Dr. C.V. Raman University
Kargi Road, Kota, BILASPUR, (C. G.),
Ph. : +07753-253801, +07753-253872
E-mail : info@cvru.ac.in | Website : www.cvru.ac.in

Business Policy and Strategic Analysis

Institute of **Open** and **Distance Education**

Faculty of Management

Business Policy and Strategic Analysis

2MBA1

DR. C.V. RAMAN UNIVERSITY

Chhattisgarh, Bilaspur

A STATUTORY UNIVERSITY UNDER SECTION 2(F) OF THE UGC ACT

2MBA1

Business policy and Strategic analysis

2MBA1
Business policy and Strategic analysis

Credit-2

Subject Expert Team

Dr. Vivek Bajpai, *Dr. C.V. Raman* University, Kota, Bilaspur, Chhattisgarh

Dr. Rajeev H. Peters, *Dr. C.V.* Raman University, Kota, Bilaspur, Chhattisgarh

Dr. Niket Shukla, *Dr. C.V. Raman* University, Kota, Bilaspur, Chhattisgarh

Dr. Satish Sahu, *Dr. C.V.* Raman University, Kota, Bilaspur, Chhattisgarh

Dr. Archana Agrawal, *Dr. C.V. Raman* University, Kota, Bilaspur, Chhattisgarh

Dr. Vikas Kumar Tiwari, *Dr. C.V. Raman* University, Kota, Bilaspur, Chhattisgarh

Course Editor:

- **Dr. Preeti Shrivastava, Associate Professor**
  Ravindra Nath Taigore University, Bhopal (M.P.)

Unit Written By:

1 **Dr. Vivek Bajpai**
Professor, Dr. C. V. Raman University, Bilaspur, Chhattisgarh

2 **Dr. Archana Agrawal**
Associate Professor, Dr. C. V. Raman University, Bilaspur, Chhattisgarh

3 **Dr. Rahul Sharma**
Associate Professor, Dr. C. V. Raman University, Bilaspur, Chhattisgarh

Published by: Dr. C.V. Raman University Kargi Road, Kota, Bilaspur, (C. G.)

Published by: Dr. C.V. Raman University Kargi Road, Kota, Bilaspur, (C. G.), Ph. +07753-253801,07753-253872 E-mail: inf o@cvru.ac.in Website: www.cvru.ac.in

CONTENTS

BLOCK I

BLOCK II

BLOCK III

BLOCK IV

BLOCK – I

Unit 1 Strategic Management: An Introduction

Unit Structure

1.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define strategies and strategic management
- Explain the need of strategy and strategic management
- Identify the challenge of strategic management
- Describe corporate governance and stakeholders
- Explain the strategic management process
- Define strategic intent

1.1 Introduction

As the intensity of competition increases in the market, the performance gap between the well managed company and the poorly managed company is widening by the minute. Competition is coming in from all directions. In these turbulent times it is very difficult for a company to survive without a clear understanding of where it is and where it wants to go as shown by the case of Iridium. For going without a clear direction of where you want to reach is like looking for a well in a desert without having any idea of which direction it is in. The chance of finding it has very little probability. Strategic Management is meant to provide that sense of direction to the company, to find the well of success in the desert of competition.

1.2 Origin of Strategy and Strategic Management

Before we understand what we mean by strategic management, let us first take a look at the term 'strategy'.

The term 'strategy' is derived from the ancient Athenian position of 'strategos'. 'Strategos' was a compound of 'stratos' which meant 'army' or more properly an encamped army spread out over ground and 'agein', 'to lead'. The emergence of the term paralleled increasing military decision-making complexity. The term 'strategy' is defined in more detail by Frontinus in the first century AD, as 'everything achieved by a commander, be it characterized by foresight, advantage, enterprise, or resolution'.

If military practice is taken as a metaphor for business competition, the strategic principles of the great strategoi still provide useful guides for those in the business of strategy formulation. Therefore, it should notbe surprising that many of the terms used in strategic management today originate from the military.

The academic origins of strategic management come from the fields of economics and company theory. Economics provided a way to begin exploring the role of management decisions and the possibility of strategic choices. In addition, early organizational theorists (Frederick W. Taylor, Max Weber, and Chester Barnard, amongothers) provided knowledge about efficient and effective companies and the role that managers played.

Key parts of this definition of strategic management are:

(a) Strategic management should help a company reach its goals;

(b) Strategic management involves decisions and actions;

(c) Strategic management is not a single, simple action but a series of related decisions and actions; and

(d) The strategic management should "match" the organizational strengths and weaknesses with the environmental opportunities and threats.

In simple terms we can say that strategic management involves a series of steps in which organizational members analyse the current situation, decide on strategies, put those strategies into action, and evaluate/modify/change strategies as needed.

The Concept of Strategy

Strategy is the overall plan of a firm deploying its resources to establish a favourable position and compete successfully against its rivals. Strategy describes a framework for charting a course of action. It explicates an approach for the company that builds on its strengths and is a good fit with the firm's external environment. It is basically intended to help firms achieve competitive advantage. Competitive advantage allows a firm to gain an edge over rivals when competing. Competitive advantage comes from a firm's unique ability to perform activities more distinctively and more effectively than rivals. A firm's distinctive competence or unique ability here implies, those special capabilities, skills, technologies or resources that enable a firm to distinguish itself from its rivals and create competitive advantage (such as superior quality, design skills, low-cost manufacturing, superior distribution etc.). The term *'terrain'* is highly relevant in explaining the concept of strategy more clearly. From a business sense, terrain refers to markets, segments and products used to win over customers. The essence of strategy is to match strengths and distinctive competence with terrain in such a way that one's own business enjoys a competitive advantage over rivals competing in the same terrain. The basic premise of strategy, as things stand now, is that an adversary can defeat a rival – even a larger, more powerful one – if it can manoeuvre a battle or engagement onto a terrain favourable to its own capabilities. The term *'capability'* refers to the ability or capacity of a bundle of resources deployed by a firm to perform an activity (Pitts and Lie).

Features of Strategy

- *Strategy is all about winning:* It is about matching the strengths and distinctive competencies of a firm with the terrain in such a way that one's own business enjoys an edge over its rivals.
- *Strategy offers broad guidelines:* It chalks out a possible future, structures various internal and external processes and puts the firm on the right path in a dynamic world. A strategy does not indicate what is to be done in detail; it only provides a general programme of action, outlining the deployment of resources with a view to improve the chances of achieving selected objectives.
- *Strategy is forward looking:* It takes the long range view.
- *Strategy's life span is limited:* It is a single–use plan. It is designed to fit a specific situation and is 'used up' when the goal is achieved.
- *Strategy is generally a product of top management thinking:* It is believed that only executives at the highest level have the necessary perspective and information to plan for the organisation as a whole.
- *Strategy is a dynamic and flexible programme of action:* Changes in the environment bring about changes in strategic planning.
- *Strategy is an inherently creative process:* Once one understands the firm's current situation and has a view of the future, improving the firm's performance requires thinking up new opportunities for creating and capturing value by leveraging its strategic assets.

Scope and Importance

Typically, scope of strategy has the following dimensions:

- *Top Management Involvement:* Strategic issues require the CEO to carefully assess the likely impact on various divisions, allocate resources thereafter and oversee the implementation process closely. At every stage, strategic decisions require consistent support and continued blessings from top management.
- *Allocation of Large doses of Resources:* As mentioned above, strategic decisions require commitment of large doses of internal as well as external resources over an extended period.
- *Effect on Long-term Prosperity of the Firm:* Strategic decisions have long-term effects on firms - for better or worse. Once a firm embraces a particular strategy, its image and competitive advantages are invariably linked to that strategy. It gains recognition in certain markets, for certain products with certain technologies. The firm would seriously jeopardize all its previous gains if it shifts focus from these markets, products or technologies by adopting a radically different strategy. For example, the ₹ 1,000 crore NEPC Group once known for its dominance in wind energy business shifted focus from its core business and ventured into paper, airlines, agro foods, tea, textiles etc. and got wiped out completely from the industrial map of India.
- *Future-Oriented:* Strategic decisions are built around forecasts. The emphasis is on selecting a suitable course of action from the available alternatives and moving ahead with confidence. In a turbulent environment, a firm will succeed only if it takes a proactive stance toward change. For example, visualising the demand for television content in the late 1990s Ekta Kapoor of Balaji Telefilms moved ahead of others and came out with stunningly popular television serials. Balaji is now rated as the most popular television content provider and has become the darling of the FIIs in the stock market as well.

- ***Multi-functional or Multi-business Consequences:*** Strategic decisions have complex implications for most areas of the firm. They impact various strategic business units especially in areas relating to product-mix, customer-mix, organisation structure, competitive focus etc.

- ***Focus on External Groups:*** In order to successfully position a firm in a competitive environment, strategists must look beyond its operations. They must keep in mind how the other stakeholders (competitors, customers, suppliers, creditors, government, and labour) are likely to react to its own strategic moves from time to time.

The importance of strategy can be explained through the help of following points:

- It provides the roadmap for the firm; it shows the way for achieving targets.

- It helps the firm utilise its resources in the best possible manner. It allows more effective allocation of time and resources for identifying opportunities.

- The firm can respond to environmental changes in a better way - by exploiting opportunities to its advantage and avoiding costly mistakes in investment decisions.

- It minimises the chances of mistakes and unpleasant surprises. It seeks to prepare the firm to confront future challenges through certain proactive steps and even shape the future to its advantage. As rightly pointed out by F R David, strategic planning "allows an organisation to initiate and influence (rather than just respond to) activities, and thus exert control over its own destiny".

- It creates a framework for internal communication among personnel. It helps to integrate the behaviour of individuals into a total effort. It provides a basis for the clarification of individual responsibilities. It gives encouragement to forward thinking. It encourages a favourable attitude towards change. It provides a cooperative, integrated and enthusiastic approach for tackling problems and realizing opportunities (Greenley).

Collecting Information on an External Environment

External Environmental analysis or scanning, is a process by which organisations monitor their external environment to spot opportunities and threats affecting their business. The basic purpose is to help management determine the future direction of the organisation. Scanning simply involves reviewing and evaluating whatever information about external environments can be gleaned from several distinct sources. Important sources of collecting information on an environmental environment include the following:

- International Sources
  - World Development Report
  - World Economic Survey
  - Statistical Year Book
  - Year book of International Trade Statistics
- Government Sources
  - Census of India
  - Five Year Plan Reports
  - India Year Book
  - Economic Survey
  - Annual Survey of Industries

Notes

- Centre for Monitoring Indian Economy Reports
- Monthly Bulletins of RBI
- YoJana
- Indian Trade Journal
- Reports of Tariff Commission, NCAER, CII, FICCI, ASSOCHAM

- Other Sources
  - The Bombay Stock Exchange Directory
  - Kothari's Industrial Directory
  - Economic Times
  - Financial Express
  - Business Line
  - Business Standard
  - Commerce/Capital
  - Southern Economist/ Eastern Economist
  - Business Today
  - Business India
  - Business World
  - ICICI Portfolio Studies; CRISIL Research Reports
  - MC Kinsey Quarterly
  - Harvard Business Review
  - Fortune
  - Economic and Political Weekly

13 Deciding the Scope of an Organisation

Igor Ansoff (1965), a leading proponent of the analytical approach, tried to weave a fire garment out of the loose threads developed by Harvard researchers. He tried to examine two things basically: (i) whether strategy had a distinct context of its own (ii) whether it can be described in a structured way.

In order to decide the scope of an organisation, Ansoff felt that strategy can be examined from several angles: institutional, corporate, business and functional level.

Corporate level	(What businesses should we be in?)
Business level	(How to function in a business once selected?)
Functional level	(How to manage internal operations such as manufacturing, marketing, finance, personnel, R&D etc.?)
Institutional level	(How to manage external relationships in an ever changing dynamic, political world?)

Ansoff felt that strategy can be divided into certain inter-related, complementary components aimed at deciding the scope of an organisation and managing growth through diversification. Ansoff, in this regard, stated thus, "strategic decisions are primarily concerned with external rather than internal problems of the firm and specifically with the selection of the product-mix that the firm will produce and the markets to which it will sell".

Nature of Strategic Management

The following are the fundamental characteristics of strategic management which assist in recognizing the nature of strategic management:

- ***Long-term Direction:*** Strategic management is concerned with the long-term direction of an organization.
- ***Recognizes Change:*** Strategic management recognizes that environment will change and that organizations should continually monitor internal and external events and trends, so that timely action can be taken as needed.
- ***Oriented Towards the Future:*** Strategic management is oriented towards the future. It is a long-range orientation, one that tries to anticipate events rather than simply react as they occur.
- ***External Emphasis:*** Strategic management process takes into account several components of the external environment, including technological, political, economic and social dimension and their impact on business.
- ***Concerned with Scope of the Organization:*** Strategic management is concerned with the scope of an organization's activities. For example, should an organization concentrate on one area of activity or should it have many? This includes important decisions about product range or geographical coverage and is concerned with the organization's boundaries.
- ***Major Impact on the Organization:*** Strategic management will have a major impact on the success or failure of a company.
- ***Significant Risk:*** Strategic management involves major risks.
- ***Major Financial or Other Resources Implications:*** Strategic management often requires investment of substantial financial and other resources.
- ***"Matching" Resources with the Environment:*** Strategic management is concerned with matching the resources and activities of an organization to the environment in which it operates. This is often referred to as "strategic fit". The notion of strategic fit is developing strategy by identifying opportunities in the business environment and adapting resources and competencies to take advantage of those opportunities. Such a strategic fit is important to achieve the correct positioning of the firm to meet clearly identified market needs.
- ***"Stretching" Resources and Competences:*** Stretch is the leverage of the resources and competences of an organization to create opportunities or to capitalize on them. Such a stretch provides an organization competitive advantage.
- ***Influenced by Stakeholders:*** The strategic decisions of an organization are not only influenced by environmental forces and resource availability, but also by the values and expectations of the stakeholders of the organization.
- ***Affect Operational Decisions:*** Strategic management affect operational decisions because it is at the operational level that real strategic advantage can be achieved. If the operational aspects of the organization are not in line with the strategy, then, no matter how well conceived the strategy is, it will not succeed.
- ***Competitive Advantage:*** Strategic management aims at achieving some advantage for the organization over competitors.
- ***Integrating Intuition and Analysis:*** In a sense, strategic management process integrates intuition and analysis. Intuition means inner voice or a gut feeling. Intuition is essential for making decisions in situations of great uncertainty or little precedents. But in most situations, an objective, logical, systematic approach for making major decisions in an organization is required, which is provided by "strategic analysis". Analytical thinking and intuitive thinking complement each other in strategic management.

Strategic Decision Making

Notes

Decision-making is the most important function of any manager. To make a decision means to make a judgment regarding how to act in a certain situation after having considered alternative courses of action. Herbert Simon defines decision-making as the process of selecting a course of action from among many alternatives.

Organizational decisions can be broadly classified into three categories: strategic, tactical and operational, according to the time horizon of the decisions. We have already distinguished between strategic and operational decisions.

Strategic decisions deal with the long-run future of the entire organization. Tactical decisions are specific plans detailing how a strategy is to be implemented. By their nature, tactical decisions are narrower in scope and shorter in time horizon than strategic decisions. Operational decisions, on the other hand, are focused on the day-to-day, real-time activities of an organization.

Though any decision-maker may undertake all the three types of decisions, strategic decision-making is the most important function of a top-level executive. Tactical decision-making, on the other hand, is primarily a middle-manger function, while the frontline manager undertakes largely operational decision- making.

The distinguishing characteristic of strategic management is its emphasis on strategic decision-making. As organizations grow larger and more complex with more uncertain environments, decisions become increasingly complicated and difficult to make, because of the very nature of strategic decisions.

Box 1.1: Strategic Decisions

Boeing 777: Designing and producing a large commercial aircraft costs as much as $5 billion before any sales revenue is realised. Boeing has taken this enormous risk with its new 777 airliner. The 777 is designed to transport 328 passengers and has a range of 5,000 miles. The design phase began in 1986 when Boeing planners probed the ideas of numerous pilots, passengers and mechanics about a new type of airliner. As Dean Thornton, head of Boeing's Commercial Airplane Group, puts it "The 777 causes me to sit bolt upright in bed periodically. It's a gamble. There's a big risk in doing things totally differently!" (Wright et. al. Strategic Management, 1998).

Kaun Banega Crorepati (KBC): Star TV began its operations in India in 1991 in partnership with Zee TV. All programmes, of course, were in English. It parted company with Zee TV in early 2000. To grab a substantial chunk of India's 35 million prime-time satellite viewers, it launched the KBC show (patterned along the lines of UK's game show: Who Wants to be a Millionaire, which was a hit in over 26 countries) spending over ₹ 60 lakh per show. At the end of 130 episodes, the show will cost Star TV a staggering ₹ 75 crore. The expenditure on the game show host Amitabh Bachchan itself is estimated at around ₹ 7 crore. 570 telephone lines in four major cities have been established to give an opportunity to over two lakh callers per day to participate in the show, filmed in Mumbai's film city. In every hour-long episode, Star TV will be selling 10 minutes advertising time for over ₹ 1.5 crore (totalling nearly ₹ 200 crore for 130 episodes). The advertising rates of ₹ 2.5 lakh per 10 seconds (later increased to ₹ 4 lakh for 10 seconds) will bring in an estimated ₹ 120 crore as profit. Star TV's chief executive, Peter Mukerjea, is obviously taking a calculated risk by spending ₹ 20 crore on just advertising in the electronic and print media promoting KBC, a sum close to Star TV's programming budget in 1999-2000. [The show has been discontinued now].

Source: India Today, July 17, 2000; Business Standard 12/8/2000, and Economic Times 17/8/2000

Levels

Many organisations develop strategies at three different levels: corporate, business and functional.

1. *Corporate-level Strategic Planning:* It is the process of defining the overall character and purpose of the organisation, the business it will enter and leave and how resources will be distributed among those businesses. Strategy at this level is typically developed by top management (The Board of Directors, CEO

Notes

etc.) The decisions are broad-based, carry greater risk and affect most parts of the organisation (e.g. The type of business that the organisation should enter, changes required in growth strategy, acquisition and diversification decisions etc.).

2. *Business-level Strategic Planning:* It is the planning process concerned primarily with how to manage the interests and operations of a particular unit within the organisation, commonly known as a Strategic Business Unit (SBU). A strategic business unit is a distinct business with its own set of competitors, that can be managed reasonably independently of other businesses within the organisation. Generally, the heads of the respective business units develop business strategies, with the approval of top management. Strategies at this level are aimed at deciding the competitive advantage to build, determining responses to changing market situations, allocating resources within the business unit and coordinating functional-level strategies developed by functional managers.

3. *Functional-level Strategic Planning:* It is the process of determining policies and procedures for (relatively narrow levels of activity) different functions of an enterprise like marketing, finance, personnel etc. These are developed by functional managers and are typically reviewed by business unit heads.

Coordinating strategies across the three levels is crucial in maximising strategic impact. The strength of the business-level strategy is enhanced when functional level strategies support its basic thrust. Similarly, the corporate-level is likely to have greater impact when business-level strategies support one another in bolstering the corporate-level strategy (A Thompson).

1.4 Role of Strategist

Strategic decisions are mainly concerned with the selection of the product-mix that the firm intends to produce and the markets in which it will sell its products. Such decisions affect the organisation as a whole over long periods of time. Because strategic decisions have such a tremendous impact on a firm and because they require large commitments of company resources, they can only be made by top managers in the organisational hierarchy (Pearce and Robinson, AITBS).

A chief executive officer (CEO) is the principal strategist (others include the Board of Directors, line managers, staff assistants to CEO, corporate planners, public relations advisors, legal officers) responsible for an organisation's overall direction, success or failure. The CEO is expected to ask and seek answers to the following questions while managing the show:

- Where have we been?
- Where are we now?
- Where do we want to go?
- Where should we go?
- Where can we go?
- Where shall we go?

Strategic decisions are the essence of strategic management. Strategies can be put into practice only after choices (decisions) have been made. Strategic decisions by their very nature are characterised by considerable risk and uncertainty. Strategic decisions involve more than one area of an organisation. They require sizeable allocation of resources. They are future-oriented with long-term ramifications. They can either take a company to commanding heights or make it a 'bottomless pit'! To be safe, therefore, the CEO has to formulate strategic decisions after receiving vital inputs from internal and external groups carefully. In actual practice, strategic decisions rarely follow this route as the following examples illustrate.

The features of strategic decisions, of course, vary with the level of strategic activity considered. Corporate level decisions are characterised by greater risk, cost, profit potential, greater need for flexibility and longer time horizon. Functional level decisions involve action oriented operational issues and are relatively short range and low risk. Business level decisions help bridge decisions at the corporate and functional levels.

1.5 Need for Strategies and Strategic Management

Need for Strategy

Those in favour of setting strategies argue that strategies are needed to give companies direction. Without strategies, incorporating objectives, companies would be adrift. If companies do not decide where they want to go, any direction and any activity is fine. People in companies would not know what they were working towards and, therefore, would not be able to judge what constitutes effective managerial behaviour.

However, those not in favour argue that direction-setting strategies can also block out peripheral vision, keeping companies sharply, yet myopically, focused on one course of action. Thus, strategies may limit the company's ability to open to new opportunities and threats as these unfold and to deviate from a set course as the company interacts with its environment and learns.

