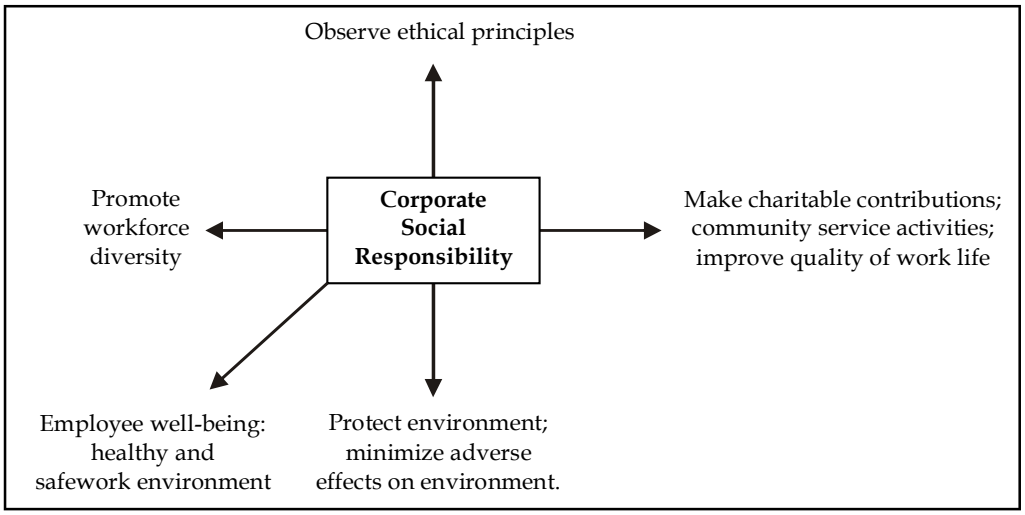
12.5 Social Responsibility and Strategic Management

Corporate social responsibility (CSR) consists of "actions that appear to further some social good, beyond the interests of the firm" It includes such topics as environmental 'green' issues, treatment of employees and suppliers, charitable work and other matters related to the community. A brief idea of the areas included in CSR is given in figure.



It is important to note that CSR requires firms to go beyond what the law requires – just doing the minimum required by the law is not sufficient. "Corporate social responsibility is concerned with the ways in which an organisation exceeds the minimum obligations to the stakeholders" (Johnson and Sholes, 2002).

Corporate Social Responsibility is therefore a company's duty to operate its business by means that *avoid harm to other stakeholders and the environment,* and also to consider *overall betterment of society* in its decisions and actions. The essence of socially responsible behaviour is that a company should strive to *balance* its actions to benefit its shareholders without any adverse impact on other stakeholders like employees, suppliers, customers, local communities and society at large, and, further, to proactively mitigate any harmful effects on the environment its actions and business may have.

12.5.1 Responsibilities of Business

A business organisation has four responsibilities:

1. ***Economic responsibilities:*** are the most basic responsibilities of a business firm. This involves the essential responsibility of business to provide goods and services to society at a reasonable cost. In discharging that economic responsibility, the company provides productive jobs to its workforce, pays taxes to central, state and local governments.
2. ***Legal responsibilities:*** reflect the firm's obligation to comply with the laws that regulate business activities, especially in the areas of consumer safety and pollution control.
3. ***Ethical responsibilities:*** reflect the company's notion of right or proper business behaviour. Ethical responsibilities go beyond legal requirements. Firms are expected, though not legally bound, to behave ethically.
4. ***Discretionary responsibilities:*** are those that are voluntarily assumed by business organisations that adopt the citizenship approach. They support ongoing charities, public-

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service advertisement campaigns, donations, medical camps, public welfare activities etc. A commitment to full corporate responsibility requires strategic managers to attack social problems with the same zeal in which they tackle business problems.

Business managers should keep in mind that economic and legal responsibilities are mandatory, ethical responsibilities are expected, and discretionary responsibilities are desirable.

The above four responsibilities are listed in order of priority. A business firm must first make a profit to satisfy its economic responsibilities. A firm must also follow the laws as a good corporate citizen. Carrol, however, argues that business firms have obligations beyond the economic and legal responsibilities; that firms must also fulfill its social responsibilities. Social responsibility includes both ethical and discretionary responsibilities, but not economic and legal responsibilities.

12.5.2 Need for CSR: The Strategy

After considering the arguments for and against CSR, it becomes evident that it is in the enlightened self-interest of companies to be good corporate citizens and devote some of their resources and energies to employees, the communities in which they operate, and society in general. There are five important reasons why companies should undertake social responsibilities.

Self-interest of the Organisation

Every organisation obtains critical inputs from the environment and converts them into goods and services to be used by society at large. In this process they help shareholders to get appropriate returns on their investment. It is expected that organisations acknowledge and act upon the interests and demands of other stakeholders such as citizens and society in general that are beyond its immediate constituencies – owners, customers, suppliers and employees. That is, they must consider the needs of the broader community at large, and act in a socially responsible way.

It generates Internal Benefits

CSR generates internal benefits like employee recruitment, workforce retention and training. Companies with good CSR reputation are better able to attract and retain employees compared to companies with tarnished reputations. Some employees just feel better about working for a company committed to improving society. This can contribute to lower turnover and better worker productivity. This also benefits the firm by way of lower costs for staff recruitment and training. Provision of good working conditions results in greater employee commitment.

It Reduces Risks

CSR reduces the risk of damage to reputation and increases buyer patronage. Consumer, environmental and human rights activist groups are quick to criticise businesses that are not socially responsive. Pressure groups can generate adverse publicity, organise boycotts, and influence buyers to avoid an offender's products. Research has shown that adverse publicity is likely to cause a decline in a company's stock price.

In the Best Interest of Shareholders

CSR is in the best interest of shareholders. Well-conceived social responsibility strategies work to the advantage of shareholders in several ways. Socially responsible behaviour can help avoid

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or prevent legal and regulatory actions that could prove costly or burdensome. A study of leading companies found that environmental compliance and developing eco-friendly products can enhance earnings per share, profitability, and the likelihood of winning contracts.

It gives Competitive Advantage

Being known as a socially responsible firm may provide a firm a competitive advantage.

Example: Firms that are eco-friendly enhance their corporate image. In western countries, many consumers boycott products that are not "green". Companies that take the lead in being environmentally friendly, such as by using recycled materials, producing 'green' products, and helping social welfare programmes, enhance their corporate image.

In sum, companies that take social responsibility seriously can improve their business reputation and operational efficiency while reducing their risk of exposure and encouraging loyalty and innovation. Overall, companies that take special pains to protect the environment (beyond what is required by law), are active in community affairs, and are generous supporters of charitable causes are more likely to be seen as good companies to work for or do business with. It will also benefit the shareholders.

Task Consider any one CSR initiative taken up by any one major corporate house in India. Do you think there was any strategic objective behind the initiative or was it purely philanthropy?

Caselet

Coca Cola India's CSR Strategy

Coca-Cola India being one of the largest beverage companies in India, realised that CSR had to be an integral part of its corporate agenda. According to the company, it was aware of the environmental, social, and economic impact caused by a business of its scale and therefore it had decided to implement a wide range of initiatives to improve the quality of life of its customers, the workforce, and society at large.

However, the company came in for severe criticism from activists and environmental experts who charged it with depleting groundwater resources in the areas in which its bottling plants were located, thereby affecting the livelihood of poor farmers, dumping toxic and hazardous waste materials near its bottling facilities, and discharging waste water into the agricultural lands of farmers. Moreover, its allegedly unethical business practices in developing countries led to its becoming one of the most boycotted companies in the world.

Notwithstanding the criticisms, the company continued to champion various initiatives such as rainwater harvesting, restoring groundwater resources, going in for sustainable packaging and recycling, and serving the communities where it operated. Coca-Cola planned to become water neutral in India by 2009 as part of its global strategy of achieving water neutrality. However, criticism against the company refused to die down. Critics felt that Coca-Cola was spending millions of dollars to project a 'green' and 'environment-friendly' image of itself, while failing to make any change in its operations. They said this was an attempt at greenwashing as Coca-Cola's business practices in India had tarnished its brand image not only in India but also globally.

Source: www.icmrindia.org

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12.6 Summary

- A firm's stakeholders are the individuals, groups, or other organisations that are affected by and also affect the firm's decisions and actions.
- An organisation needs to have an effective stakeholder management system in place, which provides a great support in achieving its strategic objectives.
- Strategic leadership establishes the firm's direction by developing and communicating a vision of the future and inspiring organisation members to move in that direction.
- A company's culture is manifested in the values and business principles that management preaches and practices. An organisation's culture can exert a powerful influence on the behaviour of all employees.
- Ethics refers to the moral principles and values that govern the behaviour of a person or group. Ethics helps us in deciding what is good or bad, moral or immoral, fair or unfair in conduct and decision-making.
- Corporate social responsibility (CSR) consists of "actions that appear to further some social good, beyond the interests of the firm" It includes such topics as environmental 'green' issues, treatment of employees and suppliers, charitable work and other matters related to the community.
- Corporate Social Responsibility is a company's duty to operate its business by means that *avoid harm to other stakeholders and the environment,* and also to consider *overall betterment of society* in its decisions and actions.

12.7 Keywords

Culture: The beliefs and behaviors that determine how a company's employees and management interact and handle outside business transactions.

Corporate Social Responsibility: A company's sense of responsibility towards the community and environment (both ecological and social) in which it operates.

Deculturation: The removing or abandoning of one's own culture and replaces it with another.

Ethics: Motivation based on ideas of right and wrong.

Stakeholders: A person, group, or organisation that has direct or indirect stake in an organisation.

Strategic leadership: A manger's potential to express a strategic vision for the organisation, or a part of the organisation, and to motivate and persuade others to acquire that vision.

12.8 Self Assessment

Fill in the blanks:

1. The company must place its stakeholders on a ……..based on their level of influence or impact.
2. A manager is concerned with short term activities of the organisation, while a ……..is concerned with the long term aspects.
3. Strategic leaders must also play a central role in creating a ……. organisation.
4. In general, ……may be defined as a system of right and wrong.

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5. ……leaders have a special ability to bring about innovation and change.
6. Charismatic leaders are often skilled in the art of ……. leadership.
7. An organisation's culture is similar to an individual's ……..
8. When the acquired firm willingly surrenders its culture and adopts the culture of the acquiring company, it is called……of culture.
9. An ethical organisation is driven by ethical …….and ……...
10. It is a……responsibility of a business to adopt the citizenship approach.