Strategists hit back arguing that early commitment to a course of action is highly beneficial. By setting objectives and drawing up a strategy to accomplish these, companies can invest resources, train people, build up production capacity and take a dear position within their environment. Strategies allow companies to mobilize themselves and to dare to take actions that are difficult to reverse and have a long payback period. We need to point out that commitment has a flip side, inflexibility, especially when mechanisms to change course midway are not in place. The absence of strategies does give the company flexibility to easily change course.

Strategic plan also has the benefit of coordinating all strategic initiatives within a company into a single cohesive pattern. A company-wide master strategy can ensure that differences of opinion are ironed out and one consistent course of action is followed throughout the entire company, avoiding overlapping, conflicting and contradictory behaviour. But the flip side is that developing a master strategy may lead to the squashing of initiative, either purposely or inadvertently.

Need for Strategic Management

We can argue that strategy formation by means of strategic management lends itself well to formalization. By its very nature, strategic management is a very structured and sequential activity, and therefore can be readily organized by employing formal procedures. Extensive formalization can culminate in the establishment of a strategic management system. In such a system, strategy formation steps can be scheduled, tasks specified, responsibilities assigned, decision-making authority clarified, budgets allocated and control mechanisms installed.

Obviously, not everyone agrees that formal strategic management systems are worth instituting. Some regard them as a mixed blessing, while others are outright hostile. Some authors, who value explicit strategies, are not enthusiastic about formal strategic management. The debate between supporters and detractors of formal strategic management systems resolves around two major tensions.

- *Formal vs. Informal Process:* The advantage of formalization, according to advocates of the strategic management perspective, is that it structures and disciplines the strategy formation process. Formalization facilitates tighter company, unambiguous responsibilities, clearer accountability and stricter review of performance.

Notes

A formal strategic management system forces managers to comply with a planning approach to strategy formation. It also gives top management more control over the company, as all major activities must be in approved strategies and the implementation of strategies is checked.

- *Differentiated vs. Integrated Tasks:* Many advocates of the strategic management perspective also believe that a division of labour within strategy formation processes is an important advantage of formal strategic management systems. The most important split facilitated by strategic management systems is between those who formulate the strategies and those who implement them. Formulation can also be divided into the task of developing strategies and the task of deciding which strategies should be implemented. Of course, other specialized functions can also be created such as strategic planner, competitive intelligence analyst, new business developer and controller. A major benefit of task differentiation is that the best managers are liberated from time-consuming operational matters, so that they can focus on strategic issues.

Formal strategic management can be used when some conditions are present and is difficult to use when the opposite is true. In his book 'Strategic Planning: What Every Manager Must Know', George A. Steiner (New York: Free Press, 1979) develops a table differentiating between the positions where formal strategic planning would be more successful and where it would not be. This table is reproduced in Table 1.1.

Therefore, not all proponents of explicit strategies are convinced of the need for formal planning systems. In general, they argue that such extensive formalization creates bureaucracy and reduces top management's freedom to manoeuvre. Their preference is to retain a certain level of organizational flexibility, despite the existence of strategies, by keeping enough power in the hands of top management to push through a change of course on command.

With this background let us turn our attention towards the structured process of strategic management, one that will retain enough flexibility and room for creativity, for that is what this book is all about.

Table 1.1: Forces Influencing Design of Strategic-Planning Systems

Towards more formality and more details	Nature of the Force	Towards less formality and fewer details
	Company	
	Small one-plant companies	→
←	Large companies	
	Management styles	
←	Policy maker	
	Democratic-permissive	→
←	Authoritarian	
	Day-to-day opeartional thinker	→
	Intuitive thinker	→
←	Experienced in planning	
	Inexperienced in planning	→
	Complexity of environment	
←	Stable environment	
	Turbulent environment	→
←	Little competition	
	Many markets and customers	→
←	Single markets and customers	
	Competition severe	→

Contd...

	Complexity of production processes	
←	Long production lead times	
	Short production lead times	→
←	Capital intensive	
	Labour intensive	→
←	Integrated manufacturing processes	
	Simple manufacturing processes	→
←	High technology	
	Low technology	→
	Market reaction time for new production is short	→
←	Market reaction time is long	
	Nature of problems	
←	Facing new, complex, tough problems having long-range aspects	
	Facing tough short-range problems	→
	Purpose of planning system	
←	Coordinate division activities	
	Train managers	→

Source: *Strategic Planning: What Every Manager must know* by George A. Steiner (New York: Free Press, 1979), p.54.

1.6 Path to Strategic Management

It does not happen that companies learn to do strategic management from the word GO. Strategic management in a company appears to evolve through four sequential phases according to Gluck, Kaufman, and Walleck, which is shown in Figure 1.1.

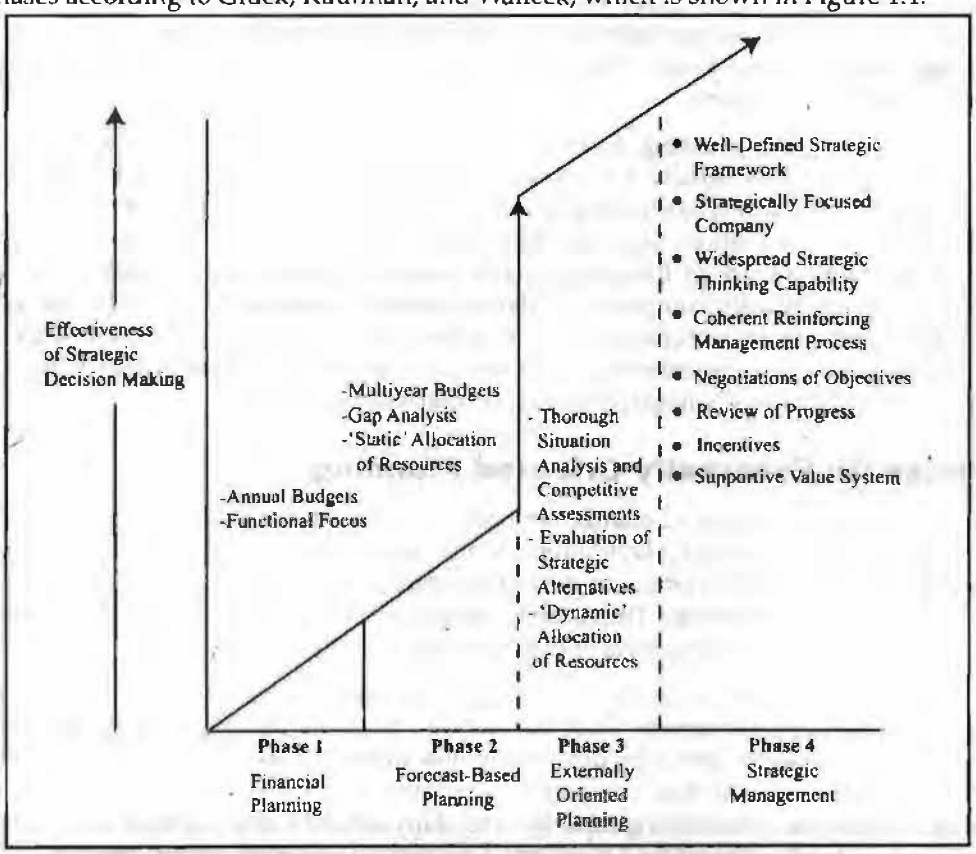


Figure 1.1: Phases in the Development of Strategic Planning (Gluck, Kaufman and Walleck, 1982)

Notes

Phase I: Basic Financial Planning

Origins of a formal planning system can be traced to the annual budgeting process where everything is reduced to a financial problem. Procedures are developed to forecast revenue, costs, and capital needs and to identify limits for expense budgets on an annual basis. Information systems report on functional performance as compared with budgetary targets.

Companies in Phase I often have sound business strategies, but they rarely exist in a formalized manner. The only concrete indication that a business strategy exists may be a projected sales/earnings growth rate, occasionally qualified by certain debt/equity target or other explicit financial objectives.

The whole onus of planning in this phase falls on the CEO and his top team. Do they really know their company's products and markets and have a good sense of what major competitors are doing and are expected to do. Based on their knowledge of their own cost structure, can they estimate what the impact of a product or marketing change will be on their plants, their distribution system, or their sales force. With this much knowledge in hand, and if they are not planning for the business to grow beyond traditional limits, they may not need to set up an expensive planning system.

Phase II: Forecast-based Planning

As the complexities increase when companies become large, more explicit documentation of the implicitly understood strategies of Phase I are required. The number of products and markets served, the degree of technological sophistication required, and the complex economic systems involved far exceed the intellectual grasp of anyone manager or a small group of managers.

The problems start from financial planning. As treasurers struggle to estimate capital needs and trade off alternative financing plans, they and their staff extrapolate past trends and try to foresee the future impact of political, economic, and social forces. Thus begins a second phase, forecast-based planning. Most long-range or strategic planning today is a Phase II system.

Usually at first, this planning differs from annual budgeting only in the length of its time frame, which is usually 3-5 years as compared to a year for Phase I. Very soon, however, the real world frustrates planners by perversely varying from their forecasts, throwing their estimations haywire. To handle these complexities planners typically reach for more advanced forecasting tools, including trend analysis and regression models and, eventually, computer simulation models. These models help achieve some improvement, but it is not enough. Sooner or later plans based on predictive models fail to signal major environmental shifts that not only appear obvious after the fact, but also have a great and usually negative impact on corporate fortunes.

Phase III: Externally Oriented Planning

In an environment of rapid change, an unforeseen event can render market forecasts obsolete almost overnight. Having repeatedly experienced such frustrations, planners begin to lose their faith in forecasting and instead try to understand the basic marketplace phenomena driving change. The result is often a new grasp of the key determinants of business success and a new level of planning effectiveness.

In this phase, resource allocation is both dynamic and creative. The Phase ill planners now look for opportunities to "shift the dot" of a business on a portfolio matrix into a more attractive sector, either by developing new business capabilities or by redefining the market to better fit their companies' strengths. A Japanese conglomerate with an under-utilized steel-fabricating capacity in its shipyard and a faltering high-rise concrete smokestack business combined them into a successful pollution control venture.

Phase IV: Strategic Management

Strategic planning and management are joined together in a single process known as Phase IV. Only a few companies are clearly managed strategically, and all of them are multinational, diversified manufacturing corporations. The challenge of planning for the needs of hundreds of different and rapidly evolving businesses, serving thousands of product/markets in dozens of distinct national environments, has pushed them to generate sophisticated, uniquely effective planning techniques. However, it is not so much planning technique that sets these companies apart, but rather the thoroughness with which management links strategic planning to operational decision making.

1.7 Is Strategy Creatively or Rationally Developed?

There is a major debate on the issue and it is difficult to say that one extreme is true or the other. Let us hear the two sides first.

In his book, *'The Mind of the Strategist'*, Kenichi Ohmae argues that the mind of the strategist is not dominated by linear, logical thinking. On the contrary, a strategist's thought processes are 'basically creative and intuitive rather than rational in his view, 'great strategies… originate in insights that are beyond the reach of conscious analysis.' He does not dismiss logic as unnecessary, but notes that it is not sufficient for arriving at innovative strategies. Yet, he observes that in most large companies, creative strategists 'are being pushed to the sidelines in favour of rational, by-the-number strategic and financial planners,' leading to a withering of strategic thinking ability.

This is because many strategists argue that strategy analysis and formulation should be conducted consciously, explicitly and rationally. In their view, strategic thinking is a 'logical activity,' while subsequent strategy implementation 'comprises a series of sub-activities that are primarily administrative.'

Another dimension to this debate is added by the introduction of game theory in strategic decision making. For many people, strategy is about behaviour in situations of competitive interaction. Generals develop strategies to out manoeuvre their military opponents, sports coaches adopt strategic moves to outwit other teams and politicians use strategic ploys to outfox their rivals. In other words, strategy is about playing interactive games. Strategists are engaged in understanding the rules of a game and developing game strategies better than their opponents. This is where game theorists come in who generally argue that strategic thinking should focus on the rational analysis of complex game situations and the selection of the most promising strategy. Games confront strategists with a competitive logic they cannot escape and therefore, game theorists propose that strategists rationally figure out their optimal moves and counter moves. Much of the work on game theory is actually strongly mathematically oriented, supporting strategists in their calculations of the best courses of action. Therefore, it has strong emphasis on logical reasoning and calculated decision making, making it lean towards a rational perspective.

Therefore, a strategy that is guided by a clear sense of purpose, is creative in its approach, is arrived at rationally and is emotionally ratified by commitment is more likely to have a successful outcome than a company whose future is left to guesswork and chance.

Having understood the basic concepts, now we turn our attention to the process of strategic management.

1.8 Strategic Management Process

The primary purpose of the strategic management process is to enable companies to achieve strategic competitiveness and earn above-average returns. Research indicates that companies that engage in strategic management generally outperform those that do

Notes

not. The attainment of an appropriate match or fit between a company's environment and its strategy, structure, and processes has positive effects on the company's performance. Bruce Henderson, founder of the Boston Consulting Group, pointed out that a company cannot afford to follow intuitive strategies once it becomes large, has layers of management, or its environment changes substantially. As the world's environment becomes increasingly complex and changing, today's companies, as one way to make the environment more manageable, use strategic management.

Strategic competitiveness is achieved when a company successfully formulates and implements a value-creating strategy. By implementing a value-creating strategy that current and potential competitors are not simultaneously implementing and that competitors are unable to duplicate, a company achieves a sustained or sustainable competitive advantage.

A framework that can assist companies in their quest for strategic competitiveness is the strategic management process, the full set of commitments, decisions and actions required for a company to systematically achieve strategic competitiveness and earn above-average returns. This process is illustrated in Figure 1.2.

Figure 1.2 illustrates the dynamic, interrelated nature of the elements of the strategic management process and provides an outline of where the different elements of the process are covered in this text.

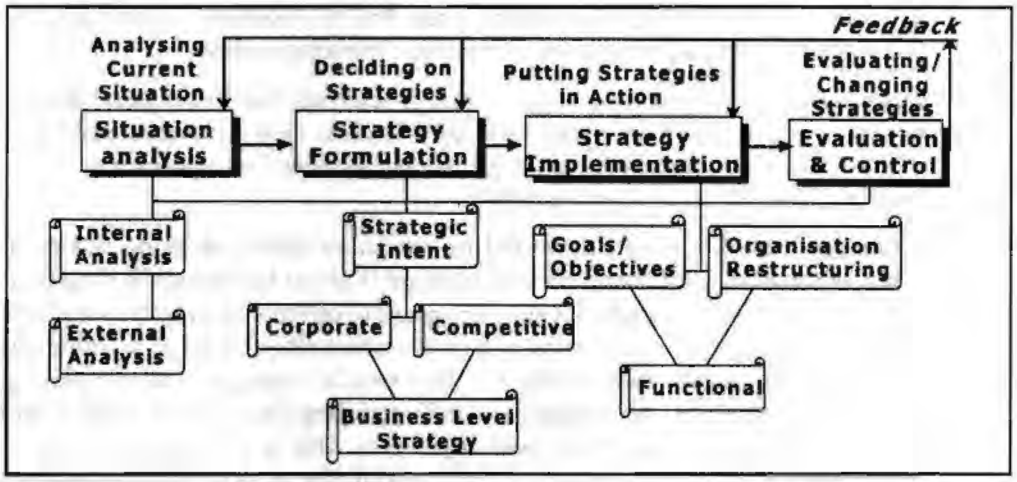


Figure 1.2: Strategic Management Process

Feedback linkages among the three primary elements indicate the dynamic nature of the strategic management process: Situation Analysis, Strategy Formulation and Strategy Implementation.

- *Situation Analysis:* in the form of information gained by scrutinizing the internal environment and scanning the external environment, is used to develop the company's strategic intent and strategic mission.
- *Strategy Formulation:* is guided by the company's strategic intent and strategic mission, and is represented by strategies that are formulated or developed and subsequently implemented or put into action.
- *Strategy Implementation:* strategic competitiveness and above-average returns result when a company is able to successfully formulate and implement value creating strategies that others are unable to duplicate.
- *Strategy Evaluation & Control:* links the elements of the strategic management process together and helps companies continuously adjust or revise strategic inputs and strategic actions in order to achieve desired strategic outcomes.

Notes

1.9 Challenge of Strategic Management

All firms and managers are challenged to achieve strategic competitiveness and earn above-average returns. This challenge can be formidable. A primary challenge facing managers today is the need to recognize—as illustrated by the comments on such companies as Infosys and Reliance—that the strategic management process and the striving for strategic competitiveness takes place in a dynamic global economy. As a result of this ongoing struggle, success today does not necessarily equate with success tomorrow.

An inspection of Table 1.2 points out that not all companies will be able to successfully meet the challenges of strategic management as measured by market value added (defined as market value minus capital invested).

As shown in Table 1.2, Wipro and Infosys lead the list of wealth creators for several consecutive years as they have created more wealth (measured by market value added) than other Indian firms.

Table 1.2: Top Ten Wealth Creators in India between 1996-97 and 1999-2000

	In four years: 1996-97 to 1999-2000			
Company	Increase in MVA (₹ Cr.)	Capital Growth	Efficiency Improvement	Current ROCE
Wipro	61,971	104%	14%	29%
Infosys Technologies	43.999	881%	4%	30%
Hindustan Lever	29,666	230%	8%	36%
Reliance Industries	27,999	72%	2%	13%
HCL Technologies	16,205	N.A.	17%	17%
ITC	14,014	84%	5%	22%
HFCL	9,645	168%	-2%	8%
Satyam Computer Services	9,487	631%	7%	24%
Zee Telefilms	8.475	3726%	-17%	7%
Ranbaxy Laboratories	6,198	41%	-1%	13%
N.A. Not applicable as HCL Technologies was listed only in November 1999				

The transient nature of strategic competitiveness is pointed out even more clearly when one realises that only 16 of the 100 largest industrial companies in the world in 1900 remain competitive in the 1990s and that six members of 2000s top ten wealth creators above were not among the top ten in 1992.

Internationalization or globalization of markets and industries has added another dimension of challenge, which makes it quite difficult to classify many companies as purely domestic. Honda, a major player in the global automobile industry, builds over 70% of cars for the US market in the US. Another automaker, Toyota continues to reduce its Japanese employment while expanding its global workforce and builds its Avalon sedan, Camry coupe and station wagon, and Sienna minivan exclusively in US.

Table 1.3: The World Competitiveness Scoreboard 1999

S. No.	COUNTRY	1998 RANK	1999 RANK
1	USA	1	1
2	SINGAPORE	2	2
3	FINLAND	5	3
4	LUXEMBOURG	9	4
5	NETHERLANDS	4	5
6	SWITZERLAND	7	6
7	CHINA - HONG KONG	3	7

Contd...

Notes

8	DENMARK	8	8
9	GERMANY	14	9
10	CANADA	10	10
11	IRELAND	11	11
12	AUSTRALIA	15	12
13	NORWAY	6	13
14	SWEDEN	17	14
15	UNITED KINGDOM	12	15
16	JAPAN	18	16
29	CHINA MAINLAND	24	29
34	THAILAND	39	34
38	KOREA	35	38
39	INDIA	41	39

This potential for continued economic growth means that all industrialized nations must continue to seek the expansion of agreements-such as the European Union, NAFTA and GATT-that will eliminate national laws that impede free trade among all nations.

As a result of this emerging competitive landscape, companies must rethink how they can achieve strategic competitiveness by positioning themselves to ask questions from a more global perspective. This would enable them to (at least) meet or exceed global standards. The questions could include questions like:

- Where should value-adding activities be performed? Where are the most cost-effective markets for new capital?
- Can products designed in one market be successfully adapted for sale in other markets?
- How can we develop cooperative relationships or joint ventures with other companies that will enable us to capitalise on international growth opportunities?

As a result of globalization and the spread of information technology, competition will become more intense. As a result of this:

- Customers over domestic customers-will continue to expect high levels of product quality at competitive prices;
- Global competition will continue to pressure companies to shorten product development-introduction time frames;
- Strategically competitive companies successfully leverage insights learned both in domestic and global markets, modifying them as necessary.

However, before a company can hope to achieve any measure of success in global markets, it must be strategically competitive in its domestic market.

1.10 Gaining Competitive Advantage

There are two approaches to deriving competitive advantage, and therefore superior returns, using strategic management process. The first, the industrial company model, suggests that the external environment should be considered as the primary determinant of a company's strategic actions. The second is the resource-based model, which perceives the company's resources and capabilities (the internal environment) as critical links to strategic competitiveness. Following the discussion in this Unit, as well as later, you should take care that these models must be integrated to achieve strategic competitiveness as both the views are important in the understanding of the strategic management process.

Notes

The two alternative models, Industrial Company (or externally focused) model and the Resource-based (or internally focused) model, have different focuses and there has been a strong debate on which one describes the process best. Both of them are shown in the Figure 1.3.

Again there is no one best solution and both are used together or independently as the situation demands. The I/O model is more suitable in situations where you are looking for a new investment opportunity and have not started the company as yet. The Resource-based model is more suitable in situations where you have an existing company and want to leverage its resources to enter a new industry.

I/O Model

The I/O or Industrial Company model adopts an external perspective. It starts with an assumption that forces external to the company represent the dominant influences on a company's strategic actions. In other words, this model presumes that the characteristics of and conditions present in the external environment determine the appropriateness of strategies that are formulated and implemented in order for a company to earn above-average returns. In short, the I/O model specifies that the choice of industries in which to compete has more influence on company performance than the decisions made by managers inside their firm.

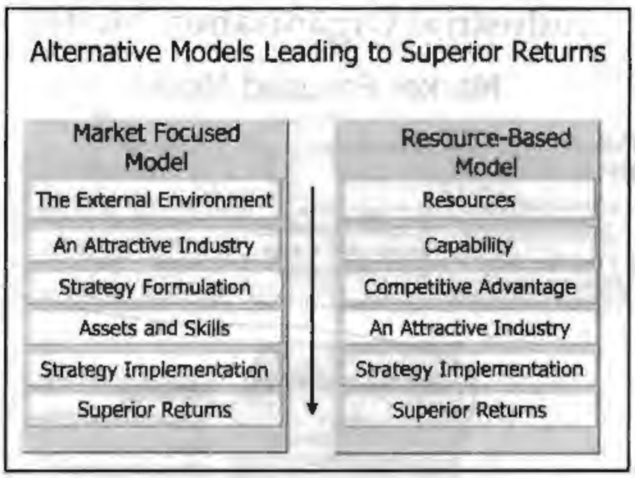


Figure 1.3: Strategic Models Leading to Superior Returns

The I/O model is based on the following assumptions:

1. The external environment-the general, industry and competitive environments imposes pressures and constraints on companies and determines strategies that will result in superior returns.

   In other words, the external environment pressures the company to adopt strategies to meet that pressure while simultaneously constraining or limiting the scope of strategies that might be appropriate and eventually successful.

2. Most companies competing in an industry or in an industry segment control similar sets of strategically relevant resources and thus pursue similar strategies.

   This assumption presumes that, given a similar availability of resources, the majority of companies competing in a specific industry – or in a segment of the industry – have similar capabilities and thus follow strategies that are similar. In other words, there are few significant differences among companies in an industry.

3. Resources used to implement strategies are highly mobile across firms.

Significant differences in strategically relevant resources among companies in an industry tend to disappear because of resource mobility. Thus, resource differences soon disappear as they are observed and acquired or learned by other companies in the industry.

Based on its underlying assumptions the I/O model prescribes a five-step process for companies to achieve above-average returns as shown in Figure 1.4:

1. Study the external environment-general, industry and competitive-to determine the characteristics of the external environment that will both determine and constrain the company's strategic alternatives.

2. Select an industry (or industries) with a high potential for returns based on the structural characteristics of the industry. A model for assessing these characteristics, the Five Forces Model of Competition, will be discussed in Unit 4.

3. Based on the characteristics of the industry, in which the company chooses to compete, strategies that are linked with above-average returns should be selected. A model or framework that can be used to assess the requirements and risks of these strategies, the Generic Strategies (cost leadership and differentiation), will be discussed in detail later.

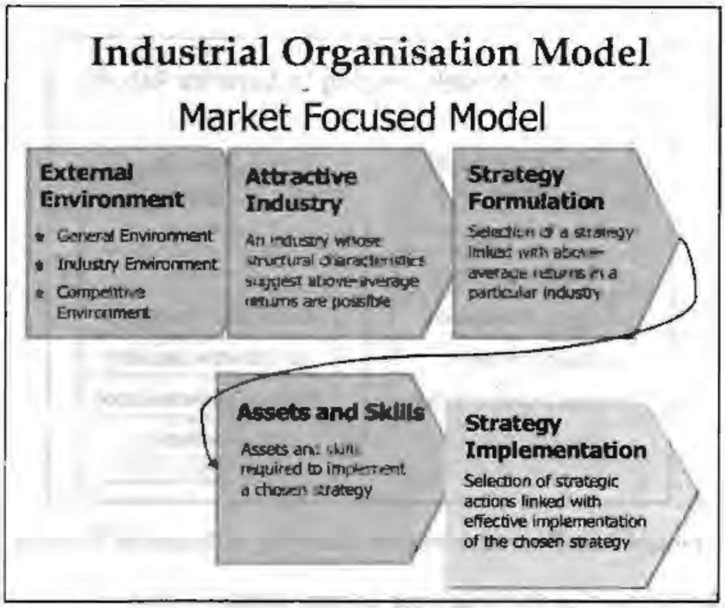


Figure 1.4: Five Step Process of the I/O Model

4. Acquire or develop the critical resources – skills and assets – needed to successfully implement the strategy that has been selected. A process for scrutinising the internal environment to identify the presence or absence of critical skills will be discussed in Unit 3. Skill-enhancement strategies, including training and development will be discussed later.

5. The I/O model indicates that above-average returns will accrue to companies that successfully implement relevant strategic actions that enable the company to leverage its strengths (skills and resources) to meet the demands or pressures and constraints of the industry in which they have elected to compete.

The I/O model has been supported by research indicating 20% of company profitability can be explained by industry characteristics and 36% of company profitability can be attributed to company characteristics and the actions taken by the company. Overall, this indicates a reciprocal relationship—or even an interrelationship—between industry characteristics (attractiveness) and company strategies that result in company performance.

1.11 Resource-based Model

Notes

The Resource-based model adopts an internal perspective to explain how a company's unique bundle or collection of internal resources and capabilities represents the foundation upon which value-creating strategies should be built.

Resources are inputs into a company's production process, such as capital equipment, individual employee's skills, patents, brand names, finance and talented managers. These resources can be tangible or intangible. Capabilities are the capacity for a set of resources to integrability – or in combination – perform a task or activity.

Thus, according to the Resource-based model, a company's resources and capabilities are more critical to determining the appropriateness of strategic actions than are the conditions and characteristics of the external environment. Thus, strategies should be selected that enable the company to best exploit its core competencies, relative to opportunities in the external environment.

The Resource-based model of above-average returns is grounded in the uniqueness of a company's internal resources and capabilities. The five-step model describes the linkages between resource identification and strategy selection that will lead to above-average returns as shown in Figure 1.5.

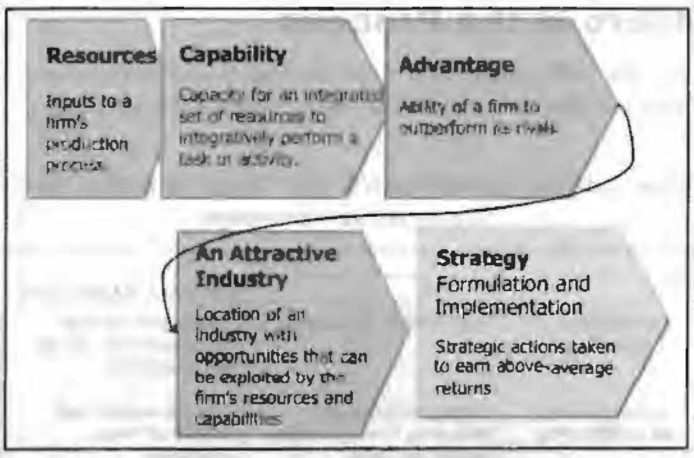


Figure 1.5: Five Steps of the Resource-based Model

1. Companies should identify their internal resources and assess their strengths and weaknesses.

   The strengths and weaknesses of company resources should be assessed relative to competitors.

2. Companies should identify the set of resources that provide the company with capabilities that are unique to the firm, relative to its competitors.

   The company should identify those capabilities that enable the company to perform a task or activity better than its competitors.

3. Companies should assess or determine the potential for their unique sets of resources and capabilities to outperform their competitors in terms of returns.

   Determine how a company's resources and capabilities can be used to gain competitive advantage?

4. Locate and compete in an attractive industry.

   Determine the industry that provides the best fit between the characteristics of the industry and the company's resources and capabilities.

5. To attain a sustainable competitive advantage and earn above-average returns, companies should formulate and implement strategies that enable them to better

exploit their resources and capabilities to take advantage of opportunities in the external environment than can their competitors.

However, taking advantage of or exploiting resources and capabilities in the new competitive landscape may not always result in a company achieving a sustainable competitive advantage and above-average returns. The potential to achieve a sustainable competitive advantage will be realised when company resources and capabilities are:

- ***Valuable:*** allowing the company to exploit opportunities or neutralize threats in the external environment.
- ***Rare:*** or possessed by few, if any, current and potential competitors.
- ***Costly to imitate:*** such that other companies will be able to obtain them only at a cost disadvantage relative to companies that already have them.
- ***Non-substitutable:*** as there are no strategic equivalents.

Core competencies are resources and capabilities that serve as a source of competitive advantage over a company's rivals and represent the dominant influences on the appropriateness of a company's strategic actions.

1.12 Stakeholders in the Process

Stakeholders are the individuals and groups who can affect and are affected by the strategic outcomes achieved and who have enforceable claims on a company's performance.

Table 1.4: Comparison of I/O and Resource-based view of Competitive Advantage

	I/O	RESOURCE-BASED VIEW
Competitive advantage	Positioning in industry	Possessing unique organizational assets or capabilities
Determinants of profitability	Characteristics of industry; firm's position within industry	Type, amount, and nature of firm's resources
Focus analysis	External	Internal
Major concern	Competition	Competencies-Resources
Strategic choices	Choosing attractive industry; appropriate position	Developing unique resources and capabilities

The stakeholder concept reflects that individuals and groups have a "stake" in the strategic outcomes of the company because they can be either positively or negatively affected by those outcomes and because achieving the strategic outcomes may be dependent upon the support or active participation of certain stakeholder groups.

Figure 1.6 provides a definition of a stakeholder and illustrates the three general classifications and members of each primary stakeholder group:

- Capital market stakeholders
- Product market stakeholders
- Organizational stakeholders
- Secondary stakeholders.

Beyond these primary stakeholders, there are other secondary stakeholders as well and include entities like the community at large, environmental groups, government, etc.

Notes

Figure 1.6: Primary Stakeholder Groups

Each type of stakeholder has different expectations or demands. This leads to potential conflicts between these stakeholders, causing friction. The primary expectations of each group are summarized in Table 1.5.

When we review the primary expectations or demands of each stakeholder group it becomes obvious that a potential for conflict exists. For instance, shareholders generally invest for wealth maximization purposes and are, therefore, interested in a company maximizing its return on investment or ROI. However, if a company increases its ROI by making short-term decisions, the company can negatively affect employee or customer stakeholders.

Table 1.5: Expectations of Stakeholder Groups

Stakeholder Group	Membership	Primary Expectation or Demand
Capital market	Shareholders lenders	Wealth enhancement Wealth preservation
Product market	Customers Suppliers	Product reliability at lowest possible price Receive highest sustainable prices
Organizational	Employees Unions	Secure, dynamic, stimulating and rewarding career environment Ideal working conditions and job security for members
Secondary Stakeholders	Environment Groups Government	Environment Protection Honest tax payments, Safety of public, Proper utilisation of resources

Strategists face ambiguous decision situations, but also have opportunities to dream and act in concert with a compelling strategic intent that motivates others in creating competitive advantage.

Corporate Governance and Stakeholders

Corporate governance is a relationship among stakeholders that is used to determine and control the direction and performance of companies. It is determining how shareholders (owners) can ensure that managers develop and implement strategic decisions that are in the best interests of the shareholders (owners) and not primarily self-serving (in the best interests of managers only, to the detriment of shareholders). In the absence of effective internal governance mechanisms, the market for corporate control—an external governance mechanism—may be activated.

Several governance mechanisms are used in a modern corporation. Some of them are as follows:

- *Ownership Concentration,* representing the relative amounts of stock owned by individual shareholders and institutional investors.

Notes

- *Board of Directors,* or the individuals responsible for representing the company's owners by monitoring the strategic decisions of top-level managers.
- *Executive Compensation,* or the use of salary, bonuses and long-term incentives to align the interests of managers with those of shareholders (owners).
- *The Market for Corporate Control,* or the purchase of a company that is under performing relative to its industry rivals in order to improve its strategic competitiveness.

Ownership Concentration

The number of large-block owners and the total percentage of the company's shares that they own define ownership concentration. Large-block shareholders are investors who typically own at least five per cent (5%) of the company's shares. Diffuse ownership (characterized as a large number of shareholders with small holdings and few, if any, large-block shareholders) produces weak monitoring of managerial decisions.

The greater the extent to which ownership of a company is concentrated, with large blocks of shares held by a few shareholders, the greater the incentive of the company's owners to monitor and control managerial actions. Shareholders' incentive to monitor is small when shareholders own few shares of stock—ownership is diffused—or when their investments are well diversified. While all shareholders bear the cost of monitoring, shareholders benefit from monitoring to the extent of their ownership. Owners of large blocks (whose investments are not diversified) have the greatest interest in monitoring.

Board of Directors

The board of directors is a group of elected individuals whose primary responsibility is to act in the owners' interests by formally monitoring and controlling the corporation's top-level executives. Legally, the board of directors has broad powers, which include directing the affairs of the company, punishing (disciplining) and rewarding (compensating) managers and protecting the rights and interests of shareholders (owners). As a result, if the board of directors is appropriately structured and operates in an effective manner, it can protect owners from managerial opportunism.

There are several types of people on the board of directors. The company's CEO and other top-level managers represent insiders. Related outsiders are individuals who are not involved in the company's day-to-day operations, but may have a relationship with the company. Examples might include the company's legal counsel, a large customer or supplier, or a close relative of one of the company's top-level managers. Outsiders are individuals who are independent of the company. They are neither involved in the company's day-to-day operations, nor do they have other relationships with the company. An example of an outsider might be the 'professional director' (normally a retired senior manager) or a representative of the institutional investors.

Because the primary role of the board of directors is to monitor and ratify major managerial actions to protect the interests of owners, there is a call by advocates of board reform that outsiders should represent a significant majority of a board's membership. Although outside directors have become more common in major companies, many critics of board effectiveness complain that boards are shirking their primary fiduciary responsibility to protect shareholders, compromising the board's objectivity, expertise, and motivation.

Executive Compensation

Decisions made by top-level managers are likely to affect company performance over an extended period of time. As a result, it is difficult to assess the effect of current decisions using current period performance. Many variables (or outside factors) intervene between management behaviour and company performance.

Changes in the company's external environment may result in good decisions becoming bad. As a result, even the best executive compensation programme is imperfect and thus will not result in the development and implementation of optimal strategies. Therefore managers may feel "pressured" to manipulate short-term performance to earn annual bonuses. In other words, achieving short-term objectives may take precedence over enhancing the long-term strategic competitiveness of the company. Long-term incentives expose managers to risks associated with uncontrollable (by managers or by the company) events, such as market fluctuations or industry decline. And, managers' risk exposure increases as the term of the incentive increases.

In other words, even when the intentions are good, the financial results may be bad and vice versa.

Although there are no ready-made solutions that can be applied across the board as every situation demands its own specific solution, a process can be evolved that would help put the things in perspective. That is the objective of this book.

What Lies Next

Units 2, 4 and 5 will provide more detail regarding the strategic inputs to the strategic management process: situation analysis of the company's external and internal environments that must be performed so that sufficient knowledge is developed regarding external opportunities and internal capabilities. This enables the development of the company's strategic intent and strategic mission and leads the way towards strategy formulation.

1.14 Establishing Strategic Focus

Strategic intent is internally focused and is concerned with leveraging the company's internal resources, capabilities and core competencies to accomplish what at first may appear to be unattainable goals in the competitive environment. It reflects what the company is capable of doing given its core competencies and the unique ways these core competencies can be used to develop a sustainable competitive advantage that will result in above-average returns.

From a competitive perspective, strategic intent is about winning – beating the competition – in the battle for market share and global dominance. Strategic intent focuses employee performance through a firm-wide commitment to achieve specific and significant performance measures. To be effective, companies also must identify their competitors' strategic intent(s) and extent of commitment to it.

Mission is a statement of the role, or purpose, by which a company intends to serve its stakeholders. It describes what the company does (current capabilities), who it serves (stakeholders), and what makes the company unique justification for existence). Mission statements always exist at the top level of a company, but may also be set for different organizational levels or components. A company's strategic mission is an externally focused application of its strategic intent that states the company's unique purpose and the scope of its operations in product and market terms. In competitive terms, the strategic mission provides general descriptions of products to be provided and markets to be served using its unique sets of resources and capabilities-its core competencies.

A vision statement identifies where the company intends to be in the future or where it should be to best meet the needs of stakeholders. It incorporates a shared understanding of the nature and purpose of the company and uses this understanding to move the company towards a greater purpose.

1.15 Strategic Intent

Strategic intent is the leveraging of a company's resources, capabilities, and core competencies to accomplish what at first may appear to be unattainable goals in the competitive environment. The challenge is for managers to successfully stimulate development of a strategic intent among employees through developing, communicating, and supporting a clearly articulated vision of the company's future. A well articulated strategic intent should drive the development of strategic actions or the establishment of goals and objectives that require that all of the company's competencies be leveraged to maximise value.

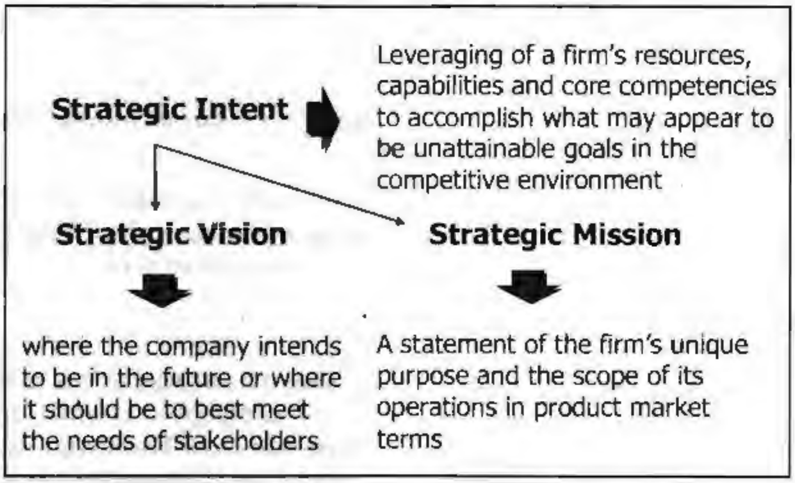


Figure 1.7: Strategic Intent, Vision and Mission

A company's strategic intent is the reason that it exists, and why it will continue to exist, providing it maintains a competitive advantage. The strategic intent of a large company may be industry leadership on a national or global scale. The strategic intent of a small company may be to dominate a market niche. The strategic intent of an up-and-coming enterprise may be to overtake the market leaders. The strategic intent of a technologically innovative company may be to pioneer a promising discovery and open a whole new vista of products and market opportunities—as did Xerox, Apple Computer, Microsoft, Merck, and Sony.

A business, or any other organization, serves a need in society. It will only continue as long as society, in general, or sufficiently large segments of society, want it to remain in existence. For example, once the cigarette industry's strategic intent was to give pleasure and satisfaction to consumers. Now its overt purpose is to provide satisfying smoking that is as safe as possible for existing smokers. In the West at least, it claims that the objective of its advertising is no longer to encourage consumers to start smoking, but only to convert existing smokers from one brand to another. Pressure from society is forcing the industry to restate its strategic intent.

Student Activity

Fill in the blanks:

1. The .... adopts an internal perspective to explain how a company's unique bundle or collection of internal resources and capabilities represents the foundation upon which value-creating strategies should be built.
2. .... is achieved when a company successfully formulates and implements a value-creating strategy.
3. .... is a relationship among stakeholders that is used to determine and control the direction and performance of companies.

Notes

1.16 Summary

Strategy could be defined as "A general direction set for the company and its various components to achieve a desired state in the future. Strategy results from the detailed strategic planning process." Strategy in this general sense should not be confused with general interpretation of the term strategies. When we use the term strategies in a general sense we are pointing towards the specific methods, processes, or steps used to accomplish Goals and Objectives. Strategies impact resources (Inputs) in some positive or negative way and they are executed in a tactical manner so as to link Goals and Objectives to day-to-day operations.

1.17 Keywords

Strategy: Strategy could be defined as a general direction set for the company and its various components to achieve a desired state in the future.

Ownership Concentration: Ownership concentration representing the relative amounts of stock owned by individual shareholders and institutional investors.

Strategic Intent: Strategic intent is the leveraging of a company's resources, capabilities, and core competencies to accomplish what at first may appear to be unattainable goals in the competitive environment.

Core Competencies: Core competencies are resources and capabilities that serve as a source of competitive advantage over a company's rivals and represent the dominant influences on the appropriateness of a company's strategic actions.

1.18 Review Questions

1. Define strategy and strategic management.
2. Describe the need for strategy and strategic management.
3. Explain the process of strategic management.
4. Write a note on I/O Model and Resource-based Model.
5. What are the key governance mechanisms used in corporations?
6. Define strategic intent.

1.19 References and Further Readings

- David, F. R., & David, F. R. (2018). Strategic management: A competitive advantage approach, concepts and cases (16th ed.). Pearson.
- Hitt, M. A., Ireland, R. D., &Hoskisson, R. E. (2020). Strategic management: Competitiveness and globalization(13th ed.). Cengage Learning.
- Wheelen, T. L., Hunger, J. D., Hoffman, A. N., & Bamford, C. E. (2018). Concepts in strategic management and business policy: Globalization, innovation and sustainability (15th ed.). Pearson.