12.9 Review Questions

1. Assess the value of stakeholders in an organsiation. Why is it important to manage the stakeholders well?
2. Critically analyse the role of strategic leader vis-à-vis managerial leaders.
3. "Visionary leadership inspires the impossible: fiction becomes truth". Substantiate
4. Discuss the three approaches to leadership. Assess the importance of each of them.
5. "An organisation's culture is similar to an individual's personality." Comment
6. "There is no best or worst culture". Elucidate
7. Suppose you are the manager of a firm that has just acquired another firm. How will you ensure that there is good 'fit' between the culture and startegy of the new firm?
8. What do you mean by problem culture? How will deal with such a culture?
9. Is it necessary for an organisation to be ethical? Give your viewpoint and justify.
10. CSR is not an obligation, then why most of the successful companies engage in it?

Answers: Self Assessment

1.	stakeholder matrix	2.	strategic leader
3.	learning	4.	ethics
5.	Transformational	6.	visionary
7.	personality	8.	assimilation
9.	values, integrity	10.	discretionary

12.10 Further Readings

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Unit 13: Functional and Operational Implementation

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Objectives

After studying this unit, you will be able to:

- Describe functional strategies
- Explain the functional plans and policies
- State the operational plans and policies
- Discuss personnel plans and policies

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Introduction

Once corporate level and business level strategies are developed, management must turn its attention to formulating strategies for each functional area of the business unit. For effective implementation of strategies, functional strategies provide direction to functional managers regarding the plans and policies to be adopted in each functional area.

13.1 Functional Strategies

Functional Strategy is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximising resource productivity. It is concerned with developing and nurturing a distinctive competence to provide a company or business unit with a competitive advantage. Just as a multi-divisional corporation has several business units, each with its own business strategy, each business unit has its own set of departments, each with its own functional strategy.

13.1.1 Nature of Functional Strategies

Functional strategies are essential to implement business strategy. In fact, the effectiveness of a corporate or business strategy execution depends critically on the manner in which strategies are implemented at the functional level. The corporate strategy provides the long-term direction and scope of a firm. The business strategy outlines the competitive posture of its operations in an industry. The functional strategy clarifies the business strategy, giving specific short-term guidance to operating managers in the areas of operations, marketing, finance, HR, R&D etc., and increases the likelihood of their success.

Orientation of the functional strategy, therefore, depends on the business strategy.

Example: If a business unit follows a differentiation strategy through high quality products, its production strategy emphasises expensive quality assurance processes over cheaper, high-volume production; a human resource functional strategy that emphasises hiring and training of a highly skilled, but costly, workforce; and a marketing functional strategy that emphasises extensive advertising to increase demand rather than using marketing incentives to retailers. Similarly, if the business unit follows a low-cost competitive strategy, a different set of functional strategies emphasising cost-cutting measures would be needed to support the business strategy.

13.1.2 Need for Functional Strategies

Functional managers need guidance from the corporate and business strategies in order to make decisions. In simple terms, functional strategies tell the functional manager what to do in his area to achieve business objectives.

Glueck and Jauch have suggested five reasons to show why functional strategies are needed. Functional strategies are developed to ensure that:

1. The strategic decisions are implemented by all the parts of an organisation.
2. There is a basis available for controlling activities in different functional areas of a business.
3. The time spent by functional managers on decision-making may be reduced.
4. Similar situations occurring in different functional areas are handled by the functional managers in a consistent manner.
5. Coordination across different functions takes place where necessary.

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13.2 Functional Plans and Policies

The process of developing functional plans and policies is quite similar to that of strategy formulation, with the difference that functional heads are responsible for their formulation and implementation. Environmental factors relevant to each functional area will have an impact on the choice of strategies. Finally, the actual process of choice involves a negotiation between functional managers and business unit managers. Thus, functional strategies are generally formulated in all key functional areas.

For each of the functional strategies, a set of policies will have to establish for appropriate areas of the business. The policies will ensure that the strategies are carried out as intended and that the different functional areas are working towards the same ends. Companies have plans and policies that cover nearly every major aspect of the firm. The firm should have strategies in every major aspect of business, at least in key functional areas. We will highlight some of the more important issues for each functional area that need to be addressed in their respective functional strategies.

The functional strategies should be comprehensive; but at the same time, they should not leave so much choice to operating mangers that they work sub-optimally or at cross purposes. At the same time, the functional strategies should be flexible enough to leave room to managers for responding quickly to situations and make exceptions for good reasons. The functional strategies required in key functional areas are outlined below:

Financial Strategy

In the financial management area, the major concern of the strategy relates to the acquisition and utilisation of funds. Major issues involved are the sources from where the funds will come, from equity or by borrowing. How much of the borrowing will be short-term and how much long-term. In terms of usage of funds, the policy decisions would relate to whether and to what extent funds have to be deployed in fixed assets and current assets. The long-term or capital investment decisions relate to buying or leasing the fixed assets. A retrenchment strategy or paucity of funds may compel the organisation to lease rather than buy. In case of an organisation where capital investment decisions are decentralised, a "hurdle rate" may be fixed so as to avoid investment in weaker projects by one division and non-investment by another division.

Cash Flow

Apart from capital budgeting, another consideration in financial strategy which influences other functional areas is the cash flow. A company may frame bonus and dividend policies based on availability of cash. In case a company proposes expansion through internally generated funds, it may reduce bonus and dividend. This is particularly so when it has formulated ambitious growth strategies which require large cash. Similarly, if the firm has high risk business, it should have a conservative debt/equity ratio to guard against heavy interest burden.

The funds position and optimisation orientation of top management also determines the accounts receivable and payable policies. Financial strategies and policies may even determine the accounting policies as these affect the profitability, balance-sheet and hence cash flow through taxes, dividend, bonus etc.

Marketing Strategy

Functional strategies in marketing area are required for marketing – mix decisions, i.e. the four Ps of marketing, viz. Product design, Product distribution, Pricing and Promotion aspects of marketing. In terms of specifics, the product decisions relate to such issues as the variety of

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product (shape, size, model etc.), quality requirements, introduction/withdrawal of products, nature of customers etc. Specific policies are also required regarding distribution channels i.e. through retailers or direct selling? What would be the spread of distribution network? Whether new dealers will be established or old ones developed? The promotion strategies will relate to mode of promotion, coverage and nature (corporate, product or brand promotion). Again, very clear and specific strategies will have to be made about pricing, etc., full cost or standard cost based pricing. Offensive vs. defensive postures also influence pricing policies.

HR Strategy

HR strategy deals with matters like HR planning, recruitment and selection, training and development, compensation management, performance management, rewards and incentives etc. What compensation/reward system will be able to attract people of the desired type to join the organisation so as to meet the task requirements demanded by the strategy? What strategies are necessary to groom internal people for new positions? The problem becomes acute in the context of turnaround strategies. On the one hand, the most competent people leave and the firm finds it difficult to attract suitable replacements. On the other hand, it faces the problem of surplus staff. HR strategies for retrenchment, though painful, are quite necessary but difficult to develop.

Production Strategy

The functions relating to production need strategies relating to quality assurance, machine utilisation, location of facilities, balancing the line, scheduling of production, and materials management. The strategy for entering into export market will dictate a different policy regarding quality of products and maintenance. Location of facilities may be determined by closeness to market or input supply points. Decisions must be made to determine whether and how much to make or buy, on the basis of cost differential, availability, criticality of the item, capacity if expansion becomes necessary. In case of bought out items, policies regarding number of suppliers and the criteria for selecting them are necessary.

R&D Strategy

In the area of research and development, functional strategies regarding the nature of research are necessary. In case of expansion through new product development, heavy emphasis has to be laid on basic and applied research.

Caution On the contrary, for expansion in the same line, research emphasis has to be on product/process improvement to cut cost and to add value. It may be noted that in case of basic research the firm should be prepared to commit resources and wait for outcome for several years. It cannot have basic research unless it is prepared to commit resources on long-term basis.

Task Consider two Indian firms from the same industry and compare their functional strategies.

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Caselet

Tata Motors: Banking on Smart Strategies

Tata Motors is an Automobile Company in India and is a very high earning company. Its revenues, reportedly, in the year 2008-2009 was 14 billions. But its achievements do not stop there. It is among the world's top automobile companies, reportedly the 4th largest truck manufacturer.

The question that many may ask is, "What can we learn from such a large company, with such great profits?" The age old statement, "Success often leaves traces" may be appropriate to add in this junction.

With 23,000 employees what is notable in Tata Motors approach is the fact that it's marketing approach is novel and founded on clear cut internet marketing guidelines. One only has to go to the Tata Motors website to find that it integrates multiple media outlets in its marketing approach. From its use of flash to its sleek website design, the company uses what is essential to great profits, innovation.

Innovation is simply the process by which companies increase their profitability in the marketplace by staking out a position that other companies in the market can't do. It clears out space in their prospect's mind as to what their company is able to offer them that no other company can.

For Tata Motors- excellence in service and presentation- is the perception that comes to the prospect's mind, for others it may understanding a customer's family needs for a car.

Essentially what Tata Motors has done is they've brought a new range of value to their market by bringing media and technology that have not been overemphasised by their competitors so that they could carve out an unshakable space in the minds of their customers and thus lead to increased sales.

Source: www.prlog.org

13.3 Operational Plans and Policies

Operations management is the core function of any organisation. This function converts inputs (raw materials, supplies, machines and people) into value added outputs. Operations management covers all manufacturing processes in an organisation and includes raw material sourcing, purchasing, production, distribution and logistics. This function contributes to the organisation's ability to add value to the goods and services.

13.3.1 Importance of Operational Strategy

The key to successful survival of an enterprise is how efficiently the production activity is managed. The two major factors that contribute to business failures are: obsolescence of the product line and excessive production costs. These factors themselves have been the outcome of ineffective production Planning.

Operations strategy plays a crucial role in shaping the ultimate success of a firm. It enables an organisation to make optimal decisions regarding product, production capacity, plant location, choice of machinery and equipment, maintenance of existing facilities and host of other aspects of production. Constant review of production plan aids in maintaining proper balance of capital investment in plant, equipment and inventory; efficient operation of the production system, product mix, Quality control; and ensures effective material handling and Planning of facilities.

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Within the broad framework of corporate and business strategies, production strategy helps in maintaining full co-ordination with marketing and engineering functions to formulate plans to improve products and services. It calls upon management to keep in constant touch with finance and personnel to achieve the optimal use of assets, cost control, recruitment of suitable personnel and management of labour disputes and negotiations.

13.3.2 Components of Operational Plan and Policies

The different components of a production strategy should ideally consist of the following:

Product Mix

A firm should decide about the product mix (how many and what kind of products to be produced) keeping in view Objectives such as productivity, cost efficiency, Quality, reliability, flexibility etc.

Capacity Planning

Capacity Planning is the process of forecasting demand and deciding what Resources will be required to meet that demand. Meclain and Thomas suggested that capacity Planning involves the following five sequential steps.