Unit 2 Vision and Mission

Unit Structure

2.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define vision and mission
- Explain the importance of communicating vision and mission
- State setting objectives
- Describe the process of developing the strategy
- Define balanced scorecard

2.1 Introduction

Strategic vision is the management's views about what activities the company intends to pursue and the long-term course it charts for the future. A strategic vision provides a big picture perspective of "who we are, what we do, and where we are headed." It leaves no doubt about the company's long-term direction and where management intends to take the company. A well-conceived strategic vision is a prerequisite to effective strategic leadership. A manager cannot function effectively as either leader or strategy-maker without a sound concept of the business, what activities to pursue, what not to pursue, and what kind of long-term competitive position to build vis-a-vis both customers and competitors.

2.2 Communicating Vision and Mission

Communicating the strategic vision and mission down the line to lower-level managers and employees is almost as important as the strategic soundness of the company's business concept and long-term direction. A vision and mission couched in words that inspire and challenge build committed effort from employees and serve as powerful motivational tools. Managers need to communicate the vision in words that arouse a strong sense of organisational purpose, build pride, and induce employee buy-in. People are proud to be associated with a company that has a worthwhile mission and is trying to be the world's best at something competitively significant. Having an exciting

Notes

mission or cause brings the workforce together, galvanises people to act, stimulates extra effort, and causes people to live the business instead of just coming to work. In companies with freshly changed missions, executives need to provide a compelling rationale for the new direction and why things must be done differently. Unless people understand how a company's business environment is changing and why a new direction is needed, a new mission statement does little to win employees' commitment or alter work practices – outcomes that can open up a trust gap and make it harder to move the company down the chosen path.

A well conceived, well-worded mission statement has real managerial value:

- It crystallises senior executives' own views about the company's long-term direction and business make-up,
- It reduces the risk of visionless management and rudderless decision making,
- It conveys an organisational purpose and identity that motivate employees to go all out and do their very best work,
- It provides a beacon lower-level managers can use to form departmental missions, set departmental objectives, and craft functional and departmental strategies that are in sync with the company's direction and strategy, and
- It helps a company prepare for the future.

2.3 Setting Objectives

Setting objectives converts the strategic vision and mission into target outcomes and performance milestones. Objectives represent a managerial commitment to producing specified results in a specified time frame. They spell out how much of what kind of performance by when. They direct attention and energy to what needs to be accomplished.

However you word the objectives, ensure they do not sound like long-term dreams. They have to have some immediacy. Performance targets and action programmes will reinforce the feeling that the objectives can be met in the near future, it is worth building attainability into every stage of the process, including the objectives.

Here are some examples of desirable strategic objectives:

Box 2.1: Desirable Strategic Objectives

Directional Objectives

Market leadership

Competitive ranking; rate of innovation; new patents; market share; licensing deals

Market spread

Number of different markets

Number of customer groups

Number of industries.

Performance Objectives

Growth: Increases in sales, profit capital

Investment: Return on capital; return on assets

Profitability: Margin on sales; earnings per share

Internal Objectives

Efficiency: Ratio of sales to assets; sales to stock

Personal: Employee relations; morale; staff development; average employee pay; retention; levels of skill

External Objectives

Social responsibility: Public relations; percentage recycled; community involvement; emissions; miles travelled by staff, suppliers. Charitable donations, endowments

The following key statements were extracted from the Mission Statement of pve piping company:

- To provide products and services for the monitoring, operation and maintenance of essential piping systems.
- To sustain profitable growth sufficient to meet the needs of the stakeholders in the business.
- Growth to be achieved primarily by expanding activities in areas related to existing businesses.
- To maintain a position of leadership and integrity in business as perceived by customers, employees and the community.

	A focus could be on	A level could be	Tentative Desirable Strategic Objectives to be offered for adoption
'Profitable growth in related businesses'	Existing products	50 million p.a. sales	To have 50 million p.a. sales from existing products by 2010.
	New products	10 million p.a. sales	To have 10 million p.a. sales from new products by 2010.
	Business acquisitions	20 million p.a. sales	To have 20 million p.a. sales from business acquisitions by 2010.
'Leadership'	International sales	25 million p.a. sales	To have 25 million p.a. international sales by 2010.
	Plastic pipe construction	To become a full line producer	To have 100% of API standard plastic pipe connections produced by own facilities by 2010.
'Integrity'	Quality	Less than 0.5% rejects	To have no more than 0.5% internal rejects by 2010.
	Quality	100% meet standards	To have 100% of shipped products meet internal standards by 2010.
To be 'market driven'	Customer requests or problems	Immediate underwater testing and repair	To have in place an operation that provides immediate underwater testing and repair of pipelines by 2010.
	Service level	24 hour delivery	To provide 24 hour worldwide delivery from four service centres by 2010.

Tentative Desirable Strategic Objectives for next fifteen years

Arising out of the above Mission Statement, possible key areas for objective setting are:

There are several characteristics of desirable strategic objectives that must be taken care of when setting them. They can be classified into four distinct characteristics:

- ***Realistic:*** Objectives should be achievable within the required time scales.
- ***Communicable:*** It should be easy to get others to understand them.
- ***Measurable:*** It should always be possible to answer the question, 'How will we know when we have achieved them?' This does not always require the measure to be a quantity. Often, very visible qualitative measures can be developed which are more effective than detailed statistics.
- ***Relevant:*** It should be possible to see how achievement of objectives will make a major contribution to the fulfillment of the organization's 'vision' and the pursuit of its 'mission'.

Unless a company's long-term direction and business mission are translated into measurable performance targets and managers are pressured to show progress in reaching these targets, statements about vision and mission will end up as nice words, window dressing, and unrealised dreams of accomplishment. The experiences of countless companies and managers teach that companies whose managers set objectives for each key result area and then aggressively pursue actions calculated to achieve their performance targets typically outperform companies whose managers have good intentions, try hard, and hope for success.

Notes

2.4 Need for Objectives at all Management Levels

For strategic thinking and strategy-driven decision making to permeate company behaviour, performance targets must be established not only for the company as a whole but also for each of the company's separate businesses, product lines, functional areas, and departments. Only when every manager, from the CEO to the lowest level manager, is held accountable for achieving specific results and when each unit's objectives support achievement of company objectives is the objective-setting process complete enough to ensure that the whole company is headed down the chosen path and that each part of the company knows what it needs to accomplish.

The objective-setting process is more top-down than bottom-up. To see why strategic objectives at one managerial level tend to drive objectives and strategies at the next level down, consider the following example. Suppose, the senior executives of a diversified corporation establish a corporate profit objective of ₹ 5 million for next year. Suppose further, after discussion between corporate management and the general managers of the firm's five different businesses, each business is given the challenging but achievable profit objective of ₹ 1 million by year end (i.e., if the five business divisions contribute ₹ 1 million each in profit, the corporation can reach its ₹ 5 million profit objective). Of course, the targets could be different for different businesses depending on their earlier performance and future potential. A concrete result has thus been agreed on and translated into measurable action commitments at two levels in the managerial hierarchy. Next, suppose the general manger of business unit X, after some analysis and discussion with functional area managers, concludes that reaching the ₹ 1 million profit objective will require selling 100,000 units at an average price of ₹ 50 and producing them at an average cost of ₹ 40 (a ₹10 profit margin times 100,000 units equals ₹ 1 million profit). Consequently, the general manager and the manufacturing manager settle on a production objective of 100,000 units at a unit cost of ₹ 40; and the general manager and the marketing manager agree on a sales objective of 100,000 units and a target selling price of ₹ 50. In turn, the marketing manager breaks the sales objective of 100,000 units into unit sales targets for each sales territory, each item in the product line, and each salesperson.

2.5 Objective Setting Horizon

A company needs both long-range and short-range objectives. Long-range objectives serve two purposes. First, setting performance targets five or more years ahead pushes managers to take actions now in order to achieve the targeted long-range performance later (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 to begin growing its sales and customer base!) Second, having explicit long-range objectives prompts managers to weigh the impact of today's decisions on longer-range performance. Without the pressure to make progress in meeting long-range performance targets, it is human nature to base decisions on what is most expedient and worry about the future later. The problem with short-sighted decisions, of course, is that they put a company's long-term business position at greater risk.

Short-range objectives spell out the immediate and near-term results to be achieved. They indicate the speed at which management wants the company to progress as well as the level of performance being aimed for over the next two or three periods. Short-range objectives can be identical to long-range objectives any time a company is already performing at the targeted long-term level. For instance, if a company has an ongoing objective of 15 per cent profit growth every year and is currently achieving this objective, then the company's long-range and short-range profit objectives coincide. The most important situation where short-range objectives differ from long-range objectives occurs when managers are trying to elevate organisational performance and cannot reach the long-range/ongoing target in just one year. Short-range objectives then serve as steps or milestones.

Notes

Objectives should not represent whatever levels of achievement management decides would be "nice." Wishful thinking has no place in objective setting. For objectives to serve as a tool for stretching a company to reach its full potential, they must be challenging but achievable. Satisfying this criterion means setting objectives in light of several important "inside-outside" considerations:

- What performance levels will industry and competitive conditions realistically allow?
- What results will it take for the company to be a successful performer?
- What performance is the company capable of when pushed?

2.6 Strategic versus Financial Objectives

For performance objectives to have value as a management tool they must be stated in quantifiable or measurable terms and they must contain a deadline for achievement. This means avoiding generalities like "maximise profits", "reduce costs", "become more efficient", or "increase sales", which specify neither how much or when. Objective setting is a call for action—what to achieve, when to achieve it, and who is responsible. As Bill Hewlett, co-founder of Hewlett-Packard, once observed, "You cannot manage what you cannot measure. . . And what gets measured gets done." Spelling out company objectives in measurable terms and then holding managers accountable for reaching their assigned targets within a specified time frame (1) substitutes purposeful strategic decision making for aimless actions and confusion over what to accomplish and (2) provides a set of benchmarks for judging the company's performance.

Objectives are needed for each key result managers deem important to success. Two types of key result areas stand out, those relating to financial performance and those relating to strategic performance. Achieving acceptable financial performance is a must; otherwise the company's survival ends up at risk. Achieving acceptable strategic performance is essential to sustaining and improving the company's long-term market position and competitiveness. Specific kinds of financial and strategic performance objectives are shown below:

Table 2.1: Financial vs. Strategic Objectives

Financial Objectives	Strategic Objectives
■ Faster revenue growth	■ A bigger market share
■ Faster earning growth	■ A higher, more secure industry rank
■ Higher dividends	■ Higher product quality
■ Wider profit margins	■ Lower costs relative to key competitors
■ Higher returns on invested capital	■ Broader or more attractive product line
■ Stronger bond and credit ratings	■ A stronger reputation with customers
■ Bigger cash flows	■ Superior customer service
■ A rising stock price	■ Recognition as a leader in technology and/or product innovation
■ Recognition as a "blue-chip" company	■ Increased ability to complete in international markets
■ A more diversified revenue base	■ Expanded growth opportunities
■ Stable earnings during recessionary periods	■ Total customer satisfaction

2.7 Developing the Strategy

Corporate strategy is the overall managerial game plan for a diversified company. Corporate strategy extends an umbrella over a diversified company's businesses. It consists of the moves made to establish business positions in different industries and the approaches used to manage the company's group of businesses. Crafting corporate strategy for a diversified company involves four kinds of initiatives:

Notes

1. ***Making the moves to accomplish diversification.*** The first concern in diversification is what the company's portfolio of businesses should consist of specifically, what industries to diversify into, and whether to enter the industries by starting a new business or acquiring another company (an established leader, an up-and-coming company, or a troubled company with turnaround potential). This piece of corporate strategy establishes whether diversification is based narrowly in a few industries or broadly in many industries, and it shapes how the company will be positioned in each of the target industries.

2. ***Initiating actions to boost the combined performance of the businesses the firm has diversified into.*** As positions are created in the chosen industries, corporate strategy making concentrates on ways to get better performance out of the business-unit portfolio. Decisions must be reached about how to strengthen the long-term competitive positions and profitabilities of the businesses the firm has invested in. Corporate parents can help their business subsidiaries be more successful by financing additional capacity and efficiency improvements, by supplying missing skills and managerial know-how, by acquiring another company in the same industry and merging the two operations into a stronger business, and/or by acquiring new businesses that strongly complement existing businesses. The overall plan for managing a group of diversified businesses usually involves pursuing rapid growth strategies in the most promising businesses, keeping the other core businesses healthy, initiating turnaround efforts in weak performing businesses with potential, and divesting businesses that are no longer attractive or that don't fit into management's long-range plans.

3. ***Finding ways to capture the synergy among related business units and turn it into competitive advantage.*** When a company diversifies into businesses with related technologies, similar operating characteristics, the same distribution channels, common customers, or some other synergistic relationship, it gains competitive advantage potential not open to a company that diversifies into totally unrelated businesses. Related diversification presents opportunities to transfer skills, share expertise, or share facilities, thereby reducing overall costs, strengthening the competitiveness of some of the company's products, or enhancing the capabilities of particular business units—any of which can represent a significant source of competitive advantage. The greater the relatedness among the businesses of a diversified company, the greater the opportunities for skills transfer and/or sharing across businesses and the bigger the window for creating competitive advantage. Indeed, what makes related diversification so attractive is the synergistic strategic fit across related business units that allows company resources to be leveraged into a combined performance greater than the units could achieve operating independently. The 2+2= 5 aspect of strategic fit makes related diversification a very appealing strategy for boosting corporate performance and shareholder value.

4. ***Establishing investment priorities and steering corporate resources into the most attractive business units.*** A diversified company's different businesses are usually not equally attractive from the standpoint of investing additional funds. This facet of corporate strategy making involves deciding on the priorities, that is, investing more capital in some of the businesses and channelling resources into areas where earnings potentials are higher and away from areas where they are lower. Corporate strategy may include divesting business units that are chronically poor performers or those in an increasingly unattractive industry. Divestiture frees up unproductive investments for redeployment to promising business units or for financing attractive new acquisitions.

Corporate strategy is crafted at the highest levels of management. Senior corporate executives normally have lead responsibility for devising corporate strategy and for choosing among whatever recommended actions bubble up from lower level managers.

Key business unit heads may also be influential, especially in strategic decisions affecting the businesses they head. Major strategic decisions are usually reviewed and approved by the company's board of directors.

Notes

Table 2.2: The Strategy-Making Tasks at Different Levels

Strategy Level	Primary Strategy Making Concerns at Each Managerial level
(Lead Responsibility) Corporate Strategy (CEO, other key executives)	■ Building and managing a high performing portfolio of business units (making acquisitions, strengthening existing business positions, divesting businesses that no longer fit into management's plans) ■ Capturing the synergy among related business units and turning it into competitive advantage ■ Establishing investment priorities and steering corporate resources into businesses with the most attractive opportunities ■ Reviewing/revising/unifying the major strategic approaches and moves proposed by business unit managers
Business/Competitive Strategies (General Manager/Head of business unit)	■ Capturing synergies between different businesses ■ Devising moves and approaches to compete successfully and to secure a competitive advantage ■ Forming responses to changing external conditions ■ Uniting the strategic initiatives of key functional departments ■ Taking action to address company specific issues and operating problems
Functional Strategies (Functional Managers)	■ Crafting moves and approaches to support business strategy and to achieve functional/departmental performance objectives ■ Reviewing/revising/unifying strategy related moves and approaches proposed by lower-level managers
Operating Strategies (Field-unit heads/Lower-level managers within functional areas)	■ Crafting still narrower and more specific approaches/moves aimed at supporting functional and business strategies and at achieving operating unit objectives

The focus of the next few units is on the development and execution of these strategies.

2.8 Aligning Performance with Objectives

The strategic architecture represents how the values, purpose, and operating principles in a company are connected to its vision and a strategy. To avoid a gap between the planning and reality, strategic objectives must be tied to the everyday operating environment-usually through some form of well-reasoned, logical performance criteria.

Performance measures come in many forms, including economic value measures, financial measures such as cash flow from return on investment, and a combination of methods for linking non-financial and financial measures. One of the more popular in this third category is the balanced scorecard method of performance management, developed by Kaplan and Norton, which creates a framework that ties or translates the strategic objectives of an company to performance measures.

While the benefits of performance measurement systems that include the balanced scorecard are numerous, perhaps most important is that performance measurement allows a company to express the intent of its strategy and how that strategy connects with everyday operations. Performance measurement systems also create an essential feedback and learning mechanism in support of key management decisions.

Notes

Student Activity

Fill in the blanks:

1. .... is the management's views about what activities the company intends to pursue and the long-term course it charts for the future.
2. .... is the overall managerial game plan for a diversified company.
3. Corporate strategy is crafted at the .... of management.
4. The .... is a management system that enables companies to clarify their vision and strategy and translate them into action.

2.9 Summary

The best-worded mission statements are simple and concise; they speak loudly and deadly, generate enthusiasm for the company's future Lourse, and elicit personal effort and dedication from everyone in the company.

A top-down process of establishing performance targets for strategy critical activities, business processes, and departmental units is a logical way of breaking down company-wide targets into pieces that lower-level units and mangers are responsible for achieving.

The balanced scorecard is a management system (not only a measurement system) that enables companies to clarify their vision and strategy and translate them into action.

2.10 Keywords

Strategic Vision: Strategic vision is the management's views about what activities the company intends to pursue and the long-term course it charts for the future.

Strategic Architecture: The strategic architecture represents how the values, purpose, and operating principles in a company are connected to its vision and a strategy.

Balanced Scorecard: The balanced scorecard is a management system (not only a measurement system) that enables companies to clarify their vision and strategy and translate them into action.

2.11 Review Questions

1. Explain the principal value of a mission statement.
2. Explain the importance of communicating vision and mission statement.
3. Describe the process of setting objectives.
4. Define strategic vs. financial objectives.
5. Write a note on balance scorecard.

2.12 References and Further Readings

- Rothaermel, F. T. (2021). Strategic management (5th ed.). McGraw-Hill Education.
- Barney, J. B., & Hesterly, W. S. (2019). Strategic management and competitive advantage: Concepts and cases (6th ed.). Pearson.
- Grant, R. M. (2021). Contemporary strategy analysis: Text and cases (11th ed.). Wiley.

Unit 3 Concept of Synergy and its Relevance to Strategy

Unit Structure

3.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Explain the role of synergy and its relevance to strategy
- Define social responsibility

3.1 Introduction

Managers must grasp the real meaning of synergy. The word 'synergy' has come into use from biology and medicine where if a patient suffering from say four ailments was prescribed medicines for three and he was cured of the fourth ailment because of the synergetic effect of the three medicines. When the sum total outcome of several persons working together is more than the sum of its individual parts, synergy is at work. Philosophers in the West have often simplified it by stating that when synergy is working two and two add up to five and not four. In India, we talk of one plus one adding up to eleven. Such is the power and potential of synergy!

3.2 Business Definition

A business definition is a clear statement of the business the firm is engaged in or is planning to enter. It answers the question: What is our business, in a precise way. Consider the statements: "We are in the beauty-enriching business" (Helen and Curtis). "We are in the business of computing technology" (Intel) , "We are watch makers to the nation" (HMT); "We are in the transportation business" (TELCO). These statements define the *'space'* that the business wants to create for itself in a competitive terrain. They broadly specify the opportunities that the business may exploit within that space and the threats it may encounter from rival firms in course of time. Of course the firm, has to define its business in a broad way, keeping changing customer tastes and aspirations in mind.

Notes

D.F. Abell suggested defining business along three dimensions: *customer groups* (who is being satisfied), *customer needs* (what is being satisfied) and *alternative technologies* (how the need is being satisfied).

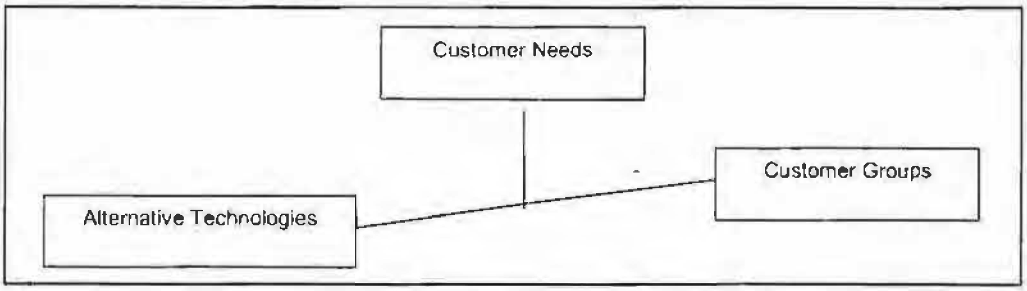


Figure 3.1: Three Dimensions of Business Definition

Most organisations, nowadays, operate several businesses. They often define their businesses in terms of products. They are in the 'Copying business' or the 'lighting business'; but Theodore Levitt argued that market definitions of a business are superior to product definitions.

Company	Product definition	Market definition
Railways	We run railways	We are a people and goods mover
Oil company	We sell gasoline	We supply energy
Films producing company	We make movies	We market entertainment
Air conditioning company	We make air conditioners	We provide climate control in the home
Publishing company	We produce and sell books	We distribute information
Copying company	We make copying equipment	We help improve office productivity.

As Drucker pointed out, there are obvious benefits of defining a business in terms of customers' needs. Products may come and go but basic needs and customer groups endure forever. So, every business needs to examine three basic questions initially before defining its nature and scope of operations:

1. Who is the customer? Where is the customer located, how to reach the customer, how does the customer buy etc.
2. What does the customer buy?
3. What does the customer consider value?