1. ***Predict future demand and competitive reactions:*** The firm should forecast the demand for various products/services as also estimate customer reaction to the products offered by it. It should also take care of potential countermoves by competitors.
2. ***Translate above estimates into capacity needs:*** Based on forecasts, the firm must decide the quantity that can be manufactured keeping input limitations, such as plant equipment, manpower etc in mind.
3. ***Create alternative capacity plans:*** Depending on what the market might absorb and what the organisation can produce, management should create alternative capacity plans for various products/services that are offered to customers.
4. ***Evaluate each alternative:*** The firm should identify the opportunities and Threats associated with each alternative, and carefully evaluate in terms of additional costs involved, payoffs etc.
5. ***Select and implement a particular capacity plan:*** The capacity plan that best serves organisational Objectives should be selected and implemented.

One of the most vital decisions which has to be made regarding production capacity is whether the company should build so much capacity to satisfy all demand during peak periods and keep the production facilities idle during lean periods.

There are some organisations that prefer to build smaller capacity to take care of normal requirements and meet peak demand by way of imports or subcontracting. Some organisations employ measures such as off-peak discounts, mail early campaign, etc. to induce customers to avoid peak periods.

Technology and Facilities Planning

Choosing Machines and Equipments

A strategic decision to be made by a production manager is what type of equipments the organisation will require for production purposes, how much it will cost, what will be its operating cost and what services it will render to the organisation and for how long.

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Choice of equipment for making a particular product essentially depends on the basic manufacturing process. The decision-maker must, therefore, familiarise himself with the production process to be adopted.

Another consideration in the choice of new equipment for a plant is the type and degree of operating skill required and presently available skills within the organisation. Other factors worth consideration are the ease with which the equipment can be operated and the safety features of the equipment.

Equipment Investment

Acquisition of equipment involves capital expenditure which will have long-term effects on the financial position of the company. Hence, before taking a final decision regarding investment in a machine, detailed analysis of such investment in terms of cost-benefits must be made and its desirability and worthwhileness should be evaluated with the help of internal rate of return or net present value method.

The decision to replace the existing machine is equally important to the enterprise. In this regard the management has to decide when the replacement should be made and the best replacement policy that must be considered while making comparisons between an existing unit of equipment and its possible replacement. In order to make a sound economic comparison, all the factors must be converted into cost considerations. The rate of return so obtained is compared with the cut-off rate to ascertain whether the replacement is economically viable.

Thus, clear-cut policy guidelines regarding methodology or computation of net investment outlay, incremental operating expenditure and income, depreciation, obsolescence, salvage value etc. will help management in taking decisions regarding acquisition and/or replacement of machines.

Physical Facilities Decisions

Facilities strategy covers plans for location analysis and selection, design and specifications including layout of equipment, plant, warehouses and related services. Facilities Planning deals with the separate but interrelated costs of material, supplies, manpower, services and facilities. Its Mission is to find ways to minimise the aggregate of such costs in making and distributing the products at the proper time.

Plant Location

Plant location is essentially an investment decision having long-term significance. Once a plant is acquired, it is a permanent asset that cannot readily be sold. The management may also contemplate relocation of the plant when business expansion and advanced technology require additional facilities to serve new market areas, to produce new products, or simply to replace the old, obsolete plants to increase the company's production capacity.

The selection of an appropriate plant site calls for location study of the region in which the factory is to be situated, the community in which it should be placed and finally, the exact site in the city or countryside.

Plant Building

Once the company has chosen the plant site, due consideration must be given to providing physical facilities. A company requiring extensive space will always construct new buildings.

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On planning a building for the manufacturing facilities, a number of factors will have to be kept in mind such as nature of the manufacturing process, plant layout and space requirements, lighting, ventilating, air-conditioning, service facilities and future expansion.

Plant Layout

Plant layout involves the arrangement and location of production machinery, work centres and auxiliary facilities and activities (inspection, handling of material storage and shipping) for the purpose of achieving efficiency in manufacturing products or supplying consumer services. Plant layout should co-ordinate material, men and machines and achieves the following Objectives:

1. Facilitate the manufacturing process.
2. Minimise materials handling.
3. Maintain flexibility of arrangement and operation.
4. Maintain high turnover of work-in-process.
5. Hold down investment in equipment.
6. Make economical use of building space.
7. Promote effective utilisation of manpower.
8. Promote employee convenience, safety and comfort in doing the work.

In designing plant layout a number of factors such as nature of product, volume of production, Quality, equipment, type of manufacture, building plant site, personnel and materials handling plan should be kept in view.

Maintenance of Equipment

Maintenance of equipment is an important component of planning consideration. It is intimately linked with replacement policies. Every manufacturing enterprise follows some maintenance routine in order to avoid unexpected breakdowns and thus minimise costs associated with machine down time, possible loss of potential sales, idle direct and indirect labour delays, customer dissatisfaction from possible delays in deliveries and the actual cost of repairing the machine.

A number of strategies can be adopted for maintenance of machines and equipment. Two most important ones are carrying excess capacity and preventive maintenance.

Excess Capacity

In carrying excess capacity method an organisation carries stand-by capacity, which is used if trouble occurs. This excess capacity can be whole machines or it can be major parts or components which ordinarily take time to obtain. Carrying excess capacity involves cost which must be compared with costs arising out of a slow-down or a shut-down of a whole series of dependent operations. Therefore, the decision in this regard is cost trade-offs.

Preventive Maintenance

Preventive maintenance is based on the premise that good maintenance prevents breakdowns. Preventive maintenance means preventing breakdowns by replacing worn-out machines or their parts before their breakdown. It anticipates likely difficulties and does the expected needed

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repairs at a convenient time before the repairs are actually needed. Preventive maintenance depends upon the past knowledge that certain wearing parts will need replacement after a normal interval of use.

Inventory Management

This is concerned with management of inventory consisting of raw materials, work-in-process, goods in transit, finished goods etc. Inventory management is a critical function because substantial money can be locked up in inventory, which can be put to productive use. There are various techniques that can be used for effective inventory management.

1. Economic Order Quantity
2. ABC analysis
3. Just-in-time (JIT) Inventory systems etc.

Quality Management

Quality is a major consideration in Production/Operations strategy. By using techniques like Total quality management (TQM), Six Sigma etc, organisations strive to produce 'Zero defect products' Operations strategy should consist of appropriate Quality improvement programmes to achieve total Quality in products and services of the organisation.

Task Find out about the quality management practices at McDonalds.

13.4 Personnel (HR) Plans and Strategies

Personnel policies are guides to action. Brewster and Ricbell defined HR policies as "a set of proposals and actions that act as a reference point for managers in their dealings with employees". Management should pay attention to the following aspects of HR policies:

1. HR policies must be related to the strategic objectives of the firm.
2. They should be stated in definite, clear and understandable language.
3. They should be sufficiently comprehensive and provide yardsticks for future action.
4. They should be stable enough to assure people that there will not be drastic overnight changes.
5. They should be built on the basis of facts and sound judgment.
6. They should be just, fair and equitable.
7. They must be reasonable and capable of being accomplished.
8. Periodic review of HR policies is essential to keep in tune with changing circumstances.

13.4.1 HR Planning

HR planning is the first key component for developing a human resource strategy. It involves translating corporate – wide strategic objectives into a workable plan and serves as a blue-print for all specific HR programmes and policies. It is the process of analysing and identifying the

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need for and availability of human resources so that the organisation can meet its objectives. It helps determine the manpower needs of firms and develop strategies for meting those needs.

According to Jeffrey Mello, key objectives of HR planning are:

1. Prevents overstaffing and understaffing.
2. Ensures the organisation has the right number of employees with the right skills in the right places and at the right time.
3. Ensures the organisation is responsive to changes in its environment.
4. Provides direction and coherence to all HR activities and systems.
5. Unites the perspectives of line and staff managers.
6. Facilitates leadership continuity through succession planning.

Although HR planning follows from the strategic plan, the information collected in the HR planning process contributes to the assessment of internal organisation's environment done in strategic planning.

13.4.2 Staffing

Staffing, the process of recruiting applicants and selecting prospective employees, remains a key strategic area for human resource strategy. Given that an organisation's performance is a direct result of the individuals it employs, the specific strategies used and decisions made in the staffing process will directly impact the success of the strategic plan.

Recruitment

Recruitment means attracting people to apply for jobs in the organisation. The strategic issues in recruitment are:

1. Temporary versus permanent employees
2. Internal versus external recruiting
3. When and how extensively to recruit
4. Methods of recruiting

Selection

Once a sufficient pool of applicants has been received, critical decisions need to be made regarding applicant screening, methods of selection and placement. The selection methods should be reliable and valid.

Placement

After selecting a candidate, he should be placed on a suitable job. Placement is an important human resource activity. If neglected, it may create employee adjustment problems. An employee placed in a wrong job may quit the organisation in frustration.

13.4.3 Training and Development

Training and development of employees is a key strategic issue for organisations. It is the means by which organisations determine the extent to which their human assets are viable

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investments. Training involves employees acquiring knowledge and skills that they will be able to use on the job.

There are two key factors to develop successful training programmes in organisations. The first is planning and strategising the training. This involves four distinct steps:

1. Needs assessment
2. The establishment of objectives and measures
3. Delivery of the training
4. Evaluation

The second key factor is to ensure that desired results are achieved or accomplished. Training needs are to be integrated with performance management systems and compensation.

13.4.4 Performance Management

An organisation's long-term success in meeting its strategic objectives rests on managing employee performance and ensuring that performance measures are consistent with the strategic needs. One purpose of performance management systems is to facilitate employee development. A second purpose is to determine appropriate rewards and compensation, which must be clearly linked to achievement of strategic goals.

13.4.5 Compensation and Rewards

Organisations face a number of key strategic issues in setting their compensation and reward policies and programmes. These include:

1. Compensation relative to the market
2. Balance between fixed and variable compensation
3. Appropriate mix of financial and non financial compensation
4. Developing an overall cost-effective compensation programme that results in high performance.

In addition to these strategic issues, the fast pace of change and the need for organisations to respond in order to remain competitive create challenges for all HR programmes, but particularly for compensation. Organisations should revaluate their compensation programmes within the context of their corporate strategy and specific HR strategy to ensure that they are consistent with the necessary performance measures required by the organisation. Overly rigid compensation systems inhibit the flexibility needed by the company's competitive strategies. HR strategy must encourage creativity to meet strategic objectives. Therefore, compensation systems must ensure that behaviours that help achieve strategic objectives are appropriately rewarded.

13.4.6 Industrial Relations

Industrial relations is a key strategic issue for organisations because the nature of the relationship between employees can have a significant impact on morale, motivation and productivity. Consequently, how organisations manage the day- to- day aspects of the employment relationship can be a key variable affecting their ability to achieve strategic objectives.