An organisation, obviously, needs to define its business covering three vital aspects: (1) The product/service offering (2) customer segment (3) value creation.

3.3 Product/Service Concepts

A product or service concept is the way in which a firm likes to position its products/services in the market, in terms of product features, quality, price, service, distribution, differentiating elements etc. While trying to position its products/services in a distinct manner, the company should not lose sight of its present and potential rivals, competitive environment, changing preferences of customers etc. If a firm tries to look at the total competitive environment this way, it can avoid what Theodore Levitt called "marketing myopia". History tells us that Railroad management thought that users wanted trains, rather than transportation and overlooked the challenge of the airlines, buses, trucks and automobiles. Coca-cola focused on its soft drink business, missed seeing the market for coffee bars and fresh fruit juices that eventually impinged on its soft-drink business. A firm, therefore, needs to define its business in a way that allows it to focus on its strengths in a pin-pointed way and march ahead of its rivals with confidence.

Customer Segment

A firm cannot appeal to all buyers in the market in the same way since buyers are too numerous, too widely scattered and too varied in their buying needs and buying practices. Also, different firms vary widely in their abilities to serve different segments of the market. Under the circumstances, covering a lot of ground without any focus does not ensure success. Each firm, therefore, needs to focus its energies and resources in a target market that is best suited to its core competencies. Target marketing basically involves three steps:

1. Market segmentation.
2. Market targeting, and
3. Market positioning

Market segmentation is the act of dividing a market into distinct groups of buyers with different needs, characteristics or behaviour who might require separate products or marketing mixes. Market targeting is the process of evaluating each market segment's attractiveness and selecting one or more segments to enter. In choosing which segments to target, a firm can choose to focus on a single segment, several segments, a specific product, a specific market or the full market. Once a firm has decided which segments to enter, it must decide on its market positioning strategy – on which positions to occupy in its chosen segments. Briefly stated, the positioning task consists of three steps: identifying a set of possible competitive advantages to build a position, picking up the right competitive advantages and effectively communicating and delivering the chosen position to the market.

Value Creation

A firm, in the final analysis, has to define the factors that offer 'value' to customers in terms of say low price, high quality, fast delivery, novel features, excellent after sales service etc. Simply stated, value is the ratio between what the customer gets (both functional and emotional benefits) and what he gives (in terms of money paid, energy expended, time spent and the opportunity scarified). To survive and flourish in a competitive market, a firm should always define its business in terms of how it is going to offer certain benefits to customers more effectively than its rivals.

The vision, mission and business definition help a firm define its basic philosophy to be adopted in the long run. Objectives and goals try to translate this rhetoric into concrete action plans in the short tem. The next section throws light on this aspect. In view of the growing importance of corporate social actions in ensuring a better standard of living to various sections of society in recent times – a separate section is also added at the end throwing light on the theoretical controversies, practical difficulties and current practices in this field.

3.4 Objectives and Goals

An objective indicates the result that the organisation expects to achieve in the long run. It is an end result, the end point, something that you aim for and try to reach. It is a desired result towards which behaviour is directed in an organisation. The organisation may or may not reach the desired state, but the chances of doing so are greater if the objectives are framed and understood properly. Objectives are the products of specific, concrete thinking. They commit persons and organisations to verifiable accomplishments. Again, objectives determine the scope of future events. They provide the spotlight on the routes over which activities are organised. They serve as reference points to concentrate resources and efforts. They determine what action to take today to obtain results tomorrow. Goals and targets are more precise and expressed in specific terms. In this section we will refer to only objectives assuming that these include the goals as well.

They are stated in precise terms as quantitatively as possible. The emphasis in goals is on measurement of progress toward the attainment of objectives. Goals have the following features, they are: (i) derived from objectives, (ii) offer a standard for measuring performance, (iii) expressed in concrete terms, (iv) time-bound and work-oriented (Ansoff).

Role of Objectives

Objectives serve the following functions:

1. *Legitimacy:* Objectives describe the purpose of the organisation so that people know what it stands for and will accept its existence and continuance. Thus, Ford sells 'American transportation', Chrysler sells 'know-how' and Godrej sells 'quality products'. Objectives help to legitimize the presence of organisation in its environment. Now the organisation can emphasise its uniqueness, identity and its raison d'être.

2. *Direction:* Objectives provide guidelines for organisational efforts. They keep attention focused on common purposes. Once objectives are formulated, they become the polar star by which the voyage is navigated. Every activity is directed toward the objectives, every individual contributes to meet the goals. 'Without seeing the target, a manager would be like a blindfolded archer-expending useless effort and creating havoc.'

3. *Coordination:* Objectives keep activities on the right track. They make behaviour in organisations more rational, more coordinated and thus more effective, because everyone knows the accepted goals to work toward. In setting effective goals, managers help members at all levels of the organisation to understand how they can 'best achieve their own goals by directing their behaviour towards, the goals of the organisation.'

4. *Benchmarks for Success:* Objectives serve as performance standards against which actual performance may be checked. They provide a benchmark for assessment. They help in the control of human effort in an organisation.

5. *Motivation:* Goals are motivators. The setting of a goal that is both specific and challenging leads to an increase in performance because it makes it clear to the individual what he is supposed to do. He can compare how well he is doing now versus how well he has done in the past and in some instance how well he is performing in comparison to others. According to Latham and Yukl, goal specificity enables the workers to determine how to translate effort into successful performance by choosing an appropriate action plan.

Characteristics of Objectives

Objectives have the following features:

1. *Objectives form a Hierarchy:* In many organisations objectives are structured in a hierarchy of importance. There are objectives within objectives. They all require painstaking definitions and close analysis if they are to be useful separately and profitable as a whole. The hierarchy of objectives is a graded series in which an organisation's goals are supported by each succeeding managerial level down to the level of the individual. The objectives of each unit contribute to the objectives of the next higher unit. Each operation has a simple objective which must fit in and add to the final objective. Hence no work should be undertaken unless it contributes to the overall goal.

2. *Objectives form a Network:* Objectives interlock in a network fashion. They are inter-related and inter-dependent. The concept of network of objectives implies that once objectives are established for every department and every individual in an organisation, these subsidiary objectives should contribute to meet the basic objectives of the total organisation. If the various objectives in an organisation do not support one another, people may pursue goals that may be good for their

own function but may be detrimental to the company as a whole. Managers have to trade off among the conflicting objectives and see that the components of the network fit one another. Because, as rightly pointed out 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. *Multiplicity of Objectives:* Organisations pursue multifarious objectives. At every level in the hierarchy, goals are likely to be multiple. For example, the marketing division may have the objective of sale and distribution of products. This objective can be broken down into a group of objectives for the product, advertising, research, promotion managers. The advertising manager's goals may include: designing product messages carefully, create a favourable image of the product in the market, etc. Similar goals can be set for other marketing managers. 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. Internal problems may hover around profitability, survival, growth, and so on. External problems may be posed by government, society, stockholders, customers, etc. In order to meet the conflicting demands from various internal and external groups, organisations generally pursue multiple objectives. Moreover, no single objective would place the organisation on a path of prosperity and progress in the long run.

4. *Long and Short-range Objectives:* Organisational objectives are usually related to time. Long-range objectives extending over five or more years are the ultimate or 'dream' objectives for the organisation. They are abstractions of the entire hierarchy of objectives of the organisation. For example, planning in India has got objectives like eradication of poverty, checking population growth through birth control. etc., which reflect certain 'ideals' the government wishes to accomplish in the long run. Short-range objectives (one-year goals) and medium-range objectives (two to four-year period goals), reflect immediate, attainable goals. The short-range and medium-range objectives are the means for achieving long-term goals and the long-term goals supply a framework within which the lower level goals are designed. Thus, all these goals reinforce each other in such a way that the total result is greater than the sum of the efforts taken individually. That is why goal setting is called a "synergistic process'. In order to remain viable, every organisation needs to set goals in all three time periods.

How are Objectives Formulated?

The central theme in traditional goal-setting is that goals are set at the top level, that is, it is a one-way process. It is believed that top management knows what is best, because only they can see the 'big picture'. This group formulates goals for middle management which, in turn, provides the necessary platform for the development of subsidiary goals at lower levels. In order to achieve results, there must be multiple goals in the form of a means-ends chain. The organisation structure should be carefully selected from out of the available alternatives so as to be effective; goals should be clear and should be prescribed at the beginning of organisational activity. The primary role of goals is to control the behaviour of organisational members. Goal-setting process is perfectly rational and there is no need to account for the difference in stated and operational goals.

The traditional goal setting process, however, suffers from many limitations: (i) Goal-setting may not always precede organisational activity. Quite often, organisations start not with goals but with resources that are readily available. (ii) The goals of many organisations are ambiguous, and it is very difficult to reduce everything in writing and interpret the same uniformly. (iii) Goals are rarely integrated into a hierarchy in the form of a means-ends chain. There are bound to be differences between stated and operational goals.

Stated vs. Operational (Official vs. Real) Goals

Stated or official goals are simply statements about desired results. They reflect what the organisation should be doing. They are normally expressed in writing and communicated to all employees by the top management through formal documents, news releases etc. Operational goals are the real goals of an organisation. They 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 abstracted phraseology. Goals like achieving 'sufficient profits' and 'market leadership' are very ambiguous and not digested by the lower level people. As goals filter down through the organisation people assign 'real' meaning to these terms. Thus, operational goals specify the way in which certain formal goals are to be achieved. For example, profit goals can be met through the pursuit of operative goals such as market penetration, emphasis on quality, employee morale, competitive pricing etc. Operative goals indicate alternative means of achieving formal goals. According to Charles Perrow, the following are the important operative goals:

1. *Environmental Goals:* These goals satisfy the people and organisations in the external environment of the organisation. For example, in profit making organisations, 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. Questions like what market should be entered, which product lines must be emphasised or lopped off are looked into while formulating and designing output goals.
3. *System Goals:* These are concerned with the maintenance of the organisation itself. Features like growth, profitability, stability and efficiency are included in this category.
4. *Product Goals:* Product goals emphasise the nature of the product delivered to customers. They define quantity, quality, variety, styling, availability or innovativeness of products.
5. *Derived Goals:* These goals refer to the utilisation of an organisation's power in secondary or derived areas like contributions to political activities, recruiting handicapped persons, promoting social service institutions etc.

3.5 Social Responsibility

Social Responsibility determines whom the organization should serve, and how the direction and purposes of the organization should be determined. Advocates of corporate social responsibility view the stakeholders in a larger perspective of the organization's and argue that business organizations must not only maximize profit but also contribute to the communities in which they operate.

"We will not either buy from or sell to companies" that do not measure up to Tata Steel's social responsibility standards, Mr. B. Muthuraman, Managing Director, Tata Steel Ltd., said at the 15th anniversary of the Institute of Directors, recently. In the context of this increasing awareness of corporate responsibility and Tisco's value systems, it is not surprising that Mr. Muthuraman gave this assurance. But what are these standards of social responsibility?

At its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to minimize any harm resulting from their activities, and to create economic, social and environmental value. This requires that before a corporation decides on an action, it must try to predict which stakeholders will be affected by given actions. The form of the interactions between a corporation and its stakeholders should be such that there is a clear understanding of the anticipated effects of the corporation's actions on those stakeholders.

For example, Nestle aggressively marketed its infant formula in East Africa. Nestle's failure to anticipate that the lack of availability of clean water would lead mothers to dilute it in contaminated water, resulted in the death of thousands of infants. The development of a corporation's moral imagination, or its ability to "envision the potential help and harm that are likely to result from a given action", should be informed by scientific and social modes of rationality. In Nestle's case, a failure to do so led to tragic results.

Companies develop strategies where they voluntarily integrate social and environmental concerns in their business operations. Organizations that are exemplary within one domain, e.g., environment or employee relations, can exhibit egregious behaviour in another, e.g., community relations or product quality. Corporate practices affect stakeholders and their environment, but no one practice can be said to fully define a company's responsibility. Making that assessment, even if we all agreed on a definition, always is a judgment call in the face of complexity and dynamism. The question that arises is, 'Responsible to whom'?

For example, a business organization may decide to use only recycled materials in its manufacturing processes. This may have a positive effect on environmental groups, but may have a negative effect on the bottom line. Shareholders who depend on dividends from the organization for their survival may be negatively affected.

Corporate Social Responsibility

An important question facing managers today is whether corporations have some responsibility to improve the world or only to improve their profits. Until the middle of the twentieth century, a firm was generally viewed, as an economic institution to provide wanted goods and services for public consumption and a profit for the owners. In the classic economic model, a firm is an economic institution governed by economic values and subject to the economic machinations of the marketplace. Two significant developments changed all of this. The first occurred in the first half of the twentieth century as professional managers replaced owners in running big companies. Professional managers played more of a trustee role; they were responsible to the board of directors and interest of suppliers, customers, employees, and other claimants. The second development was the change in public attitude towards big businesses. The Needs Theory of human behaviour states that, once basic economic necessities are satisfied, people become more concerned with psychological needs relating to status, esteem, social justice and quality of life. As Dow Votaw observed: "In a land of scarcity, economics is king; in a land of plenty, economics is just another member of the royal court". Goals, values and attitudes of various groups in society have changed significantly over the years-reflecting a greater concern for improvements in quality of life. A firm, after all, is a social institution. It does not flourish in a vacuum. In all its operations it is vitally influenced by its environment. The decisions made by corporate managers not only affect the community lives but may affect significantly both the national and international economic activity. For instance, when a manager decides to raise product prices or move out of an economically backward region, the lives of millions of people are affected. Modern corporation, thus, is the principal producer of environmental impacts. A healthy organisation should visualise these impacts realistically and deal with them firmly by converting these social problems into opportunities for successful performance and positive contribution. As Drucker has pointed out, a healthy business cannot exist in a sick, impoverished society.

Causes of Growing Concern for Social Responsibilities

There were times when business used to be run only as a sole-ownership concern. But today while that institution (sole-ownership) still continues, we are witnessing different types of business concerns (partnership firms, public and private limited companies and even multinationals etc.,) thanks to the revolution in science and technology and tremendous progress in socio-economic and political fields. In keeping with the significant changes in other walks.of life, business also has been changing its patterns, priorities and perceptions in tune with the times. Maximisation of profit used to be the only motto of all business enterprises, big or small in the past. This is no longer the case today. No business enterprise can thrive on the profit motive alone for long these days and if it has to succeed, business must be conscious and alive to its social responsibility as well.

The once all-powerful and all-conquering profit motive has been slowly but surely yielding place to a broad-based and more enlightened policy of commitment to social welfare measures. The only reason for this turnaround could be the instinct for survival. Besides there are certain other factors which have contributed to the growing concern of business for the welfare of society. These factors are:

1. *Growing Awareness due to Education:* With the growing literacy rate, more and more people are becoming increasingly aware of their right to a decent and healthy life. They have started analysing and comparing the goods and services available in the market in terms of quality, purity and cost. Keeping in view the public demand, businessmen have started thinking more in terms of quality and cost-effectiveness than in terms of profit alone. Spread of education has helped the business community also to understand their role and the changing patterns in society. They have, therefore, chosen willy-nilly to adopt the twin objectives of profit and social responsibility in the best interests of both business and society.

2. *Newspapers and Consumer Organisations:* The proliferation of language and dialect newspapers has made it easier and cheaper to reach out to the consumes even in far-flung areas. Besides, of late, various 'consumer organisations' have been coming up in urban areas to protect the interests of consumers and to expose the malpractices or bad elements of business with the sole object of enlightening or forewarning the consumers. Due to these developments and the fear of adverse publicity, businessmen have, by and large, learnt to live for the sake of society also in a purposeful and meaningful way, thus keeping a check on their profit motive.

3. *Fear of Government's Interference:* In the event of any business enterprise persisting in its fraudulent or deceitful ways to quench its hunger for more profit, the enlightened public can, through the various means at its command, compel the government to introduce legislation to check the malpractices of business. The threat of public opinion building up against it and the ever-increasing fear of public regulation through legislative measures have left businesses with no other alternative except to fall in line with the demands of society. The avaricious businessmen have been forced to desist from resorting to dubious means to augment profits.

4. *Trade Union Movement:* Well-organised Trade Unions have become omnipresent and omnipotent in almost all big business establishments these days. The bargaining power and strength of these Unions keep the Captains of Industry on tenterhooks and ensure that they behave responsibly towards not only employees but also the public at large.

5. *Public Image:* Building up a better public image is essential for any business to survive and grow. Hence, enlightened entrepreneurs or professional managers of today are all locked up in a healthy competition to build up their public image, even if it means lesser and lesser profits.

6. *Competitive Market Forces:* The cut-throat competition in the market has certainly played its part in forcing the businessmen to narrow down their profits in the interests of survival. Thanks to the competitive market forces, businessmen have come to accept the reality and thought it wiser and safer to adopt a more reasonable and durable means to keep their profit motive in check in the larger interests of business.

7. *Public Relations:* Maintaining good public relations is sine qua non to success in business. Whether a customer or an employee or a government servant-a businessman has to deal with all of them in a humble and polite way. This constant interaction with many types of persons, both literate and illiterate, makes it imperative for him (businessman) to harp on the theme of social good rather than his own personal good which creates an aversion or ill-feeling in the minds of people against such selfish businessmen. Good public relations would teach him how to behave and respect other peoples' aspirations as well.

8. *Managerial Skills:* The Industrial Revolution has brought in its wake a new breed of competent and professional managers who vie with one another in evolving and developing a more durable and balanced trade policy. Their competence and managerial skills have helped the business enterprises to strike and maintain a healthy balance between business interests and social obligations.

While the above factors have played their role in awakening a sense of public good in businessmen, by and large, the question t hat inevitably arises is, why should a business enterprise at all think of the welfare of the society at large?

Areas of Social Responsibility

Let us now identify the areas in which business can effectively discharge its social obligations.

1. *Pollution Control:* Today, perhaps, the biggest problem confronting society is pollution of all kinds-air, water, sound, etc. Installing pollution controlling devices and other related actions might cost the business considerably in terms of money and effort. It might also mean lesser profits. But the amount of goodwill and image that the business concern comes to enjoy as a result of such voluntary steps will more than offset the losses, if any, envisaged in the beginning. It is, therefore, necessary that business must take preventive measures for pollution control and it must view the costs involved as a long-term investment in public image.

   ABB: At ABB's Vadodra facility, vermiculture has helped the company dispose off tonnes of wooden wastes besides generating 5,000 tonnes of organic manure per month.

   Coromandel Fertilizers: With investments of around ₹ 40 crore, the company has been able to set up a fluorine recovery unit, effluent treatment plant, molten sulphur handing facility and install pollution control equipment at the Visakhapatnam city where the plant covers an area of around 500 acres. The setting up of the four-stage scrubbing system recently has led to reduction in ammonia emission elastically.

2. *Health and Hygiene:* A manufacturing company or a factory throws up lot of wastes and chemicals which prove to be health hazards. Although, normally business takes all preliminary precautions to keep away from inhabited areas and to safeguard the health and hygiene of workers, it usually tries to shirk its responsibility towards the people residing in the vicinity of the business or factory premises. If business forgets or conveniently ignores its obligation to safeguard the health of not only the workers but also the people outside the business premises, government or society will force it to see reason which might prove most costly in terms of money and reputation. Therefore, business must realise that to protect the public interest is in its own interest.

   TISCO: The Tata Steel Rural Development Society delivers health care services to the rural population around its operational areas through the Life Line Express. The company uses mobile medical care vans to reach out to rural areas. Through 25 clinics in Jamshedpur, it serves over 6 lakh people; including non-employees.

   NALCO: National Aluminium Company has given great importance to medical and health programmes. Full-fledged hospitals with outdoor and specialised indoor treatment facilities at Damanjodi and Angul have been established. The facilities are extended to nearby villages also. Regular health consultation sessions, family welfare camps, rehabilitation of handicapped persons are the major thrust areas at NALCO.

3. *Training and Self-help:* Big business provides big opportunities for both direct and indirect employment. Self-employed persons outside the premises of a factory can contribute to the growth of business if they are well aware of the product and its raw materials needed by the manufacturing company. In that event business might not have to depend on suppliers at far off places. If the people in the surrounding areas of the business premises are enlightened about the product and its raw material requirement and also trained to develop the necessary skills, they will readily come forward to serve the business interests which by the way helps them to earn their livelihood. Hence, business can profitably think of educating and training the people outside the factory and the cost involved might be meagre when compared to the benefits accruing to it by such a wise and farsighted step.

4. *Philanthropic Activities:* The performance of some charitable trusts promoted by big business houses is far from satisfactory and even smacks of favouritism and partisan ends. Genuine philanthropic activity must benefit the people in their day-to-day life. Hence, by building educational institutions or hospitals, business will be spending its enormous profits in a useful and meaningful way while at the same time showing its real and genuine concern for the welfare of the society at large. Such philanthropy will help build a bridge of goodwill between the business and society.

Different Interest Groups

There are different interest groups both within and outside the business organisation whose, often, conflicting interests business has to keep in view, reconcile and satisfy in a balanced manner. These different interest groups are:

1. *Owners or Shareholders:* The social responsibilities of business to this group include: (a) fair and regular return on investment, (b) safe and steady appreciation of investment, (c) periodical disclosure of full and accurate information regarding financial and functional aspects of business and (d) reasonable representation to minority shareholders to participate in business management.

2. *Employees:* The labour force is the mainstay of any business and therefore, the latter's responsibility towards it is all the more greater. These responsibilities are: (a) fair wages, (b) security of employment, (c) safe and secure working conditions, (d) representation in decision-making bodies which affect their working life, (e) providing fair opportunity for personal advancement through education and training, (f) meaningful freedom and job satisfaction and (g) humane treatment.

3. *Consumers:* The obligations of business to this group are: (a) supply goods of right quality, and right quantity at the right place and time at reasonable prices, (b) provide goods and services according to the needs, tastes and preferences of different classes of customers, (c) inform and educate the customers on the availability and use of alternative products which may be cheaper and better, (d) be honest and truthful in advertising the product, (e) provide prompt, efficient and effective after sales service, (f) extend a hearty and courteous service, and (g) avoid unhearty trade practices like black-marketing, hoarding and adulteration, etc.

4. *Responsibility to Creditors and Suppliers:* The responsibilities include: (a) provide accurate information regarding the financial health of the firm, (b) ensure a reasonable price for the articles supplied, and make prompt repayments (including interest on borrowings); there should be fairness in transactions, and (c) promote a healthy atmosphere where creditors, suppliers and other interest groups are treated as partners in a co-operative endeavour.

Notes

5. *General Public or Community at Large:* The obligations of business to this group include: (a) proper and effective utilisation of natural resources to produce cheaper and better goods, thereby rendering help to generate indirect self-employment opportunities, (b) maintain a healthy environment free from all sorts of pollution in and around the business area to protect the health interests of people residing in the vicinity, (c) contribute liberally and voluntarily to the community development and public utility services which promote communal harmony and cultural enrichment, (d) help maintain law and order in the society by refraining from aiding and abetting anti-social elements or activities and (e) avoid exploiting the religious sentiments or backwardness of the minorities and weaker sections of society.

6. *Government:* Business will be discharging its duties to the government if it (a) pays taxes regularly and correctly, (b) applies faithfully all the laws governing regulation of business, (c) avoids political lobbying through donations to political parties, (d) follows a fair trade policy and refrains from unhealthy business practices like hoarding, black-marketing and corruption etc., (e) contributes its mite to the socio-economic growth and goals of the nation, (f) helps in tackling the problems of unemployment, poverty and price rise, etc. and (g) helps in establishing a secular, democratic and socialistic pattern of society.

Student Activity

Explain the CSR strategy of Tata Motors.

3.6 Summary

Synergy means the sum total outcome of several persons working together is more than the sum of its individual parts. Companies develop strategies where they voluntarily integrate social and environmental concerns in their business operations. Organizations that are exemplary within one domain, e.g., environment or employee relations, can exhibit egregious behaviour in another, e.g., community relations or product quality. Corporate practices affect stakeholders and their environment, but no one practice can be said to fully define a company's responsibility.

3.7 Keywords

Synergy: When the sum total outcome of several persons working together is more than the sum of its individual parts.

Social Responsibility: Social Responsibility determines whom the organization should serve, and how the direction and purposes of the organization should be determined.

3.8 Review Questions

1. What is meant by term synergy?
2. What is the relevance of synergy?
3. Discuss the role of social responsibility in an organisation.

3.9 References and Further Readings

- Porter, M. E. (2019). Competitive strategy: Techniques for analyzing industries and competitors (2nd ed.). Free Press.
- Grant, R. M. (2021). Contemporary strategy analysis (11th ed.). Wiley.
- Hill, C. W. L., & Jones, G. R. (2019). Strategic management: Theory and cases: An integrated approach (13th ed.). Cengage Learning.

Unit 4 Understanding External Environment

Unit Structure

4.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Analyse external environment
- Explain the segments of general environment
- State the global effect
- Determine industry attractiveness
- Define strategic groups

4.1 Introduction

External analysis is the process of scanning and evaluating a company's various external environmental sectors in order to determine positive and negative trends that could impact upon organizational performance. It's how strategists determine the opportunities (those positive external environmental trends or changes that will help the company improve its performance) and the threats (those negative external environmental trends or changes that will hinder the company's performance).

4.2 External Environmental Analysis

Each company must continue to analyse the external environment to identify and deal with new threats and opportunities. This means that, given the technological and globalization changes that characterize today's competitive landscape, external environmental analysis should be treated as a continuous process.

Notes

There are four primary components of external analysis:

1. *Scanning:* Scanning entails the study of all segments in the general environment. Companies use the scanning process to either detect early warning signals regarding potential changes or to detect changes that are already underway most cases, information and data being collected or observed are ambiguous, incomplete! and appear to be unconnected. Scanning is most important in highly volatile environments, and the scanning system should fit the organizational context (i.e., scanning systems designed for volatile environments are not suitable for: companies competing in a stable environment).
2. *Monitoring:* Monitoring represents a process whereby strategists observe environmental changes (over time) to see if, in fact, an important trend begins to emerge. The critical issue in monitoring is that strategists be able to detect meaning from the data and information collected during the scanning process (this data is generally ambiguous, incomplete and unconnected). By continuously monitoring emerging trends in the political, regulatory, economic, and technological environments, companies should ensure that they are not caught off guard by material changes in the competitive landscape for their businesses. Also by monitoring the environment they may be able to identify potential opportunities to better serve their customers.
3. *Forecasting:* The next step is for strategists to take the information and data gathered during the scanning and monitoring phases and attempt to project forward. Forecasting represents the process where strategists develop feasible projections of what might happen, and how quickly, as a result of the changes and trends detected through scanning and monitoring. For example, PaperExchange.com maintains its website to enable paper suppliers and buyers from 40 countries to negotiate for products ranging from containerboard to writing paper.
4. *Assessing:* Assessing represents the step in the external analysis process where all of the other steps come together. The objective of assessing is to determine the timing and significance of the effects of changes and trends in the general environment on the strategic management of a company. For example, toy makers, especially Hasbro and Mattel, and retailing giants Wal-Mart and Toys'R Us, are becoming more committed to selling their products (including toys) through electronic commerce, a trend which should affect eToys' strategic decisions.

In fact, a major challenge for managers and companies engaging in the process of external analysis is to recognize biases and assumptions that may affect the analysis process. This is important because biases and assumptions may limit the accuracy of forecasts and assessments.

4.3 Segments of the General Environment

The general environment is made up of five segments: demographic, economic, political/legal, socio-cultural and technological. The challenge is to scan all five segments of the general environment, focusing the primary effort on those elements in each segment of the general environment that have the greatest potential impact on the company. Not to forget, any analysis of the general environment and its segments should recognize global elements that may have an impact on the company.

Table 4.1: Some Social, Cultural, Demographic and Environmental Variables

Social Variables	Cultural Variables
1. Life expectancy rates	1. Attitudes towards business
2. Average level of education	2. Attitudes towards saving & investing
3. Number of marriages	3. Attitudes towards product quality & customer service
4. Number of divorces	4. Trust and attitude towards government
5. Number of births	5. Attitudes towards racial equality & foreigners

Contd...

6. Number of deaths	6. Bying habits
7. Number of social interest groups	7. Ethical concerns
8. Social programmes	8. Attitudes towards authority
9. Child bearing rates	9. Attitudes towards work, career and retirement
10. Social responsibility	10. Attitudes towards and value placed on leisure time.
11. Use of birth control	
Environmental Variables	**Demographic Variables**
1. Recycling waste management	1. Population changes by race, age, sex, and level of affluence
2. Air and water pollution	2. Population changes by city, state, and country
3. Pollution control	3. Regional changes in tastes and preferences
4. Ozone depletion	4. Number of women and minority workers
5. Endangered species	5. Number of college graduates by geographic area
6. Government regulation	6. Immigration and emigration rates
7. Energy conservation	7. Location of retailing, manufacturing, and service businesses
8. Traffic congestion	8. Per capita income
9. Inner-city environment	9. Average disposable income

Demographic Segment

The demographic segment is concerned with a population's size, age structure, geographic distribution, ethnic make-up, and distribution of income. While each of the major elements of this segment are discussed below, the challenge for strategists is to determine what the changes, that have been identified in the demographic characteristics or elements of a population, imply for the future strategic competitiveness of the company.

1. ***Population Size:*** While population size itself, large or small, may be important to companies that require a "critical mass" of potential customers, changes in the specific make-up of a population's size may have even more critical implications. Among the most important changes in a population's size are:
   (a) changes in a nation's birth rate and/or family size;
   (b) increases or declines in the total population;
   (c) effects of rapid population growth on natural resources or food supplies.
2. ***Age Structure:*** Changes in a nation's birth rate or life expectancy can have important implications for companies. Are people living longer? What is the life expectancy of infants? There will be implications for the health care system (for companies serving that segment) and for the development of products and services targeted at older (or younger) population.
3. ***Geographic Distribution:*** Population shifts from one region of a nation to another or from metropolitan to non-metropolitan areas may have an impact on a company's strategic competitiveness. Issues that should be considered include:
   (a) The attractiveness of a company's location may be influenced by governmental support.
   (b) Companies may have to consider relocation if population shifts have a significant impact on the availability of a qualified workforce.
   (c) The trend toward working-at-home and commuting electronically on the "information highway" may imply changes in recruiting and managing the workforce.

4. ***Ethnic Mix:*** This reflects the changes in the ethnic make-up of a population and has implications both for a company's potential customers and for the workforce. Issues that should be addressed include:
   (a) What do changes in the ethnic mix of the population imply for product and service design and delivery?
   (b) Will new products and services be demanded or can existing ones be modified?
   (c) How will changes in the ethnicity of a population affect the composition of the workforce?
   (d) What adjustments are needed to accommodate an older workforce? Are managers prepared to manage a more culturally diverse workforce?
   (e) How can the company position itself to take advantage of increased workforce heterogeneity?
5. ***Income Distribution:*** Changes in income distribution are important because changes in the levels of individual and group purchasing power and discretionary income often result in changes in spending (consumption) and savings patterns. Tracking, forecasting, and assessing changes in income patterns may identify new opportunities for companies.

Socio-cultural Segment

The socio-cultural segment is concerned with different societies' social attitudes and cultural values. This segment is important because changes here are reflected in changes in the society's economic, demographic, political/legal, and technological segments.

Strategists need to pay special attention to socio-cultural changes and the effects that they may have on:

- Workforce composition, and the implications for managing, resulting from an increase in the number of women, and increased ethnic and cultural diversity.
- Changes in attitudes about the quality of work life.
- Environmental concerns.
- Shifts in work and career preferences, including an increase in new business formation by women.
- Shifts in product and service preferences.

Economic Segment

The economic segment of the general environment refers to the nature and direction of the economy in which a company competes or may compete. Strategists must scan, monitor, forecast, and assess a number of key economic indicators or elements mentioned in Box 4.1 for both domestic and key international markets.

In addition, the implications of changes and trends in the economic segment may affect the political/legal segment both domestically and in other global markets. This may be of critical importance as nations eliminate or reduce trade barriers through such mechanisms as NAFTA (the North American Free Trade Agreement) and the WTO (World Trade Company), and as the European Union moves closer to full monetary union.

Notes

Box 4.1: Key Economic Variables

• Shift to a service economy	• Demand shifts for different categories of goods and services
• Availability of credit	• Income differences by region and consumer groups
• Level of disposable income	• Price fluctuations
• Propensity of people to spend	• Exportation of labour and capital
• Interest rates	• Monetary & Fiscal policies
• Inflation rates	• Stock market trends
• Tax rates	• Foreign countries' economic conditions
• Money market rates	• Import/export factors
• Government budget deficits	• Company of Petroleum Exporting Countries (OPEC) policies
• Gross national product trend	• Coalitions of Lesser Developed Countries (LOC) policies
• Consumption patterns	• Unemployment trends
• Trade Block Formations	• Worker productivity levels

Political/Legal Segment

The political/legal segment is the arena in which companies and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding the interactions among nations. In other words, this segment is concerned with how interest groups and companies attempt to influence representatives of governments (and governmental agencies) and how they influence them, ill turn.

Because of the influence that this segment can have on the nature of competition as well as on the overall profitability of industries and individual companies, strategists must assess changes and trends in administration philosophies regarding the variables mentioned in the Box 4.2.

Box 4.2: Important Political/Legal Variables

• Governing regulations or deregulations	• Import-export regulations
• Changes in tax laws	• Fiscal and monetary policy changes
• Special tariffs	• Political conditions in foreign countries
• Political action committees	• Special local, state, and federal laws
• Legislation on equal employment	• Lobbying activities
• Number, severity, and location of government protests	• Size of government budgets
• Number of patents	• World oil, currency, and labour markets
• Changes in patent laws	• Location and severity of terrorist activities
• Environmental protection laws	• Local, state, and national elections
• Level of defence expenditures	• level of government subsidies
	• Antitrust legislation

For example, how can individual companies and industries manage the effects of free trade, which will lower entry barriers for new, lower-cost competitors? How might companies position themselves to take advantage of emerging, free-market economies? Questions that are haunting the management of most of the companies in India today.

Notes

Technological Segment

Because the technology is a key driver of the new competitive landscape, technological changes can have broad effects on society. The technological segment includes institutions and activities involved with creating new knowledge and translating that knowledge into new outputs: new products, processes and materials.

Companies should pay careful attention to a number of elements in the technological segment. These include monitoring, forecasting, and assessing the implications of global and multi-industry changes in:

- the scope and speed of product innovation
- the scope and applicability of process innovation
- application of knowledge
- advances in communications and information management technology

4.4 Global Effect

Today's competitive landscape requires that companies also must analyse global factors. Among the global factors that should be assessed are:

- Potential impact of significant international events such as peace in the Middle East or the recent approval of China's entry into the WTO.
- Identification of both important emerging global markets and global markets that are changing. This includes shifts in the newly industrialized countries in Asia that may imply the opening of new markets for products or increased competition from emerging globally competitive companies in countries such as South Korea.
- Differences between cultural and institutional attributes of individual global markets (The focus in Korea is on Inhwa, or harmony, based on respect for hierarchical relationships and obedience to authority. The focus in China is on Guanxi; or personal relationships. The focus in Japan is on Wa, or group harmony and social cohesion).

We will look at these factors in detail when we will discuss the International Stra tegy.

4.5 Industry Environment Analysis

An industry is a group of companies producing products that are close substitutes for each other. As they compete for market share, the strategies implemented by these companies influence each other and include a broad mix of competitive strategies as each company pursues strategic competitiveness and above-average returns.

It should be noted that, unlike the general environment, which has an indirect effect on strategic competitiveness and company profitability, the effect of the industry environment is direct Industry, and individual company, profitability and the intensity of competition in an industry are a function of five competitive forces as presented in Figure 4.1.

Notes

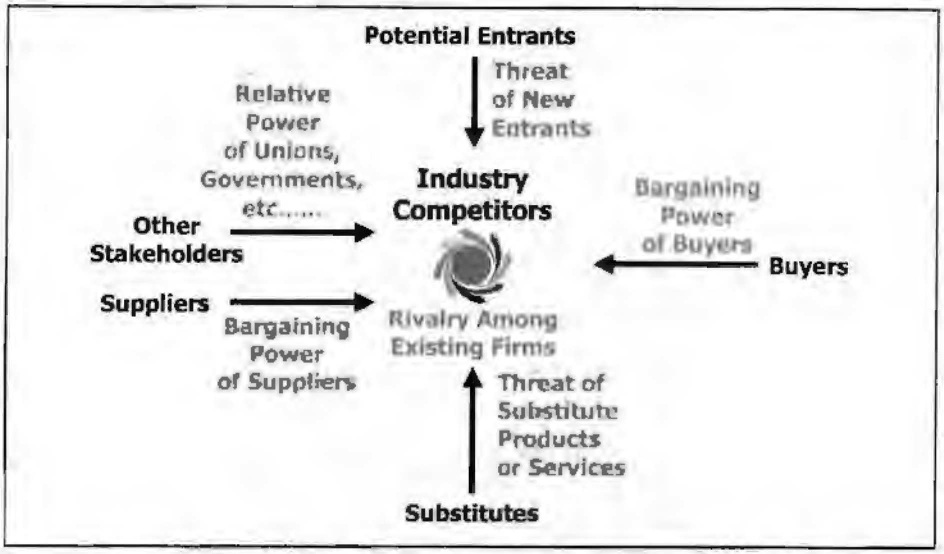


Figure 4.1: Porter's Five Forces Model of Competition

Michael Porter's Five Forces Model of Competition indicates that these five forces interact to determine the intensity or strength of competition, which ultimately determines the profitability of the industry. Assessing the relative strength of the five competitive forces is important to a company's ability to achieve strategic competitiveness and earn above-average returns.

Viewed differently, competition should be viewed as groupings of alternative ways that customers can obtain desired results. Thus, any analysis of an industry must expand beyond the traditional practice of concentrating on direct competitors to include potential competitors. For example,

- suppliers can become competitors by integrating forward.
- buyers or customers can become competitors by integrating backward.
- companies, who are not competitors today, could produce products that serve as substitutes for existing products offered by companies in an industry, transforming themselves into competitors.

Threat of New Entrants

New entrants to an industry are important because, with new competitors, the intensity of competitive rivalry in an industry generally increases. This is because new competitors may bring substantial resources into the industry and may be interested in capturing a significant market share. If a new competitor brings additional capacity to the industry when product demand is not increasing, prices that can be charged to consumers generally will fall. One result may be a decline in sales revenues and lower returns for many companies in the industry.

The seriousness or extent of the threat of new entrants is affected by two factors: (1) barriers to entry and (2) expected reactions from, or the potential for retaliation by, incumbent companies in the industry.

Barriers to Entry

Barriers to entering an industry are present when entry is difficult or when it is too costly and places potential entrants at a competitive disadvantage (relative to companies already competing in the industry). There are seven factors that represent potentially

Notes

significant entry barriers that can emerge as an industry evolves or might be explicitly "erected" by current participants in the industry to protect profitability by deterring new competitors from entry.

1. *Economies of Scale* refer to the relationship between quantity produced and unit cost. As the quantity of a product produced during a given time period increases, the cost of manufacturing each unit declines.

   Economies of scale can serve as an entry barrier when existing companies in the industry have achieved these scale economies and a potential new entrant is only able to enter the industry on a small scale (and produce at a higher cost per unit). For example, entry for a new company in the FMCG sector at a big scale is difficult because of presence of the multiple players who have already achieved the economies of scale.

   Companies that produce multiple customised products or that enter an industry on a large-enough scale can sometimes overcome economies of scale as a potential entry barrier. However, because large-scale entry may greatly increase industry capacity, it may risk a strong reaction from established companies.

2. *Product Differentiation:* Customers may perceive that products offered by existing companies in the industry are unique as a result of service offered, effective advertising campaigns, or being first to offer a product or service to the market. If customers perceive a product or service as unique, they generally are loyal to that brand. Thus, new entrants may be required to spend a great deal of money over a long period of time to overcome customer loyalty to existing products. For example, Titan's offering of quartz watches in a market, which was dominated by HMT, enabled it to become the dominant player in a short span of time.

3. *Capital Requirements:* Companies choosing to enter any industry must commit resources for facilities, to purchase inventory, to pay salaries and benefits, etc. While entry may seem attractive (because there are no apparent barriers to entry), a potential new entrant may not have sufficient capital to enter the industry. For example, entry into the petrochemical industry is characterised by huge capital investments.

4. *Switching Costs* are the one-time costs customers will incur when buying from a different supplier. These can include such explicit costs as retraining of employees or retooling of equipment as well as the psychological cost of changing relationships. Incumbent companies in the industry generally try to establish switching costs to offset new entrants that try to win customers with substantially lower prices or an improved (or, to some extent, different) product. For example, switching costs have to be borne by companies for switching from Microsoft's Windows to other operating systems creating entry barriers in the market for operating systems.

5. *Access to Distribution Channels:* As existing companies in an industry generally have developed effective channels for distributing products, these same channels may not be available to new companies entering an industry. Thus, access (or lack thereof) may serve as an effective barrier to entry.

6. *Cost Disadvantages Independent of Scale:* Existing companies in an industry often are able to achieve cost advantages that cannot be costlessly duplicated by new entrants (other than those related to economies of scale and access to distribution channels). These can include proprietary process (or product) technology, more favourable access to or control of raw materials, the best locations, or favourable government subsidies. For example, Vesuvius Industries has a unique refractory product finding application in steel industry, that cannot be made by other companies because the product technology is proprietary. Another example could be of pharmaceuticals where new products discovered are under patent protection for a period of time.

7. *Government Policy:* Governments (at all levels) are able to control entry into an industry through licensing and permit requirements. For example, at the company level, entry into the banking industry is regulated at the central levels, while liquor sales are regulated at the state and local levels.

   On the other end is the monopolistic nature (on a market-by-market basis) of the public utility industry including local telephone service, water, electric power, etc.

Even if a company concludes that it can successfully overcome all of the entry barriers, it still must take into account or anticipate reactions that might be expected from existing companies.

Bargaining Power of Suppliers

The bargaining power of suppliers depends on suppliers' economic bargaining power relative to companies competing in the industry. Suppliers are powerful when company profitability is reduced by suppliers' actions. Suppliers can exert their power by raising prices or by restricting the quantity and/or quality of goods available for sale.

Suppliers are powerful relative to companies competing in the industry when:

- the supplier segment of the industry is dominated by a few large companies and is more concentrated than the industry to which it sells;
- satisfactory substitute products are not available to buyers;
- buyers are not a significant customer group for the supplier group;
- suppliers' goods are critical to buyers' marketplace success;
- effectiveness of suppliers' products has created high switching costs for buyers;
- suppliers represent a credible threat to integrate forward into the buyers' industry, especially when suppliers have substantial resources and provide highly differentiated products.