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Unionised employees present a number of key strategic challenges for management:

1. The power base within the organisation is redistributed
2. Management's ability to manage workers at their discretion to achieve the organisation's strategic objectives will be severely curtailed.
3. Outside leadership may pose additional challenges to the management.
4. Unionised work setting can greatly impact the organisation's cost structure. Since liberalisation of the Indian economy since 1990s, there is a perceptible change in the industrial relations scenario of our country. Labour militancy, strikes and lockouts have reduced drastically. However, in certain sectors of the economy, especially the government and public sector, there is not much change in the clout of the unions.

Through appropriate collective bargaining and participative management practices, industrial relations can be managed effectively. HR strategy must incorporate long-term plans and programmes to maintain industrial peace for effective implementation of the business strategy.

Case Study

Does Sincerity Pay?

Rajdhani Tyres Ltd (RTL) was a medium-sized tyre company, manufacturing tyres of various types and grades. It had 6000 workers and 400 executives on its rolls.

The manufacturing division was headed by Ramlal. Shekhar was the Chief Engineer reporting to Ramlal directly. The division had 400 workers, 20 executives and 40 supervisors.

Baluja joined the manufacturing division four years back as a skilled worker. He was technically sound, hardworking and performed his duties sincerely. He was promoted as a supervisor recently.

On Monday, Baluja was taking rounds in the department. It was a routine inspection and he spotted Raghu doing nothing. Baluja advised Raghu to concentrate on the job given to him instead of wasting his time. Raghu shot back saying "You mind your business. I am the senior most in this department. Don't think you have become big after your recent promotion." Other workers witnessed the exchange of words with interest and finally burst into laughter when Baluja tried to retort. Encouraged by the favourable response from his team mates, Raghu retaliated by using unparliamentary words. In frustration, Baluja had to report the matter to the Chief Engineer, Shekhar. Shekhar took a serious note of the situation and issued a stern warning to Raghu, ignoring the fact that Raghu was quite notorious for such incidents in the past as well.

Baluja was able to get along with others in the departments, despite occasional flare-ups over matters relating to discipline and production targets. After a two-year stint, Baluja was in the midst of a crisis again.

A worker named Roberts came to duty in a drunken state and was celebrating his birthday with other colleagues, disrupting work. Even after half an hour the noise did not subside and Baluja had to intervene and check Roberts to go back to work and allow others to resume normal duties. Roberts got wild when he was physically forced to go to his workspot. In a fit of anger, Roberts resorted to physical abuse and slapped Baluja in front of others. Not content with this, Roberts reported the matter to the union, alleging verbal as well as physical abuse from the supervisor, Baluja.

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Three days afterwards, Baluja got the shock of his life when he came to know about this from another supervisor. After the ugly incident, Baluja had to rush back to his house for admitting his son in the local hospital for viral fever. Since Roberts was drunk and it was his birthday, Baluja never thought of reporting the matter to his boss.

The union presented a highly fabricated case to the chief of manufacturing, Ramlal and demanded immediate disciplinary action against Baluja. Ramlal instructed Shekhar to demote Baluja immediately so that he would mend his violent ways of dealing with workers. Shekhar advised restraint since this would send wrong signals to other supervisors and would demoralise them thoroughly. Shekhar however, fearing a revolt from the union, had to demote Baluja.

Unable to swallow the insult to his ego, Baluja resigned immediately thereafter, citing personal reasons. Shekhar was quite unhappy with the turn of events and sought advice from the personnel manager, Khurana.

Khurana was quick to respond, "Incidents of this nature should help us realise the importance of picking up people with good interpersonal skills as supervisors rather than technical skills. After all, they need to extract work from others, without losing their cool even under provocative situations. You see, we can't put unions in a spot even when they are on the wrong side."

Shekhar: 'I know people were after Baluja, since he is sincere and hard-working. He was a race horse. Others were not. With a little bit of tact, Baluja could have managed the situation well."

Ramlal: "It's sad to lose people like him. But Shekhar, workers are illiterates and respond negatively when you talk tough language. A supervisor should use his brains rather than hands while dealing with people. This fellow rubbed shoulders with union people on the wrong side previously too. Other supervisors seem to be OK. Be careful in your selections from now on."

Questions

1. What is the main problem in the case?
2. What would you do, if you were in place of Shekhar?

Source: Adapted from IGNOU

13.5 Summary

- Functional Strategy is concerned with developing and nurturing a distinctive competence to provide a company or business unit with a competitive advantage.
- Functional strategies are essential to implement business strategy.
- Functional policies will ensure that the strategies are carried out as intended and that the different functional areas are working towards the same ends. Companies have plans and policies that cover nearly every major aspect of the firm.
- Operations strategy plays a crucial role in shaping the ultimate success of a firm. It enables an organisation to make optimal decisions regarding product, production capacity, plant location, choice of machinery and equipment, maintenance of existing facilities and host of other aspects of production.
- Personnel policies are guides to action. Brewster and Ricbell defined HR policies as "a set of proposals and actions that act as a reference point for managers in their dealings with employees".

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13.6 Keywords

Capacity Planning: Process of forecasting demand and deciding what Resources will be required to meet that demand.

Cash flow: The excess of cash revenues over cash outlays in a given period of time (not including non-cash expenses)

Functional Strategy: Approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximising resource productivity.

Human Resource Planning: The ongoing process of systematic planning to achieve optimum use of an organisation's most valuable asset - its human resources.

Industrial Relations: Interaction between employers, employees, and the government; and the institutions and associations through which such interactions are mediated.

Inventory Management: Management of inventory consisting of raw materials, work-in-process, goods in transit, finished goods etc.

Operations Management: Design, execution, and control of a firm's operations that convert its resources into desired goods and services, and implement its business strategy.

13.7 Self Assessment

Fill in the blanks:

1. …….. strategy outlines the competitive posture of its operations in an industry.
2. …….. will ensure that the strategies are carried out as intended.
3. A company often frames bonus and dividend policies based on availability of …….
4. Marketing strategy includes the decision regarding the four Ps referred to as the…….
5. Decision related to logistics comes under the purview of……..strategy.
6. Some organisations that prefer to build smaller capacity to take care of normal requirements, meet peak demand by way of imports or ……
7. Plant location is essentially ……. decision that has a long-term significance.
8. ABC Analysis is a technique used for…….
9. …….is the process of recruiting applicants and selecting prospective employees.
10. The main purpose of performance management systems is to facilitate …….

13.8 Review Questions

1. Analyse the importance of functional strategies. Are they more important than business strategy?
2. Suppose you are the manager of a newly established garments company. You have a business strategy ready for you that stresses on competitive positioning and proper stakeholder management. Draft out a proper functional strategy for your company, if the objective is to establish a brand name in the long run.
3. Discuss the functional strategies required in key functional areas of business.

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4. "Operations management is the core function of any organisation". Justify
5. Why is choice of equipments to be used in business a major strategic decision?
6. "It is necessary to have personnel strategies in place in order to make other strategies successful." Comment
7. Critically analyse staffing and training as strategies decisions.
8. Evaluate the importance of effective marketing and R&D strategies.
9. "The key to successful survival of an enterprise is how efficiently the production activity is managed." Discuss
10. How does obsolescence of the product line affect the organisation?

Answers: Self Assessment

1.	Business	2.	Policies
3.	cash	4.	marketing mix
5.	operation	6.	subcontracting
7.	investment	8.	inventory management
9.	Staffing	10.	employee development

13.9 Further Readings

Books

Azhar Kazmi, *Strategic Management and Business Policy,* 3rd Edition, Tata McGraw Hill

C Appa Rao, B Parvathiswara Rao and K Sivaramakrishna, *Strategic Management and Business Policy*, Excel Books

Hill and Jones, *Strategic Management: An Integrated Approach*, 6th Edition, Biztanatra/ Cengage

Online links

http://www.kulzick.com/funcstrat.htm

http://www.allbusiness.com/business-planning-structures/business-plans/2524-1.html

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Unit 14: Strategic Evaluation and Control

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Objectives

After studying this unit, you will be able to:

- State the nature of strategic evaluation and control
- Discuss the concept of strategic control and operational control
- Explain the techniques for strategic control
- Identify the role of organisational systems in evaluation

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Introduction

Strategic evaluation and control is the final phase in the process of strategic management. Its basic purpose is to ensure that the strategy is achieving the goals and objectives set for the strategy. It compares performance with the desired results and provides the feedback necessary for management to take corrective action.

According to Fred R. David, strategy evaluation includes three basic activities (1) examining the underlying bases of a firm's strategy, (2) comparing expected results with actual results, and (3) taking corrective action to ensure that performance conforms to plans. Sometime, the best formulated strategies become obsolete as a firm's external and internal environments change. Managers should, therefore, identify important milestones and set strategic thresholds to assist them in knowing the changes in the underlying assumptions of a strategy and, if necessary alter the basic strategic direction. The evaluation process thus works as an early warning system for the organisation.

Strategic evaluation generally operates at two levels – strategic and operational level. At the strategic level, managers try to examine the consistency of strategy with environment. At the operational level, the focus is on finding how a given strategy is effectively pursued by the organisation. For this purpose, different control systems are used both at strategic and operational levels.

14.1 Nature of Strategic Evaluation and Control

Strategic evaluation and control is defined as the process of determining the effectiveness of a given strategy in achieving the organisational objectives and taking corrective actions wherever required. According to Pearce and Robinson, strategic control *is concerned with tracking a strategy as it is being implemented, detecting problems or changes in its underlying premises, and making necessary adjustments.* In contrast to post-action control, strategic control seeks to guide action on behalf of the strategies,. as they are taking place and when the end result is still several years off .

Strategic control in an organisation is similar to what the "steering control" is in a ship. Steering keeps a ship, for instance, stable on its course. Similarly, strategic control systems sense to what extent the strategies are successful in attaining goals and objectives, and this information is fed to the decision-makers for taking corrective action in time. Strategic managers can steer the organisation by instituting minor modifications or resort to more drastic changes such as altering the strategic direction altogether. Strategic control systems thus offer a framework for tracking, evaluating or reorienting the functioning of the firm's strategy.

14.1.1 Types of General Control Systems

Basically, there are three types of general control systems:

1. Output control (i.e. control on actual performance results)
2. Behaviour control (i.e. control on activities that generate the performance)
3. Input control (i.e. control on resources that are used in performance)

Output Control

Output controls specify *what* is to be accomplished by focusing on the end result. This control is done through setting objectives, targets or milestones for each division, department, section and executives, and measuring actual performance. These controls are appropriate when specific output measures haven't been agreed on. Often rewards and incentives are linked to performance goals.

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Example: Sales quotas, specific cost reduction or profit targets, milestones or deadlines for completion of projects are examples of output controls.

Behaviour Control

Behaviour controls specify *how* something is to be done. This control is done through policies, rules, standard operating practices and orders from superiors. These controls are the most appropriate when performance results are hard to measure. Rules standardise the behaviour and make outcomes predictable. If employees follow rules, then actions are performed and decisions handled the same way time and again. The result is predictability and accuracy, which is the aim of all control systems. The main mechanisms of behaviour control are:

1. Operating budgets
2. Standard operating practices
3. Rules and procedures

Example: One example of an increasingly popular behaviour control is the *ISO 9000 Standards Series* on quality management and assurance developed by the International Standards Association of Geneva, Switzerland. The ISO 9000 series is a way of documenting a company's quality operations, and strictly complying with it. Many corporations worldwide view ISO 9000 certification as assurance that the firm sells quality products.

Input Control

Input controls specify the amount of resources, such as knowledge, skills, abilities, of employees to be used in performance. These controls are most appropriate when output is difficult to measures.

14.1.2 Basic Characteristics of Effective Evaluation and Control System

Effective strategy evaluation systems must meet several basic requirements. They must be:

1. ***Simple:*** Strategy evaluation must be simple, not too comprehensive and not too restrictive. Complex systems often confuse people and accomplish little. The test of an effective evaluation system is its simplicity not its complexity.
2. ***Economical:*** Strategy evaluation activities must be economical. Too many controls can do more harm than good.
3. ***Meaningful:*** Strategy evaluation activities should be meaningful. They should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence.
4. ***Timely:*** Strategy evaluation activities should provide timely information. For example, when a firm has diversified into a new business by acquiring another firm, evaluative information may be needed at frequent intervals. Time dimension of control must coincide with the time span of the event being measured.
5. ***Truthful:*** Strategy evaluation should be designed to provide a true picture of what is happening. Information should facilitate action and should be directed to those individuals who need to take action based on it.
6. ***Selective:*** The control systems should focus on selective criteria like key important factors which are critical to performance. Insignificant deviations need not be focused.

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7. ***Flexible:*** They must be flexible to take care of changing circumstances.
8. ***Suitable:*** Control systems should be suitable to the needs of the organisation. They must conform to the nature and needs of the job and area to be controlled.
9. ***Reasonable:*** Control standards must be reasonable. Frequent measurement and rapid reporting may frustrate control.
10. ***Objective:*** A control system would be effective only if it is unbiased and impersonal. It should not be subjective and arbitrary. Otherwise, people may resent them.
11. ***Acceptable:*** Controls will not work unless they are acceptable to those who apply them.
12. ***Foster Understanding and Trust:*** Control systems should not dominate decisions. Rather they should foster mutual understanding, trust and common sense. No department should fail to cooperate with another in evaluating and control of strategies.
13. ***Fix Responsibility for Failure:*** An effective control system must fix responsibility for failure. Detecting deviations would be meaningless unless one knows where they are occurring and who is responsible for them. Control system should also pinpoint what corrective actions are needed.

There is no ideal strategy evaluation and control system. The final design depends on the unique characteristics of an organisation's size, management style, purpose, problems and strengths.

14.2 Strategic Control

Strategic control is a type of *"steering control"*. We have to track the strategy as it is being implemented, detect any problems or changes in the predictions made, and make necessary adjustments. This is especially important because the implementation process itself takes a long time before we can achieve the results. Strategic controls are, therefore, necessary to steer the firm through these events.

14.2.1 Types of Strategic Control

There are four types of strategic controls:

1. Premise control
2. Strategic surveillance
3. Special alert control
4. Implementation control

Premise Control

Strategy is built around several assumptions or predictions, which are called *planning premises.* Premise control checks systematically and continuously whether the assumptions on which the strategy is based are still valid. If a vital premise is no longer valid, the strategy may have to be changed. The sooner these invalid assumptions are detected and rejected, the better are the chances of changing the strategy. The premise control is concerned with two types of factors:

1. Environmental factors
2. Industry factors

1. ***Environmental Factors:*** The performance of a firm is affected by changes in environmental factors like the rate of inflation, change in technology, government regulations, demographic and social changes etc. Although the firm has little or no control over

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environmental factors, these factors have considerable influence over the success of the strategy because strategies are generally based on key assumptions about them.

Example: A firm may assume massive increase in demand, and embark on an expansion plan. If suddenly there is recession and demand for the products of the firm fall down, it may have to change its strategic direction.

2. ***Industry Factors:*** Industry factors also affect the performance of a company. Competitors, suppliers, buyers, substitutes, new entrants etc. are some of the industry factors about which assumptions are made. If any of these assumptions go wrong, strategy may have to be changed.

Strategic Surveillance

Strategic surveillance is a broad-based vigilance activity in all daily operations both inside and outside the organisation. With such vigilance, the events that are likely to threaten the course of a firm's strategy can be tracked. Business journals, trade conferences, conversations, observations etc. are some of the information sources for strategic surveillance.

Special Alert Control

Sudden, unexpected events can drastically alter the course of the firm's strategy. Such events trigger an immediate and intense reconsideration of the firm's strategy.

Example: The tragic events of September 11, 2001, created havoc in many US companies, especially the airline and hotel industry. Sudden acquisition of a leading competitor or an unexpected product difficulty (like defective tyres of Firestone) etc. may shatter a firm's strategy and require a rapid reconsideration of the strategy. Generally, firms develop contingency plans along with crisis teams to respond to such sudden, unexpected events.

Implementation Control

Strategy implementation takes place as a series of steps, programmes, investments and moves that occur over an extended period of time. Resources are allocated, essential people are put in place, special programmes are undertaken and functional areas initiate strategy related activities. Implementation control is aimed at assessing whether the plans, programmes and policies are actually guiding the organisation towards the predetermined objectives or not. Implementation control assesses whether the overall strategy should be changed in the light of the results of specific units and individuals involved in implementation of the strategy. Two important methods to achieve implementation control are:

1. Monitoring strategic thrusts
2. Milestone reviews

1. ***Monitoring Strategic Thrusts:*** Strategic thrusts are small critical projects that need to be done if the overall strategy is to be accomplished. They are critical factors in the success of strategy.

   One approach is to agree early in the planning process on which thrusts are critical factors in the success of the strategy. Managers responsible for these -implementation controls will single them out from other activities and observe them frequently. Another approach is to use stop/go assessments that are- linked to a series of these thresholds (time, costs, success etc.) associated with a particular thrust.

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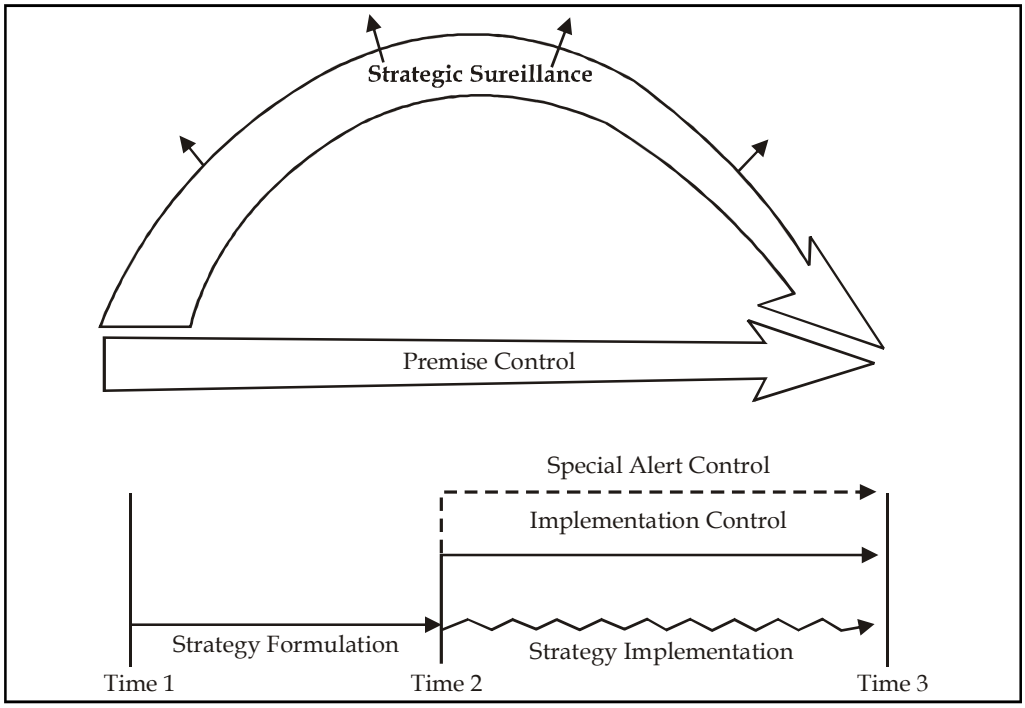
2. ***Milestone Reviews:*** Milestones are critical events that should be reached during strategy implementation. These milestones may be fixed on the basis of.

   (a) Critical events

   (b) Major resource allocations

   (c) Time frames etc.



Network controls like PERT/CPM for project implementation are examples of milestone reviews. After doing a milestone review, managers often undertake a full scale reassessment of the strategy to decide whether to continue or refocus the firm's strategy.

Implementation control is also done through operational control systems like budgets, schedules, key success factors etc.

The major characteristics of the above four types of strategic control are summarised in figure.

Strategic controls are, thus, designed to systematically and continuously monitor the implementation of the strategy over long periods to decide whether the strategic direction should be changed in the light of unfolding events. However, for post-action evaluation and control over short periods, the firm needs operational controls.

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14.2.2 Approaches to Strategic Control

According to Dess, Lumpkin and Taylor, there are two approaches to strategic control.

Traditional Approach

Traditional approach to strategic control is sequential:

1. Strategies are formulated and top management sets goals
2. Strategies are implemented
3. Performance is measured against goals
4. Corrective measures are taken, if there are deviations.

Control is based on a feedback loop from performance measurement to strategy formulation. This process typically involves lengthy time lags and often tied to a firm's annual planning cycle. This reactive measure is not sufficient to control a strategy. As already explained, this is because a strategy takes a long period for implementation and to produce results. The uncertain future requires continuous evaluation of the planning premises and strategy implementation. There is a better contemporary approach for strategic control.

Contemporary Approach

Under this approach, adapting to and anticipating both internal and external environment change is an integral part of strategic control.

This approach addresses the assumptions and premises that provide the foundation for the strategy. The key question addressed here is: do the organisation's goals and strategies still fit within the context of the current environment?

This involves two key actions:

1. Managers must continuously scan and monitor the external and internal environment
2. Managers must continuously update and challenge the assumptions underlying the strategy.

This may even need changes in the strategic direction of the firm.

While strategic control requires the contemporary approach, operational control is generally done through traditional approach.

Task Indentify some control practices used in top companies in India.

14.3 Operational Control

Operational control provides post-action evaluation and control over short periods.

They involve systematic evaluation of performance against predetermined objectives. The major differences between strategic control and operational control are summarised in Table 14.1.