Bargaining Power of Buyers

While companies competing in an industry seek to maximise their return on invested capital (and earn above-average returns), buyers are interested in purchasing products at the lowest possible price (the price at which sellers will earn the lowest acceptable return). To reduce cost or maximise value, customers bargain for higher quality or greater levels of service at the lowest possible price by encouraging competition among companies in the industry.

Buyer groups are powerful relative to companies competing in the industry when:

- buyers are important to sellers because they purchase a large portion of the supplier industry's total sales;
- supplier industry's products represent a significant portion of the buyers' costs;
- buyers are able to switch to another supplier's product at little, if any, cost;
- suppliers' products are undifferentiated and standardised;
- buyers represent a credible threat to integrate backwards into the suppliers' industry because of resources or expertise.

Threat of Substitute Products

All companies must recognise that they compete against companies producing substitute products, those products that are capable of satisfying similar customer needs but come from outside the industry and thus have different characteristics. In effect, prices charged for substitute products represent the upper limit on the prices that suppliers can charge for their products.

The threat of substitute products is greatest when:

- buyers or customers face few, if any switching costs;
- prices of the substitute products are lower;
- quality and performance capabilities of substitutes are equal to or greater than those of the industry's products.

Companies can offset the attractiveness of substitute products by differentiating their products in ways that are perceived by customers as relevant. Viable strategies might include price, product quality, product features, location or service level.

Table 4.2: Examples of Traditional and Substitute Products and their Usage

Traditional product	Substitute product	Usage
Overnight delivery	Fax machines Internet	Document delivery Message delivery
Sugar	Sugar free	Sweetener
Glass	Plastic	Containers
Paper bags	Plastic bags	Flexible packaging

Intensity of Rivalry among Competitors

The intensity of rivalry in an industry depends upon the extent to which companies in an industry compete with one another to achieve strategic competitiveness and earn above-average returns because success is measured relative to other companies in the industry. Competition can be based on price, quality or innovation.

Because of the interrelated nature of companies actions, action taken by one company generally will result in retaliation by competitors (also known as competitive actions and reactions). For example, consider the speed with which some companies have expanded into Internet activities to counter similar strategies of competitors. In addition to actions and reactions that result as companies attempt to offset other competitive forces in the industry, threat of new entry, power of suppliers and buyers, and threat of substitute products, the intensity of competitive rivalry is also a function of the following factors:

1. ***Numerous or Equally Balanced Competitors:*** Industries with a high number of companies can be characterised by intense rivalry when companies feel that they can make competitive moves that will go unnoticed by other companies in the industry. However, other companies will generally notice these moves and offer countermoves of their own in response. Patterns of frequent actions and reactions often result in intense rivalry, such as in local restaurant, retailing, or dry-cleaning industries.
2. ***Slow Industry Growth:*** When a market is growing at a level where there seem to be "enough customers for everyone," competition generally centres around effective use of resources so that a company can effectively serve a larger, growing customer base. Because of sufficient growth in the market, companies do not concentrate on taking customers away from other companies, which was the case in the personal computer industry in the 1980s. During this stage of the industry cycle, companies are more concerned with establishing a position and achieving economies of scale than with taking share away from competitors because of the level of growth in the market.

3. ***High Fixed Costs or High Storage Costs:*** When an industry is characterised by high fixed costs relative to total costs, companies produce in quantities that are sufficient to use a large percentage, if not all of their production capacity so that fixed costs can be spread over the maximum volume of output. While this may lower per unit costs, it also can result in excess supply if market growth is not sufficient to absorb the excess inventory. The intensity of competitive rivalry increases as companies utilise price reductions, rebates, and other discounts or special terms to reduce inventory.

4. ***Lack of Differentiation or Low Switching Costs:*** Products that are not characterised by brand loyalty or perceived uniqueness are generally viewed by buyers as commodities. For such products, industry rivalry is more intense and competition is based primarily on price, service to the customers, and other features of interest to consumers.

5. ***Capacity Augmented in Large Increments:*** In industries where scale economies dictate that additions to production capacity must be made in large increments (such as in steel and automobile manufacturing), adding capacity may result in excess production capacity in an industry. Competitive rivalry will increase (and industry profitability will decrease) as companies engage in price-cutting to increase demand to match the new production level.

6. ***Diverse Competitors:*** Industries also may be characterised by companies having dissimilar goals and cultures, making it difficult to determine any pattern of industry competition. Often, companies may engage in competitive actions merely to determine how their competitors might react. Given the uncertainty and unpredictability of competitive rules, industry profitability might be reduced.

7. ***High Strategic Stakes:*** The intensity of competitive rivalry increases when success in an industry is important to a large number of companies (such as the domestic airline industry following deregulation). For example, the success of a diversified company may be important to its effectiveness in other industries, especially when the company is interdependent or related industries. Geographic stakes may also be high.

8. ***High Exit Barriers:*** Exit barriers, created by economic, strategic, and emotional factors that cause companies to remain in an industry, even though the profitability of doing so is in question, also can increase the intensity of competition in an industry. The higher the barriers to exit, the greater the probability that competitive actions and reactions will include price-cuts and extensive promotions.

4.6 Interpreting Industry Analysis

Effective industry analyses are products of careful study and interpretation of data. Because of globalization, international markets and rivalry must be included in the company's analyses; in fact, research shows international variables may have more impact on strategic competitiveness than domestic ones, in some cases. Some examples of strategic importance of an industry's key economic characteristics are given below in Table 4.3.

Following the study of the five industry forces, the company has the insights required to determine an industry's attractiveness in terms of the potential to earn adequate or superior returns on its invested capital. In general, the stronger the competitive forces; the lower is the profit potential for an industry's companies. An unattractive industry has low entry barriers, suppliers and buyers with strong bargaining positions, strong competitive threats from product substitutes, and intense rivalry among competitors, which makes it difficult for companies to achieve strategic competitiveness and earn above-average returns.

Notes

Table 4.3: Examples of the Strategic Importance of an Industry's Key Economic Characteristics

Factor/Characteristic	Strategic Importance
Market size	Small markets don't tend to attract big/new competitors; large markets often draw the interest of companies looking to acquire competitors with established positions in attractive industries.
Market growth rate	Fast growth breeds new entry; growth slowdowns spawn increased rivalry and a shake out of weak competitors.
Capacity surpluses or shortages	Surpluses push prices and profit margins down; shortages pull them up.
Industry profitability	High-profit industries attract new entrants; depressed conditions encourage exit.
Entry/exit barriers	High barriers protect positions and profits of existing companies; low barriers make existing companies vulnerable to entry.
Product is a big-ticket item for buyers	More buyers will shop for lowest price.
Standardised products	Buyers have more power because it is easier to switch from seller to seller.
Rapid technological change	Raises risk factor; investments in technology facilities! equipment may become obsolete before they wear out.
Capital requirements	Big requirements make investment decisions critical; timing becomes important; creates a barrier to entry and exit.
Vertical integration	Raises capital requirements; often creates competitive differences and cost differences among fully versus partially versus non-integrated companies.
Economies of scale	Increases volume and market share needed to be cost competitive.
Rapid product innovation	Shortens product life cycle; increases risk because of opportunities for leap frogging.

An attractive industry has the mirror image of these features and offers potential for favourable performance. Some indicators of an attractive industry are given below:

- high returns on capital for players accounting for most of the market;
- a stable or rising average industry return on. capital; clear barriers to entry, keeping out many new entrants;
- capacity at or below the level of demand, and low exit barriers; reasonable or high market growth;
- little or no threat from substitutes (competing industries); low bargaining power of suppliers relative to the industry;
- low bargaining power of customers relative to the industry.

Characteristics of attractive and unattractive industries are summarized in Table 4.4.

Table 4.4: Characteristics of Attractive and Unattractive Industries

Industry Characteristic	Attractive	Unattractive
Threat of New Entry	High	low
Bargaining Power of Suppliers	low	High
Bargaining Power of Buyers	low	High
Threat of Substitute Products	low	High
Intensity of Competitive Rivalry	low	High

4.7 Determining Industry Attractiveness

The following questionnaire will help determine the industry attractiveness for entry:

1. ***What is the weighted average ROI (Return on Investment) in your industry over the past five years?***

   Score: whatever the average ROI is, with a minimum of 0 and up to a maximum of 40.

2. ***What is the trend in ROI over the past five years?***

   Score: (a) falling - no points; (b) erratic and no trend - 3 points; (c) stable - 7 points; (d) rising - 10 points.

3. ***How substantial are the barriers stopping new entrants to the industry?***

   Score: (a) few barriers - no points; (b) low barriers - 3 points; (c) fairly high barriers - 7 points; (d) very high barriers - 10 points.

4. ***What is your best estimate of the next five years' average annual market growth?***

   Score: (a) negative - no points; (b) 0-5 per cent p.a. - 3 points; (c) 5-10 per cent points; (d) over 10 per cent - 10 points.

5. ***What is the current balance in the industry between customer demand and the total industry capacity?***

   Score: (a) there is serious industry over capacity, and no plans to remove it minus 20 points; (b) there is serious over capacity, but plans are in place to remove the excess - minus 10 points; (c) there is minor excess capacity - minus 5 points; (d) supply is in line with demand, or lower than demand - no points.

6. ***What is the threat from substituting products, services or technologies?***

   Score: (a) serious threat - minus 20 points; (b) may be a serious threat, but uncertain - minus 10 points; (c) only minor threats expected - minus 3 points; (d) threats do not appear to exist and unlikely - no points.

7. ***What relative bargaining power do the industry's suppliers have?***

   Score: (a) the suppliers are more concentrated and can dictate terms to the industry - no points; (b) the suppliers are slightly more powerful and concentrated than the industry - 3 points; (c) the suppliers are slightly less Powerful than the industry - 7 points; (d) the industry is more concentrated and more powerful than suppliers and can dictate terms to them - 10 points.

8. ***What relative bargaining power do the industry's customers have?***

   Score: (a) the customers are more concentrated and powerful - no points; (b) the customers are slightly more powerful than the industry - 7 points; (c) there is a rough balance between the power and concentration of customers and the industry - 12 points; (d) the industry is more concentrated than the customers and has more collective bargaining power because there are few suppliers and little choice - 20 points.

Notes

Interpreting the Scores

The scores will range between minus 40 and plus 100. Industry attractiveness can be interpreted as follows:

Score	Interpretation
Negotive [minus 1 to minus 401	Try to get out of the industry. If you are still reporting profits or anyone is foolish enough to buy the business,sell.
0 to 25	This is on unattroctive industry. If you ore not the market leoder, sell the business.
26 to 50	The industry is not very attractive, but it is possible for segment leaders ond very well run firms to make o living.
51 to 60	The industry is neither attractive nor unattractive. Competitive position is all.
61 to 75	The industry is attractive. If you are in it, consolidate your position and gain or maintain leadership. If not, consider entry if it is adjacent to your business and you have the expertise or can share costs with your existing business.
Over 75	The industry is unusually attractive. If you are in it, invest heavily for leadership. If you are not in it, you may find it difficult to enter without acquisition, but if there is o suitable way in, take it with both.

4.8 Strategic Groups

As implied by the previous discussion, not all companies in an industry may adopt the same strategies in their quest for strategic competitiveness and above-average returns. However, many companies in an industry may follow similar strategies. These companies are generally classified as strategic groups, or groups of companies in an industry following the same or similar strategies along the same strategic dimensions.

Membership in a particular strategic group is determined by the essential characteristics of a company's strategy, including the:

- extent of technological leadership
- degree of product quality
- pricing policies
- choice of distribution channels
- degree and type of customer service.

The strategic group concept can be useful in analysing the competitive structure of an industry and can serve as a framework for assessing competition, positioning alternatives, and potential profitability of companies in an industry. Use of this concept requires that strategic dimensions that are relevant to companies performance be used to analyse strategic group and industry structure. Relevant dimensions might include price and quality, image and distribution, or level of service and product features.

Forecasting the Trends

Forecasting the trends of all these variables is an integral part of the process—which could really make or mar the future of company. Environmental scanning provides reasonably hard data on the present situation and current trends, but intuition and luck are needed to accurately predict if these trends will continue. The resulting forecasts are, however, usually based on a set of assumptions that may or may not be valid.

Faulty underlying assumptions are the most frequent cause of forecasting errors. Nevertheless many managers who formulate and implement strategic plans rarely consider that their success is based on a series of assumptions. Many long-range plans are simply based on projections of the current situation.

Notes

Brainstorming, expert opinion and statistical modelling are also very popular forecasting techniques. Brainstorming is a non-quantitative approach requiring simply the presence of people with some knowledge of the situation to be predicted. The basic ground rule is to propose ideas without first mentally screening them. No criticism is allowed. Ideas tend to build on previous ideas until a consensus is reached. This is a good technique to use with operating managers who have more faith in "gut feel" than in more quantitative "number-crunching" techniques.

Expert opinion is a non-quantitative technique in which experts in a particular area attempt to forecast likely developments. This type of forecast is based on the ability of a knowledgeable person(s) to construct probably future developments based on the interaction of key variables. Delphi technique of forecasting is an extension of the same.

Statistical modelling is a quantitative technique that attempts to discover causal or at least explanatory factors that link two or more time series together. Examples of statistical modelling are regression analysis and other econometric methods. Although very useful in the grasping of historic trends, statistical modelling, like trend extrapolation, is based on historical data. As the patterns of relationships change, the accuracy of the forecast deteriorates. Other forecasting techniques, such as cross-impact analysis (CIA) and trend-impact analysis (ITA), have not established themselves successfully as regularly employed tools.

Scenario writing appears to be the most widely used forecasting technique after trend extrapolation. Originated by Royal Dutch Shell, scenarios are focused descriptions of different likely futures presented in a narrative fashion. The scenario thus may be merely a written description of some future state, in terms of key variables and issues, or it may be generated in combination with other forecasting techniques.

An industry scenario is a forecasted description of a particular industry's likely future. Such a scenario is developed by analysing the probable impact of future societal forces on key groups in a particular industry. The process may operate as follows:

- Examine possible shifts in the societal variables globally.
- Identify uncertainties in each of the six forces of the task environment (for example, potential entrants, competitors, likely substitutes, buyers, suppliers, and other key stakeholders).
- Make a range of plausible assumptions about future trends.
- Combine assumptions about individual trends into internally consistent scenarios.
- Analyse the industry situation that would prevail under each scenario. Determine the sources of competitive advantage under each scenario.
- Predict competitors' behaviour under each scenario.
- Select the scenarios that are either most likely to occur or most likely to have a strong impact on the future of the company. Use these scenarios in strategy formulation.

As forecasting can be done using both quantitative and qualitative techniques, their complexity levels and cost implications are given in Table 4.5.

Notes

Table 4.5: Quantitative versus Qualitative Forecasting Techniques

	Cost	Popularity	Complexity
QUANTITATIVE TECHNIQUES			
Economic Models	High	High	High
Regression	High	High	Medium
Trend Extrapolation	Medium	High	Medium
QUALITATIVE TECHNIQUES			
Sales Force Estimate	Low	High	Low
Nominal Grouping Technique	Low	High	Low
Juries of Executive Opinion	Low	High	Low
Anticipatory Surveys and Market	Medium	Medium	Medium
Research			
Scenario	Low	Medium	Low
Delphi	Low	Medium	Medium
Brainstorming	Low	Medium	Medium

Source: J.A. Pearce and R.B. Robinson, Jr., "Environmental Forecasting. Key to Strategic Management," Business, July-September 1983.

4.9 Competitor Analysis

Competitor analysis represents a necessary adjunct to performing an industry analysis. An industry analysis provides information regarding potential sources of competition (including the possible strategic actions and reactions and effects on profitability for all companies competing in an industry). However, a structured competitor analysis enables a company to focus its attention on those companies with which it will directly compete, and is especially important when a company faces a few powerful competitors.

Competitor analysis is interested ultimately in developing a profile on how competitors might be expected to react in response to a company's strategic moves.

A major concern to many managers is the methods that are used to gather data on competitors; a process generally referred to as competitor intelligence. The managerial challenge is to ensure that all data and information related to competitors is gathered both legally and ethically. This is important because many employees may feel pressure to rely on techniques that are questionable from an ethical perspective to gather information that may be valuable to their company, especially if they perceive value to their own careers from successfully obtaining such information.

It seems obvious that information that (1) is either publicly available (annual reports, regulatory filings, brochures, advertising and promotional materials) or (2) is obtained by attending trade shows and conventions can be used without ethical or legal implications. However, information obtained illegally (as a result of activities such as theft, blackmail, or eavesdropping) cannot, or, at least, should not, be used as its use is unethical as well as illegal.

Notes

Table 4.6: Categorising the Objectives and Strategies of Competitors

Competitive Scope	Strategic Intent	Market Share Objective	Competitive Position/ Situation	Strategic Posture	Competitive Strategy
Local	Be the dominant leader	Aggressive expansion via both acquisition and internal growth	Getting stronger; on the move	Mostly offensive	Striving for low cost leadership
Regional	Overtake the present industry leader	Expansion via internal growth (boost market share at the expense of rival companies)	Well-entrenched; able to maintain its present position	Mostly defensive	Mostly focusing on a market niche -High end -Low end -Geographic -Buyers with special needs -Other
National	Be among the industry leaders (top 5)	Expansion via acquisition	Stuck in the middle of the pack	A combination of offence and defence	Pursuing differentiation based on -Quality -Service -Technological superiority -Breadth of product line -Image and reputation -More value for the money -Other attributes
Multicountry	Move into the top 10	Hold on to present share (by growing at rate equal to the industry average)	Going after a different market position (trying to move from a weaker to a stronger position)	Aggressive risk-taker	
Global	Move up a notch or two in the industry ran kings Overtake a particular rival (not necessarily the leader) Maintain position Just survive	Give up share if necessary to achieve short-term profit objectives (stress profitability, not volume)	Struggling; losing ground Retrenching to a position that can be defended	Conservative follower	

Another indication of the importance of competitive intelligence is the emergence of "Web-spying service" companies, also known as corporate intelligence companies. Dow Chemical hired one such company to determine (through studying competitor Websites) whether competitors had developed, or were in the process of developing, a particular clay/plastic composite product.

Companies need to be careful when posting information on their Websites and treat each item as carefully as though they were preparing to publish it in their annual reports. Companies should also verify information posted about their company on other companies' Websites.

Still some estimate that only 10-15 per cent of all businesses have formal competitor intelligence gathering processes in place. And some of the companies that assess competitors' current assumptions and capabilities fail to analyse their future objectives, yielding incomplete insights.

Student Activity

What are key components of external environment?

4.10 Summary

When we look at the environment as a source of resources we have a view that the resources are scarce and valued. As organizations depend on the environment for these resources, these resources are sought by competing organizations. The level of dependency is determined by difficulty of obtaining and controlling resources. Dependency can only be managed properly by controlling environmental resources which makes it necessary to know about the environment before attempting to change or influence it.

A manager's ability to recognize and anticipate environmental changes plays a key role in shaping the company's future because it limits or opens up strategic options. However, it's not enough to simply know what's happening in your company's environment. A strategist also needs to assess, to evaluate what these various data and trends mean for the company. In other words, a strategist needs to do an external analysis and determine the opportunities and threats.

4.11 Keywords

Monitoring: Monitoring represents a process whereby strategists observe environmental changes (over time) to see if, in fact, an important trend begins to emerge.

Assessing: Assessing represents the step in the external analysis process where all of the other steps come together.

Ethnic Mix: This reflects the changes in the ethnic make-up of a population and has implications both for a company's potential customers and for the workforce.

Economies of Scale: It refer to the relationship between quantity produced and unit cost. As the quantity of a product produced during a given time period increases, the cost of manufacturing each unit declines.

4.12 Review Questions

1. Explain how to conduct an external strategic management analysis.
2. Identify a recent economic, social, political, or technological trend that significantly affected financial institutions.
3. Discuss the following statement: Major opportunities and threats usually result from an interaction among key environmental trends rather than from a single external event or factor.

4. Identify two industries experiencing rapid technological changes and three industries that are experiencing little technological change. How does the need for technological forecasting differ in these industries? Why?
5. Use Porter's five-forces model to evaluate competitiveness within the Indian banking industry.
6. What major forecasting techniques would you use to identify (1) economic opportunities and threats and (2) demographic opportunities and threats? Why are these techniques most appropriate?
7. How does the external audit affect other components of the strategic management process?

4.13 References and Further Readings

- David, F. R., & David, F. R. (2018). Strategic management: A competitive advantage approach, concepts, and cases (16th ed.). Pearson.
- Barney, J. B., & Hesterly, W. S. (2019). Strategic management and competitive advantage: Concepts and cases (6th ed.). Pearson.
- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases (12th ed.). Pearson.

BLOCK – II

Unit 5 Analysis of Internal Environment

Unit Structure

5.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Describe internal environment
- State the internal analysis framework
- Define core competencies
- Make value chain analysis
- Build corporate strategy
- Define restructuring
- Explain competitive rivalry outcomes

Notes

5.1 Introduction

Analysing the external environment enables a company to identify what it might do by identifying what opportunities exist. Analysing the internal environment enables a company to identify what it can do or is capable of doing. The challenge is for companies to achieve a match between what the company might do and what it can do. This match allows the development of a company's strategic intent and strategic mission, as well as the subsequent implementation of value-creating strategies that will result in strategic competitiveness and above-average returns.