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Table 14.1: Differences between Strategic Control and Operational Control

Attribute	Strategic control	Operational control
1. Basic question	"Are we moving in the right direction?"	"How are we performing?"
2. Aim	Proactive continuous questioning of the basic direction of strategy	Allocation and use of orgnisational resources
3. Main concern	"Steering" the orgnisation's future direction	Action control
4. Focus	External environment	Internal orgnisation
5. Time horizon	Long-term	Short-term
6. Exercise of control	Exclusively by top management, may be through lower-level support	Mainly by executives of middle-level management on the direction of top management
7. Main techniques	Environmental scanning, information gathering, questioning and review	Budgets, schedules and MBO

To be effective, operational control systems, involve four steps common to all post-action controls:

1. Set standards of performance
2. Measure actual performance
3. Identify deviations from standards set
4. Initiate corrective action

14.3.1 Setting of Standards

The first step in the control process is setting of standards. Standards are the targets against which the actual performance will be measured. They are broadly classified into quantitative standards and qualitative standards.

Quantitative

These are expressed in physical or monetary terms in respect of production, marketing, finance etc. They may relate to:

1. Time standards
2. Cost standards
3. Productivity standards
4. Revenue standards

Qualitative

Qualitative criteria are also important in setting standards. Human factors such as high absenteeism and turnover rates, poor production quality or low employee satisfaction can be the underlying causes of declining performance. So, qualitative standards also need to be established to measure performance.

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14.3.2 Measurement of Performance

The second step in operational control is the measurement of actual performance. Here, the actual performance is measured against the standards fixed. Standards of performance act as the benchmark against which the actual performance is to be compared. It is important, however, to understand how the measurement of performance actually takes place. Operationally measuring is done through accounting, reporting and communication systems. A variety of evaluation techniques are used for this purpose, which are explained in the next section. The other important aspects of measurement relates to:

Difficulties in Measurement

There are several activities for which it is difficult to set standards and measure performance.

Example: Performance of a worker in terms of units produced in a day, week or month can easily be measured. On the other hand, it is not easy to measure the contribution of a manager or to assess departmental performance. The solution lays in developing verifiable objectives, stated in quantitative and qualitative terms, against which performance can be measured.

Timing of Measurement

Timing refers to the point of time at which measurement should take place. Delay in measurement or measuring before time can defeat the very purpose of measurement. So measurement should take place at critical points in a task schedule, which could be at the end of a definable activity or the conclusion of a task.

Example: In a project implementation schedule, there could be several critical points at which measurement would take place.

Periodicity in Measurement

Another important issue in measurement is "how often to measure", Generally, financial statements like budgets, balance-sheets, and profit and loss accounts are prepared every year. But there are certain reports like production reports, sales reports etc. which are done on a daily, weekly, monthly basis.

14.3.3 Identifying Deviations

The third step in the control process is identifying deviations.

The measurement of actual performance and its comparison with standards of performance determines the degree of deviation or variation between actual performance and the standard. Broadly, the following three situations may arise:

1. The actual performance matches the standards
2. The actual performance exceeds the standards
3. The actual performance falls short of the standards

The first situation is ideal, but sometimes may not be realistic. Generally, a range of tolerance limits within which the results may be accepted satisfactorily, are fixed and deviations from it are considered as variance.

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The second situation is an indication of superior performance. If exceeding the standards is considered unusual, a check needs to be made to test the validity of tests and the measurement system.

The third type of situation, which indicates shortfall in performance, should be taken seriously and strategists need to pinpoint the areas where the performance is below standard and go into the causes of deviation.

The analysis of variance is generally presented in a format called 'variance chart' and submitted to the top management for their evaluation. After noting the deviations, it is necessary to find the causes of deviation, which can be ascertained through the following questions: (Thomas)

1. Is the cause of deviation internal or external?
2. Is the cause random or expected?
3. Is the deviation temporary or permanent?

Analysis of variance leads to a plan for corrective action.

14.3.4 Taking Corrective Action

The last and final step in the operational control process is taking corrective action. Corrective action is initiated by the management to rectify the shortfall in performance.

If the performance is consistently low, the strategists have to do an in depth analysis and diagnosis to isolate the factors responsible for such low performance and take appropriate corrective actions.

There are three courses for corrective action:

1. Checking performance
2. Checking standards
3. Reformulating strategies, plans and objectives.

Checking Performance

Performance can be affected adversely by a number of factors such as inadequate resource allocation, ineffective structure or systems, faulty programmes, policies, motivational schemes, inefficient leadership styles etc. Corrective actions may therefore include the change in strategy, systems, structure, compensation practices, training programmes, redesign of jobs, replacement of personnel, re-establishment of standards, budgets etc.

Checking Standards

When there is nothing significantly wrong with performance, then the strategist has to check the standards. A manager should not mind revising the standards when the standards set are unreasonably low or high level. Higher standards breed discontentment and frustration. Low standards make employee unproductive. So, standards check may result in lowering of standards if it is concluded that organisational capabilities do not match the performance requirements. It may also lead to elevation of standards if the conditions have improved to allow better performance. For example, better equipment, improved systems, upgraded skills etc. need modification in existing standards.

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Reformulating Strategies, Plans and Objectives

A more radical and infrequent corrective action is to reformulate strategies, plans and objectives. Strategic control, rather than operational control, generally leads to changes in strategic direction, which will take the strategist back to the process of strategy formulation and choice.

Techniques like total quality management (TQM) and ISO 9000 standards series are examples of very good control mechanisms. These are explained in exhibits 40.3. and 40.4 respectively.

Notes TQM is a management philosophy that aims at total customer satisfaction through continuous improvement of all organisational processes. The main elements of TQM are:

1. ***Intense focus on the customer:*** The customer includes not only outsiders but also internal customers.

   Concern for continuous improvement: TQM is committed to improve quality continuously.

2. ***Improvement in the quality of everything the organisation does:*** TQM relates not only to the final product but also how the organisation handles deliveries, responds to complaints etc.

3. ***Accurate measurement:*** TQM uses statistical techniques to measure every critical performance variable in the organisation's operations. These performance variables are then compared against standards or benchmarks to identify problems. The problems are traced to their roots, and causes are eliminated.

4. ***Empowerment of Employees:*** TQM involves all the employees in the improvement process. Teams are widely used in TQM programmes as empowerment vehicles for finding and solving problems.

14.4 Techniques of Strategic Control

Organisations use many techniques or mechanisms for strategic control. Some of the important mechanisms are:

1. ***Management Information systems:*** Appropriate information systems act as an effective control system. Management will come to know the latest performance in key areas and take appropriate corrective measures.

2. ***Benchmarking:*** It is a comparative method where a firm finds the best practices in an area and then attempts to bring its own performance in that area in line with the best practice. Best practices are the benchmarks that should be adopted by a firm as the standards to exercise operational control. Through this method, performance can be evaluated continually till it reaches the best practice level. In order to excel, a firm shall have to exceed the benchmarks. In this manner, benchmarking offers firms a tangible method to evaluate performance.

3. ***Balanced scorecard:*** It is a method based on the identification of four key performance measures i.e. customer perspective, internal business perspective, innovation and learning perspective, and the financial perspective. This method is a balanced approach to performance measurement as a range of financial and non-financial parameters are taken into account for evaluation.

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What is Balanced Scorecard?

The Balanced Scorecard method is a strategic approach and performance management system that enables the organisations to translate its vision and strategy into implementation. The Balanced Scorecard is a conceptual framework for translating an organization's vision into a set of performance indicators distributed among four perspectives: Financial, Customer, Internal Business Processes, and Learning and Growth. Indicators are maintained to measure an organization's progress toward achieving its vision. Other indicators are maintained to measure the long term drivers of success. Through this scorecard, an organization monitors both its current performance (finances, customer satisfaction, and business process results) and its efforts to improve processes, motivate and educate employees, and enhance information systems - its ability to learn and improve. A Balanced Scorecard enables us to measure not just how we have been doing, but also how well we are doing ("current indicators" and can expect to do in the future ("leading indicators"). This in turn gives us a clear picture of reality.

The Balanced Scorecard is a way of:

1. Measuring organizational, business unit's or department's success
2. Balancing long-term and short-term actions
3. Balancing different measures of success
   (a) Financial
   (b) Customer
   (c) Internal Operations
   (d) Human Resource System & Development (learning and growth)

Four Kinds of Measures

The scorecard seeks to measure a business from the following perspectives:

1. ***Financial perspective:*** Measures reflecting financial performance, for example, number of debtors, cash flow or return on investment. The financial performance of an organization is fundamental to its success. Even non-profit organisations must make the books balance. Financial figures suffer from two major drawbacks
2. ***Customer perspective:*** This perspective captures the ability of the organization to provide quality goods and services, effective delivery, and overall customer satisfaction for both Internal & External customers. For example, time taken to process a phone call, results of customer surveys, number of complaints or competitive rankings.
3. ***Business Process perspective:*** This perspective provides data regarding the internal business results against measures that lead to financial success and satisfied customers. To meet the organizational objectives and customers expectations, organizations must identify the key business processes at which they must excel. Key processes are monitored to ensure that outcomes are satisfactory. Internal business processes are the mechanisms through which performance expectations are achieved. For example, the time spent prospecting new customers, number of units that required rework or process cost.

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4. ***Learning and Growth perspective:*** This perspective captures the ability of employees, information systems, and organizational alignment to manage the business and adapt to change. Processes will only succeed if adequately skilled and motivated employees, supplied with accurate and timely information, are driving them. In order to meet changing requirements and customer expectations, employees are being asked to take on dramatically new responsibilities that may require skills, capabilities, technologies, and organizational designs that were not available before. It measures the company's learning curve for example, number of employee suggestions or total hours spent on staff training.

Objectives, Measures, Targets and Initiatives

Within each of the balanced scorecard financial customer, internal process, and learning perspectives, the organisation must define the following:

1. ***Strategic objectives*** - the strategy for achieving that perspective.
2. ***Measures*** - how progress for that particular objective will be measured.
3. ***Targets*** - the target value sought for each measure
4. ***Initiatives*** - what will be done to facilitate reaching out the target.

The balanced scorecard provides an inter-connected model for measuring performance and revolves around four distinct perspectives - financial, customer, internal processes, and innovation and learning. Each of these perspectives is stated in terms of the organisation's objectives, performance measures, targets, and initiatives, and all are harnessed to implement corporate vision and strategy.

The name also reflects the balance between the short-and long-term objectives, between financial and non-financial measures, between lagging and leading indicators and between external and internal performance perspectives.

Under the balance scorecard system, financial measures are the outcome, but do not give a good indication of what is or will be going on in the organization. Measures of customer satisfaction, growth and retention is the current indicator of company performance, and internal operations (efficiency, speed, reducing non-value added work, minimizing quality problems) and human resource systems and development are leading indicators of company performance.

Robert S Kaplan and David P Norton the architects of the balanced scorecard approach, recognized early that long-term improvement in overall performance was unlikely to happen through technology only and hence placed greater emphasis on organizational learning and growth. These, in turn, consist of the integrated development of employees, information, and systems capabilities.

Context and Strategy

Just as financial measures have to be put in context, so does measurement itself. Without a tie to a company strategy, more importantly, as the measure of company strategy, the balanced scorecard is useless. A mission, strategy and objectives must be defined. Measures of that strategy must be agreed upon to and actions need to be taken for a measurement system to be fully effective. Otherwise, it will appear as if the organisation is standing at a crossroad but unaware of which path to take.

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Purpose of the Balanced Scorecard

Kaplan and Norton found that organisations are using the scorecard to:

1. Clarify and update strategy
2. Communicate strategy throughout the company
3. Align unit and individual goals with strategy
4. Link strategic objectives to long term targets and annual budgets
5. Identify and align strategic initiatives
6. Conduct periodic performance reviews to learn about and improve strategy.

The Process of Building a Balanced Scorecard

Kaplan and Norton suggest following four step process for building a scorecard:

1. Define the measurement architecture
2. Specify strategic objectives
3. Choose strategic measures
4. Develop the implementation plan

Benefits of Balanced Scorecard

Some of the benefits include:

1. Translation of strategy into measurable parameters
2. Communication of the strategy to all stakeholders
3. Alignment of individual goals with the organisation's strategic objectives
4. Feed-back of implementation results to the strategic planning process
5. Preparing the organisation for the Change - It provides for a front-end justification as well as a focus and integration for the continuous improvement, re-engineering and transformation process

Balanced Scorecard for Enhancing Performance

In such constantly shifting environments, management must learn to continuously adapt to new strategies that can emerge from capitalizing on opportunities or countering threats. A properly constructed balanced scorecard can provide management with the ideal tool in reacting to the turbulent environment and helping the organisation to correct the course to success.

Scorecard provides managers with feedback, thus, enabling them to monitor and adjust the implementation of their strategy - even to the extent of changing the strategy itself. In today's information age, organisations operate in very turbulent environments. Planned strategy though initiated with the best of intentions and with the best available information at the time of planning may no longer be appropriate or valid for contemporary conditions.

As companies have applied the balanced scorecard, they have begun to recognize that the scorecard represents a fundamental change in the underlying assumptions about performance measurement.

The scorecard puts strategy and vision, not control, at the centre. It establishes goals but assumes that people will adopt whatever behaviours and take whatever actions are

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necessary to arrive at those goals. The measures are designed to pull people toward the overall vision. Senior managers may know what the end result should be, but they cannot tell employees exactly how to achieve that result, because the conditions in which employees operate are constantly changing.

This new approach to performance measurement is consistent with the initiatives under way in many organisations: cross-functional integration, customer supplier partnerships, global scale, continuous improvement, and team rather than individual accountability. By combining the financial, customer, internal process and innovation, and organizational learning perspectives, the balanced scorecard helps managers understand, at least implicitly, many interrelationships. This understanding can help managers transcend traditional notions about functional barriers and ultimately lead to improved decision making, problem solving and enhanced performance. The balanced scorecard keeps organisations moving forward.

4. ***Key factor rating:*** It is a method that takes into account the key factors in several areas and then sets out to evaluate performance on the basis of these. This is quite a comprehensive method as it takes a holistic view of the performance areas in an organisation.

5. ***Responsibility Centres:*** Control systems can be established to monitor specific functions, projects or divisions. Responsibility centers are used to isolate a unit so that it can be evaluated separately from the rest of the corporation. There are five major types of responsibility centers: Cost centres, Revenue centres, Expense centres, Profit centres and Investment centres. Each responsibility centre has its own budget and is evaluated on the basis of its performance.

6. ***Network techniques:*** Network techniques such as Programme Evaluation and Review Technique (PERT), Critical Path Method (CPM), and their variants, are used extensively for the operational controls of scheduling and resource allocation in projects. When network techniques are modified for use as a cost accounting system, they become highly effective operational controls for project costs and performance.

7. ***Management by Objectives (MBO):*** It is a system proposed by Drucker, which is based on a regular evaluation of performance against objectives which are decided upon mutually by the superior and the subordinate. By the process of consultation, objective-setting leads to the establishment of a control system that operates on the basis of commitment and self-control. Thus, the scope of MBO to be used as an operational control is quite extensive.

8. ***Memorandum of Understanding:*** This is an agreement between a PSU and the administrative ministry of the government in which both specify their respective commitments and responsibilities. The system works as an effective control on the performance of the PSU.

Task Find out more about various strategic control techniques.

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Caselet

Balanced Scorecard: A Concept for the Future

WHY is it difficult for successful companies to remain so on a continuous basis? Is it because companies only focussed on the financial numbers?

Yes, says Dr Anil Naik, a consultant and an expert on this concept called `Balanced Scorecard'. "Balanced Scorecard gives a picture of the future," says Dr Naik. "There were many successful companies like Nirlon, Paragon Textiles, Mafatlal in the past. Where are they now? They failed because they could not devise proper strategy for the future," Dr Naik told Business Line on the sidelines of a seminar organised by Indian Electrical and Electronics Manufacturers' Association (IEEMA) here recently.

`Balanced', as the name suggests, calls for a balance between financial and non-financial measure, long term and short-term objectives and external and internal performance. `Scorecard' initially came into being as a measurement system, and gradually evolved into a core management system.

Dr Naik said Balanced Scorecard continues to emphasise on the financial performance measure but at the same time highlights future performance drivers, key initiatives to be taken and provides a framework for strategic management. It has been designed around four perspectives - financial, customer, internal and learning and growth.

In Balanced Scorecard, financial perspective is always important. But a healthy revenue growth, proper utilisation of assets and investment strategy are also must for any organisation. Balanced Scorecard articulates customer and market-based strategy that will deliver super value to customer, build customer loyalty and bring superior financial results. It specifically looks at the value proposition that the organisation will deliver to the customer in target market segment. It propagates building better understanding and leveraging relationship with customers.

Source: thehindubusinessline.com

14.5 Role of Organisational Systems in Evaluation

There are six types of organisational system involved in evaluation.

Information System

Organisations evaluate by comparing actual performance with standards. Purpose of information management system is to enable managers to keep the track of performance through control reports. Whether strategic surveillance or financial analysis, are based on information system to provide relevant & timely data to managers to allow them to evaluate performance & strategy & initiate corrective action

Control System

The control system is core of any evaluation process & is used for setting standards, measuring performance, analysing variances, & taking corrective action.

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Appraisal System

This is the system that actually evaluates performance. When measuring the performance of managers, it is contribution to the organisational objectives which is sought to be measured. The evaluation process through appraisal system, measure the actual performance and provides for the control system to work.

Motivation System

The primary role of the motivation system is to induce strategically desirable behavior so that managers are encouraged to work towards the achievement of organisational objectives. This system plays an important role in ensuring that deviations of actual performance with standards. Performance checks, which are a feedback in the evaluation process, are done through the motivation process.

Development System

The development system prepares the managers for performing strategic & operational tasks. Among the several aims of development, the most important is to match a person with the job to be performed. This in other words is matching actual performance with standards. This matching can be done provided it is known what a manager is required to do and what is deficient in terms of knowledge, skills & attitude. Such a deficiency is located through the appraisal system. The role of development system in evaluation is to help the strategists to initiate & implement corrective action.

Planning System

The evaluation process also provides feedback to planning systems for the reformulation of strategies, plans & objectives. Thus planning system closely interacts with the evaluation process on a continual basis.

Case Study

Global Automotive Giants – Toyota, GM and Ford

In March 2004, the Japanese automotive company Toyota announced that it had sold 6.78 millions cars and trucks around the world in the year 2003. This total was 60,000 higher than the American company Ford. It was the first time ever that Toyota had beaten Ford. It made Toyota second only to the American company General Motors in world automotive sales. (By the time this case goes to the press, Toyota might have surpassed even GM). This case explores competition in the global automotive industry.

Toyota Strategy – Stand Alone

In around 2000, Toyota identified its purpose to take over global market leadership by 2010. It called this its '2010 Global Vision Strategy'. During the 1980s and 1990s, the company targeted North America as its prime strategic focus. Along with Honda, Toyota launched cars of superior quality and with lower manufacturing costs than its US competitors. During the years 1991-2002, the main three US companies GM, Ford and DaimlerChrysler lost over 21 percentage share points of the American car market to Japanese and European

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competition. The combined losses of the three major US companies in 1991 alone were US$7.5 billions. The US car manufacturers were only saved by three changes:

1. The launch of specialist vehicles – like sports utility vehicles, minivans and pickups;
2. A severe economic recession in Japan, which made Toyota's Japanese home base difficult;
3. A substantial rise in the Japanese yen, which made Japanese exports to the US less profitable.

GM has been enormously successful in the light truck business and the secular market share losses have occurred in the passenger car business, where the Europeans and Japanese have been the strongest. Nevertheless by 2003, Toyota was selling the most popular single car model – the Camry – in North America. Toyota also now produces many of its basic models in North America so it is unlikely to be affected again by changes in the Japanese yen. Toyota now has six manufacturing plants in North America that produce over 1.2 millions units per year. It has announced plans for Mexican and Texan plants in the years 2005 and 2006. The company has now become a major employer in North America and is not merely outsourcing work to Japan.

In the 1990s, Toyota decided to attack the Western European market, which is the next largest market in the world. They had been selling vehicles in Europe for many years but decided to build their first factory – at Burnaston in the UK – in 1995. This was then followed by other factories and a design facility in France in the late 1990s. Toyota was cautious about Europe for many years for two reasons: first, because the European vehicle industry was protected by trade barriers; and, second, by a voluntary agreement by the Japanese car companies to restrict their European sales. However, the EU removed such barriers in the mid-1990s and Toyota responded by a major drive into the region. Much of Toyota's world growth has come from this European expansion. According to one commentator, "The main reason for the success is the decision by Toyota to be a major player in Europe." Before that, Toyota focused on America and gave second priority to Europe.

In earlier years, Toyota based its European strategy on selling cars that were reliable but were not perhaps the most attractively designed – arguably even dull. However, European car manufacturers like Volks-wagen were rapidly able to replicate any competitive advantage based on quality. More recently, Toyota has begun to design cars specifically for EU markets: In Europe, styling and performance is generally high. European people enjoy driving their cars more than, for example, Americans. In 1999, Toyota introduced the Yaris. That is a vehicle designed specifically for Europe. Until then, although Toyota tried to develop a vehicle that would suit Europe, the main target was not Europe.

But all is not completely satisfactory with Toyota Europe's strategy. Its factories are still not as efficient as Nissan. Its customers do not recognise Toyota quality as being the highest, reserving that accolade for Volkswagen. Moreover, profit margins on its European operations are small – but it built a new plant jointly with PSA Citroen in the Czech Republic, where labour costs are lower, to make the Yaris.

Toyota has enjoyed substantial growth in both sales and profits over the period 1999-2003. Its market share, its assets and its worldwide influence have impacted on other companies and, at the same time, delivered real growth. Apart from some production co-operation with competitors – it shared a manufacturing plant with GM in North America and built a manufacturing plant with PSA Peugeot Citroen in the Czech Republic – Toyota never

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co-operated or acquired another company outside its home market. This strategy was quite different from that of Ford.

Importantly, Toyota always had some doubts about a simple global strategy. It used basic model designs for its volume car ranges but essentially produced cars that were designed for major regions of the world. For example, the Yaris small car was designed purely for the requirements of the European market in 2002 and there were no plans to develop the model as a global car.

GM's Strategy

General Motors has often followed a strategy of building alliances, minority shareholdings and joint ventures outside its traditional North American and European markets. Over recent years, it has also followed a policy of reducing its prices in order to hold its market share, especially in its home country.

GM's Alliance Strategy

GM's home country is the US where it has some of the strongest established brand names like Buick, Cadillac, Chevrolet and Pontiac. Its North American operations include around 100 manufacturing, assembly and warehousing facilities.

It has also been involved for many years in Europe, where its brands include Opel (Germany), Vauxhall (UK) and Saab. It has 10 production and assembly facilities in seven European countries.

In addition to investment activity in its existing plants, GM has taken minority shareholdings in a number of world vehicle companies – for example, it owns 20 percent of the shares of Fuji Heavy Industries, the owner of the Japanese brand Subaru; it has 10 percent of the shares of Fiat, Italy. The only company bought outright by GM was the Swedish company Saab. GM spent around US$4.7 billions to build such minority stakes over the period 2001-2004.

Essentially, GM has built a series of alliances and minority shareholdings and then co-operated with such companies in order to gain purchasing savings from extra scale. Thus, it has obtained benefits in diesel engines from its links with Isuzu and Fiat; it has sold Chevrolets in Japan through its co-operation with Suzuki; it has sold a Suzuki-designed car as one of its own brands in European markets. Essentially, such a strategy derives from serious doubts about the benefits of mergers and acquisitions in the car industry – both Ford below and DaimlerChrysler are examples of companies that have struggled with outright acquisitions.

One drawback of such GM-type links is that the biggest benefits often go to their smaller partners, who benefit from access to GM's size and negotiating power without making much difference to the overall GM purchasing power base. For example, Suzuki has put only 5 percent of its purchasing bill through GM's worldwide purchasing network, which is insignificant for GM. Suzuki has then been able to benchmark the GM prices and see if its own supply network – mainly in Japan, where GM is weak – can offer a better deal.

In addition, some links are not easy to manage. An investment banker commented: The good part is that GM has not spent much, and it doesn't have the Daimler Chrysler problem of integration (of the Daimler and Chrysler companies) Managing all these alliances is exceedingly complex, and the synergies it can extract, while significant, are limited.

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GM's Market Share Strategy – Reduce Prices

In 2004, GM spent US$6.5 billions on developing new car and truck designs with the aim of changing its reputation for poor quality and indifferent design. It sold its vehicles at an average price in the US of $18,891 – exactly $1 less than the price in 2003. In other words, GM was investing more in R&D at the same time as reducing its prices. It was offering cash buyers rebates up to US$1,400 per vehicle. The company actually sold 50,000 fewer vehicles in 2004 than in 2003. In other words, GM was following a strategy of holding its market share by selling at lower prices.

GM's Problem of 'Legacy Costs'

At the same time, GM – along with Ford – faced another major problem that did not apply to Toyota. It was paying contributions to its employee health insurance and pension scheme that amounted to US$6 billions per year and these were growing at an additional US$500 millions per year. Two-thirds of the payments were not even to present employees but to GM's former employees who outnumbered current staff by two-and-a-half to one. These were the so-called 'legacy costs' associated with the American method of paying its employees, including those who had retired or otherwise left the business. No chief executive would wish to deny former employees their rights. But GM was in danger of putting its current employees and its shareholders at risk by such a strategy.

Ford Strategy

Global Strategy

For many years, Ford has been both a leading company in North America and in Europe. Its strategy during much of the 1990s was to gain the benefits of a global strategy. It made substantial attempts to integrate its operations on a global scale in the period 1995-98. Core engineering and production operations were simplified and combined with common parts, common vehicle platforms and common sourcing from outside suppliers. The purpose was to achieve annual cost savings of around US$42 billions through economies of scale and through the spread of the development costs of a specific model across the sales in more countries. Substantial savings were achieved and Ford's profits then rose.

Acquisitions Strategy

Following this success, the company then embarked on what it called a 'global niche' strategy. The company judged that world market demand was moving towards niche car markets – like off-road vehicles, people carriers – and this meant that the company should invest in these areas. The company therefore invested heavily by acquiring companies in its specialist brands in these areas – Jaguar cars, Lincoln luxury cars, Volvo cars, Land-Rover vehicles, Aston Martin sports cars. The strategy of acquiring rival companies in some cases carries the major risk that it becomes difficult to gain sufficient economic benefits from the acquisition premium paid to buy such companies.

An additional danger with the acquisition strategy was that the company was distracted by the need to integrate its acquisitions. Ford failed to invest sufficiently in its basic car ranges – like the Mondeo and the Fiesta in Europe – during the period 1999-2001. This allowed other companies to move ahead in these areas. The outcome was a profit disaster in 2001.

Back to Basics Strategy

With the benefit of hindsight, Ford's global niche acquisition strategy was considered to be wrong and the Ford chief executive of that period, Jac Nasser, was sacked. A new

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strategy of 'Back to Basics' was introduced under the guidance of one of the members of the Ford founding family, Bill Ford. Ford was attempting to introduce basic new models, improve quality and reduce costs across its main passenger car ranges. The company was also part-way through introducing 'flexible manufacturing' systems. This meant that the company was able to allow different models to be made simultaneously on the same assembly line without the need for expensive tooling and robot changes. In addition, Ford was also developing a series of production designs that would allow a variety of models to be made using one basic vehicle template, thus saving across a range of models. However, GM, Chrysler, Toyota were also introducing such systems – indeed, Toyota has had much of this in place for some years.

Importantly, Ford had switched its efforts to redesigning its mid-sized cars to improve quality and equip them with many of the features found on more luxury models – higher driving positions, more storage space, etc. "Redefining the North American saloon is a tall order, but that is what we set out to do," says Phil Marten – Ford's group vice-president of product creation. The Ford company relaunched some of its American models in early 2004 with such a strategy and had plans to follow this up with more products in later years. It was undertaking a similar range of activities across its European models over a similar time-period. More launches would follow in subsequent years as it attempted to regain its former position.

The company also had similar 'legacy cost' problems like its American rival, General Motors. Ford was also deeply engaged in a price-cutting strategy in its main North American markets in order to protect market share. Both Ford and GM faced a major competitive threat from rivals, including Toyota.

Thus, there is a strategic battle going on between the three market leaders. Both GM and Ford have been trying to catch up with Toyota for some years. Considerable data is available on the car market from the web, starting with the car companies themselves. The web data would allow you to analyse the immediate past strategies of each of the three companies. It would then be possible to assess their present levels of success.

Question

Evaluate the strategies of Ford, GM and Toyota.

14.6 Summary

- Strategic evaluation generally operates at two levels – strategic and operational level. At the strategic level, managers try to examine the consistency of strategy with environment. At the operational level, the focus is on finding how a given strategy is effectively pursued by the organisation.
- Strategic control is a type of "steering control". We have to track the strategy as it is being implemented, detect any problems or changes in the predictions made, and make necessary adjustments.
- Operational control provides post-action evaluation and control over short periods.
- They involve systematic evaluation of performance against predetermined objectives.
- Organisations use many techniques or mechanisms for strategic control. Some of the important mechanisms are management Information systems, benchchmarking, balanced scorecard, key factor rating, responsibility centres, network technique, Management by Objectives (MBO), Memorandum of Understanding.

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- If the need for evaluation was recognised from the outset, then a strategic evaluation will ideally take place before the project begins delivering activities.
- The purpose of evaluating causal connections between activities, outputs and outcomes, is to explore whether or not the project's assumptions about the likely outcomes and effects of its activities and outputs are well-founded.
- There are three fundamental strategy evaluation activities, viz. reviewing external and internal factors that are the bases for current strategies; measuring performance and taking corrective actions.

14.7 Keywords

Balanced Scorecard: Strategic performance management tool - a semi-standard structured report supported by proven design methods and automation tools.

Benchmarking: Comparative method where a firm finds the best practices in an area and then attempts to bring its own performance in that area in line with the best practice.

Management by Objectives: Process of agreeing upon objectives within an organisation so that management and employees agree to the objectives and understand what they are in the organisation.

Operational control: ensures that day-to-day actions are consistent with established plans and objectives.

Responsibility centre: A segment of a business or other organisation, in which costs can be segregated, with the head of that segment being held accountable for expenses.

Strategic evaluation and control: Process of determining the effectiveness of a given strategy in achieving the organisational objectives and taking corrective actions wherever required.

Strategic surveillance: Broad-based vigilance activity in all daily operations both inside and outside the organisation.

14.8 Self Assessment

Fill in the blanks:

1. ……control focuses on finding how a given strategy is effectively pursued by the organisation.
2. ……..control is concerned with tracking a strategy as it is being implemented.
3. ……control is done through policies, rules, standard operating practices and orders from superiors.
4. Assumptions or predictions around which a strategy is built is referred to as……
5. PERT and CPM are techniques of……control.
6. Control is based on a ……..from performance measurement to strategy formulation.
7. The analysis of variance in performance is generally presented in a format called ……

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8. Best practices serve as……..against which actual performance is evaluated.
9. …… are used to isolate a unit so that it can be evaluated separately from the rest of the corporation.
10. Management by Objectives method was proposed by…….

14.9 Review Questions

1. Comment on the nature of strategic control and evaluation.
2. According to you, what should be the criteria for an effective evaluation system?
3. In evaluating a strategy, it is important to examine whether an organisation has the abilities, competencies, skills and talents needed to carry out a given strategy. Why?
4. If you were a strategist making evaluation, what would you do if you find something wrong though nothing is wrong with the performance?
5. Suggest some corrective actions that you would undertake if the performance is being affected adversely by inadequate resource allocation and ineffective systems.
6. How would you check whether a strategy can be implemented within the resources of an enterprise?
7. "Strategic control is a type of steering control". Discuss
8. Discuss the general approaches to strategic control.
9. Discuss the steps in implementing effective operational control system.
10. Analyse the role of organisational systems in evaluation.

Answers: Self Assessment

1.	Operational	2.	Strategic
3.	Behaviour	4.	planning premises
5.	network	6.	feedback loop
7.	variance chart	8.	benchmarks
9.	Responsibility centres	10.	Peter F Drucker

14.10 Further Readings

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