5.2 Internal Analysis

Today's competitive landscape makes it more difficult for companies to expect that they can sustain a level of strategic competitiveness strictly by managing the costs of labour, capital, and raw materials (because, in a global environment, all companies potentially can do this).

Internal analysis adopts the position that the Resource-based model of competitive advantage may be the key to a company's ability to achieve strategic competitiveness, by treating each company as a bundle or set of heterogeneous resources and capabilities. In other words, resources and capabilities are not equally distributed among companies as is assumed by the I/O model of strategic competitiveness.

By using or exploiting their core competencies, companies are in a position to develop and perform value-creating strategies better than their competitors or to create and perform value-creating strategies those competitors either are unable or unwilling to imitate.

As illustrated in Figure 5.1, a company's tangible and intangible resources (for example, its facilities and corporate culture, respectively) represent sources of capabilities. These capabilities (teams or bundles of resources) represent sources of core competencies, which when exploited and nurtured (and valuable, imperfectly imitable, rare, and non- substitutable), are potential sources of competitive advantage. If a company is able to use its core competencies to achieve a competitive advantage, it will achieve strategic competitiveness and earn above-average returns so long as competitors are unable or unwilling to imitate them successfully.

Figure 5.1: Strategic Role of Organizational Resources & Capabilities

5.3 Internal Analysis Framework

Correctly identifying, developing, deploying, and exploiting company resources, capabilities, and core competencies requires managers to make difficult decisions. In part, these challenges are a result of characteristics of both the internal and external

Notes

environments of the company. This challenge is multiplied because of three conditions that characterize important, strategic decisions.

The conditions or decision characteristics affecting managerial decisions about Resources, Capabilities, and Core Competencies basically fall under three heads:

1. Uncertainty regarding the assessment of the general and industry environments, assessment and predictability of competitive actions and customer preferences. Uncertainty is present because of the inherent difficulty in identifying, assessing, and predicting changes and trends in characteristics of the external environment. Among these characteristics are correctly predicting the extent, direction, and timing of changes in the general environment, such as societal values, political and economic conditions, customer preferences, and emerging technologies from other industries (and how they might ultimately affect the company).

2. Complexity regarding the nature of any interrelatedness of the causes of change in the environment and how the environments are perceived, especially regarding decisions as to which of the company's resources and capabilities might serve as the foundation for competitive advantage. Complexity is increased because of the uncertain nature of interrelationships among the characteristics of the external environment and the related challenge regarding how to assess the effects of changes in them. The issue becomes more complex when managers must relate the complex external environment to their assessment of the company's internal environment. The assessment affects the decisions regarding the company's resources, capabilities, and core competencies, and their relationship to opportunities in the external environment that can be exploited successfully to achieve competitive advantage.

3. Intraorganizational conflicts among managers making decisions about which core competencies are to be nurtured and about how the nurturing should take place. Intraorganizational conflicts often develop as a result of uncertainty and complexity. When managers make decisions regarding the identification of the company's capabilities and choose to nurture them (with resources) to develop core competencies that can be exploited to achieve a competitive advantage, they must make these important decisions with absolute certainty that the decision is correct. And, such decisions may result in changes or shifts in power and interrelationships among individuals and groups within the company. When this occurs, there may be conflict as those who are affected adversely, or perceive that they will be so affected, may resist these changes. In some cases, managers faced with decisions that may have unpleasant consequences or are uncomfortable often experience denial, an unconscious coping mechanism used to block out and not initiate major changes that may have some pain associated with them.

Thus, managers that must make decisions under conditions of uncertainty, complexity, and Intraorganizational conflict must exercise judgement, a capacity for making a successful decision in a timely manner when no correct model is available or when relevant data are unreliable or incomplete.

5.4 Resources, Capabilities and Core Competencies

Now let us look at the background and relationships between resources, capabilities and core competencies that represent potential sources upon which a company can build the foundation for a sustainable competitive advantage.

Resources

It might be said that resources represent those assets, both tangible and intangible, with which the company has to work: its assets, including its people, and the value of its brand, a variety of individual, social, and organizational phenomena. To put it more succinctly, resources represent inputs into a company's production process, such as capital equipment, the skills of individual employees, brand names, financial resources, and talented managers.

By themselves, or individually resources generally will not enable a company to achieve a competitive advantage. They must be combined or integrated with other company resources to establish a capability. When these capabilities are identified and nurtured, they can result in core competencies, which may lead to a competitive advantage. A company's resources can be classified either as tangible or intangible.

Tangible Resources

Tangible resources are assets that can be seen or quantified, such as a company's physical assets (for example, its plant and equipment). Tangible resources can be classified in one of four ways as illustrated below:

- *Financial resources,* such as borrowing capacity
- *Organizational resources,* such as its formal reporting structure and systems
- *Physical resources,* such as location

Box 5.1: Resources

Resources	
Tangible Resources * Financial * Physical * Human Resources * Organisational	What a firm has to work with: • Its assets, including its people and the value of its brand name
Intangible Resources * Technological * Innovation * Reputationl	Resources Represent Inputs into a firm's production process... Such as capital equipment, skills of employees, brand names, finances and talented managers

Intangible Resources

A company's intangible resources may be less visible, but they are no less important. In fact, they may be more important if a company expects to achieve a competitive advantage. Intangible resources range from innovation resources, such as knowledge, trust, and organizational routines, to the company's people-dependent or subjective resources of know-how, networks, organisational culture, to the company's reputation for its goods and services and the way it interacts with others (such as employees, suppliers, or customers). Three primary classifications of intangible resources are presented below:

- *Human resources,* such as knowledge, trust, and managerial capabilities
- *Innovation resources,* such as scientific capabilities and capacity to innovate
- *Reputational resources,* such as the company's reputation with customers or suppliers.

Capabilities

A company's capabilities represent its capacity to integrate individual company resources to achieve a desired objective. However, this ability does not emerge overnight. Capabilities develop over time as a result of complex interactions that take advantage of the interrelationships between a company's tangible and intangible resources that are based on the development, transmission, and exchange or sharing of information and knowledge as carried out by the company's employees (its human capital).

A company's ability to achieve a competitive advantage is thus reflected in its knowledge base and the ability of its human capital to successfully exploit company capabilities. Thus, human capital is of significant value in the company's ability to develop capabilities and core competencies to achieve strategic competitiveness.

The knowledge possessed by the company's human capital may be one of the most significant sources of a company's competitive advantage. This is because it represents everything that the company has learned, and thus everything that it knows about successfully linking or bundling sets of individual resources to develop capabilities as a foundation for developing core competencies and, ultimately, to achieve a competitive advantage.

Establishing and nurturing the skills and abilities of the workforce is of critical importance to a company's ability. Important not only to establish, but to sustain a competitive advantage by acquiring new knowledge and developing new skills that will both enhance existing capabilities and core competencies, as well as aid in the development of new ones.

Current research suggests four methods by which knowledge is transferred within a company:

- *Socialisation*—common with apprentice and mentors, this occurs by observation and practice.
- *Externalisation*—this is the process used to convert tacit knowledge into explicit terms, a type of metaphorical model-building.
- *Combination*—this considers knowledge stores in different groups within the company to try to meld the knowledge and distribute it to other groups.
- *Internalisation*—the process by which knowledge generated by the other three methods gets embedded into the employees of the company. Newly internalised knowledge becomes a base upon which the cycle of knowledge creation, transfer, and embedding repeats itself.

Box 5.2: Capabilities

Capabilities represent:

the firm's capacity or ability to integrate individual firm resources to achieve to desired objective.

Capabilities develop overtime as a result of complex interactions that take a dvantage of the interrelationships between a firm's tangible and intangible resources that are based on the development, transmission and exchange or sharing of information and knowledge as carried out by the firm's employees.

Capabilities become important when they are combined in unique combinations which create core competencies which have strategic value and can lead to competitive advantage.

A company needs to answer a lot of questions before it can truly understand its resources and capabilities. A sample list is shown in the Box 5.3.

Box 5.3: Resources and Capabilities Questions

MANAGEMENT

1. Does the company use strategic management concepts?
2. Are company objectives and goals measurable and well communicated?
3. Do managers at all hierarchical levels plan effectively?
4. Do managers delegate authority well?
5. Is the organization's structure appropriate?
6. Are job description and job specifications clear?
7. Is employee morale high?
8. Is employee turnover and absenteeism low?
9. Are organisational reward and control mechanisms effective?

Contd...

MARKETING

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the company's market share been increasing?
4. Are present channels of distribution reliable and cost-effective?
5. Does the company have an effective sales organization?
6. Does the company conduct market research?
7. Is product quality and customer service good?
8. Are the company's products and services priced appropriately?
9. Does the company have an effective promotion, advertising, and publicity strategy?
10. Is marketing planning and budgeting effective?
11. Do the company's marketing managers have adequate experience and training?

FINANCE

1. Is the company financially strong or weak as indicated by financial ratio analyses?
2. Can the company raise needed short-term capital?
3. Can the company raise needed long-term capital through debt and/or equity?
4. Does the company have sufficient working capital?
5. Are capital budgeting procedures effective?
6. Are dividend payout policies reasonable?
7. Does the company have good relations with its investors and stockholders?
8. Are the company's financial managers experienced and well trained?

PRODUCTION

1. Are suppliers of raw materials, parts, and sub-assemblies reliable and reasonable?
2. Are facilities, equipment, machinery, and offices in good condition?
3. Are inventory control policies and procedures effective?
4. Are quality control policies and procedures effective?
5. Are facilities, resources, and markets strategically located?
6. Does the company have technological competencies?

RESEARCH AND DEVELOPMENT

1. Does the company have R&D facilities? Are they adequate?
2. If outside R&D companies are used, are they cost-effective?
3. Are the organization's R&D personnel well qualified?
4. Are R&D resources allocated effectively?
5. Are management information and computer systems adequate?
6. Is communication between R&D and other organisational units effective?
7. Are present products technologically competitive?

COMPUTER INFORMATION SYSTEMS

1. Do all managers in the company use the information system to make decisions?
2. Is there a chief information officer or director of information systems position in the company?
3. Are data in the information system updated regularly?
4. Do managers from all functional areas of the company contribute input to the information system?
5. Are there effective passwords for entry into the company's information system?
6. Are strategies of the company familiar with the information systems of rival companies?
7. Is the information system user friendly?
8. Do all users of the information system understand the competitive advantages that information can provide companies?
9. Are computer training workshops provided for users of the information system?
10. Is the company's information system continually being improved in content and user friendliness?

Notes

Once a company has identified its resources and capabilities, it is ready to identify its core competencies, the resources and capabilities that are a source of competitive advantage for the company over its competitors.

Core Competencies

Resources and capabilities serve as the foundation upon which companies formulate and implement value-creating strategies so that the company can achieve strategic competitiveness and earn above-average returns.

However, not all of a company's resources and capabilities represent strategic assets, that have competitive value and the potential to serve as a source of competitive advantage. If the company has a deficiency in some of its resources, it may not be able to achieve strategic competitiveness. For example, insufficient financial resources may prevent the company from implementing the processes or integrating the activities required to add superior value by limiting the company's ability to hire workers with the necessary skills or to invest in the capital assets (facilities and equipment) that are needed.

Thus, companies not only are challenged to scan the external environment to identify opportunities that can be exploited, but also to have an in-depth understanding of company resources and capabilities. This will enable the company not only to develop strategies that enable it to exploit external opportunities but also to avoid competing in areas where the company's resources and capabilities' are inadequate. Some indicators of competitive strengths and weaknesses are shown in Table 5.1.

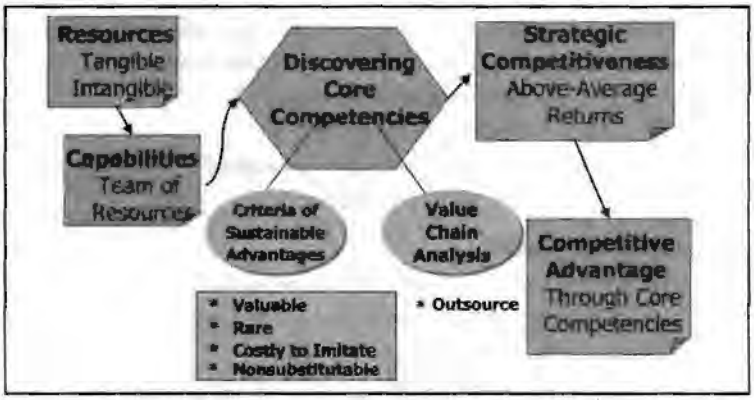


Figure 5.2: Discovering Core Competencies

Table 5.1: Signs of Strength and Weakness in Competitive Position

Signs of Competitive Strength	Signs of Competitive Weakness
• Important core competencies	• Confronted with competitive disadvantages
• Strong market share (or a leading market share)	• losing ground to rival companies
• A pace-setting or distinctive strategy	• Below-average growth in revenues
• Growing customer base and customer loyalty	• Short on financial resources
• Above-average market visibility	• A slipping reputation with customers
• In a favourably situated strategic group	• Trailing in product development
• Concentrating on fastest growing market segments	• In a strategic group destined to lose ground
• Strongly differentiated products	• Weak in areas where there is the most market potential
• Cost advantages	• A higher-cost producer
• Above-average profit margins	• Too small to be a major factor in the market place
• Above-average technological and innovational capability	• Not in good position to deal with emerging threats
• Weak product quality	• A creative, enterpreneurially alert management
• In position to capitalise on opportunities	• lacking skills and capabilities in key areas

Notes

When the company's resources and capabilities result in a core competence, the company will be able to produce goods or services with features and characteristics that are valued by customers. This implies that companies can implement valuecreating strategies only when its capabilities and resources can be combined to form core competencies.

The question is asked: "How many core competencies are required for a competitive advantage?" McKinsey & Company recommends that companies identify 3 or 4 competencies around which to frame their strategic actions. For example, McDonald's has exactly four competencies (in real estate, restaurant operations, marketing, and its global infrastructure).

5.5 Building Core Competencies

We will discuss two conceptual tools or frameworks available to companies as they search for competitive advantage:

1. Four criteria which determine which of the company's resources and capabilities are core competencies, and
2. Value chain analysis, a framework for determining which value-creating competencies should be maintained, upgraded and developed and which should be outsourced.

Criteria of Sustainable Competitive Advantage

Figure 5.3 illustrates the relationship between resources, capabilities, and the decision point at which managers determine whether or not capabilities are (or are not) core competencies.

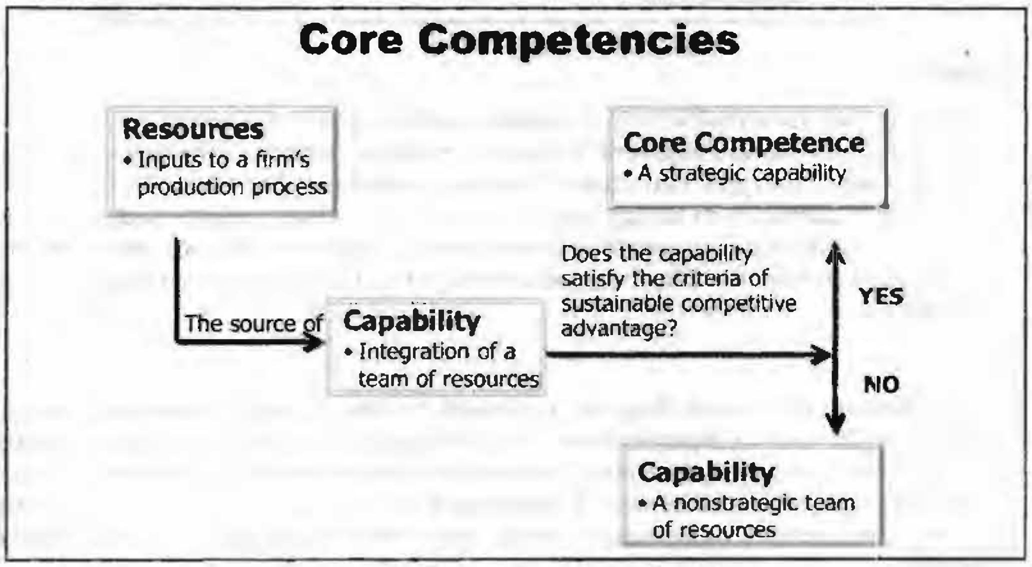


Figure 5.3: Core Competence Decision

This decision point, which includes four criteria, should be used to determine whether or not a company's capabilities are core competencies and can be a source of competitive advantage.

However, a short-term competitive advantage is available when company capabilities are valuable, rare, and non-substitutable. The length of time that a company possessing such capabilities can expect to sustain a competitive advantage depends on how long it takes for competitors to successfully imitate the value creating activity or process, or reproduce valued features or characteristics of the product or service.

Thus, the ability to sustain a competitive advantage is dependent on company capabilities being valuable, rare, non-substitutable, and costly to imitate as given in Box 5.4.

Notes

Box 5.4: Four Criteria for Determining Core Competencies

Core Competencies must be:

- **Valuable**

  Capabilities that either help a firm to exploit opportunities to create value for customers or to neutralize threats in the environment

- **Rare**

  Capabilities that are possessed by few, if any, current or potential competitors

- **Costly to Imitate**

  Capabilities that other firms cannot develop easily, usually due to unique historical conditions, causal ambiguity or social complexity

- **Non Substitutable**

  Capabilities that do not have strategic equivalents, such as firm-specific knowledge or trust-based relationships

Valuable

Capabilities that are valuable help a company exploit opportunities and/or neutralise threats in the external environment. Valuable capabilities enable a company to develop and implement strategies that create value for customers. For example, Sony uses its valuable capabilities to design, manufacture, and market miniaturised electronic technology to add value for consumers (or to serve as a joint venture partner or perform outsourced activities for other manufacturers who do not possess these valuable capabilities).

Rare

Capabilities are rare when they are possessed by few, if any, current or potential competitors. If many companies have the same capabilities, the same value-creating strategies will be selected. As a result, none of the companies will be able to achieve a sustainable competitive advantage. Companies that develop and nurture capabilities that are different from those held by other companies would achieve a competitive advantage.

Costly to Imitate

Capabilities are costly to imitate when other companies are unable to develop them except at a cost disadvantage relative to companies that already have them. This usually is a result of one or a combination of three conditions:

1. Unique historical conditions such as establishing facilities in a key location that pre-empts competition when no other locations have 'the same or similar value related characteristics or developing a unique organisational culture in the early stages of the company's life that cannot be duplicated by cultures developed at different times. A unique culture can not only serve as a source of competitive advantage, but also may be a source of competitive disadvantage. The latter may be the case when a company's culture prevents it from recognising or successfully

Notes

adapting to changes in a turbulent environment. At the same time, a unique culture may be a source of sustainable competitive advantage.

2. Causal ambiguity also may prevent competitors from perfectly imitating a competency if the link between a company's resources, capabilities, and core competencies is not identified or understood. Also, competitors may not be able to identify or determine how a company uses its competencies to achieve a sustainable competitive advantage.

3. Social complexity means that a company's capabilities are the product of complex social phenomena such as interpersonal relationships within the company or between the company and its customers and suppliers.

Non-substitutable

A company's capabilities are non-substitutable when they do not have strategic equivalents. In addition, if capabilities are invisible, it is even more difficult for competitors to identify viable substitutes. Examples of capabilities that can be difficult to identify or to find suitable substitutes for include company-specific knowledge and trust-based working relationships.

Table 5.2 summarises the relationship between the characteristics of company capabilities, the sustainability of competitive advantage, and performance implications.

Table 5.2: Outcomes from Combinations of the Criteria for Sustainable Competitive Advantage

Valuable	Rare	Costly to Imitate	Nonsub-stitutable	Competitive Consequences	Performance Implications
NO	NO	NO	NO	Competitive Disadvantage	Below Average Returns
YES	NO	NO	YES/NO	Competitive Parity	Average Returns
YES	YES	NO	YES/NO	Temporary Competitive Advantage	Aver./Above Average Returns
YES	YES	YES	YES	Sustainable Competitive Advantage	Above Average Returns

Major inferences are:

- Resources and capabilities that are neither valuable, rare, costly-to-imitate, nor non-substitutable mean that the company will be at a competitive disadvantage and will earn below-average returns.
- Resources and capabilities that are valuable, but are neither rare nor costly to imitate and mayor may not be non-substitutable mean that the company can achieve competitive parity and earn average returns.
- Resources and capabilities that are both valuable and rare, but are not costly to imitate and mayor may not be non-substitutable, may enable the company to achieve a temporary competitive advantage and will earn above-average to average returns.
- Resources and capabilities that are valuable, rare, costly-to-imitate, and non-substitutable will enable the company to achieve a sustainable competitive advantage and earn above-average returns.

Table 5.3: Diversification using Core Competencies

Company	Country of Origin	Original core business	Key skills	Growth path
Honda	Japan	Motor cycles	Piston engine design and development	Cars, lawn mowers, small generators
Gillette	USA	Shaving products	Advertising effectiveness	Other toiletnes, e.g. deodorants
Hanson	UK	Textiles	Financial control; acquisition evaluation	Post-acquisition cash maximisation in low technology businesses
McDonald's	USA	Hamburger restaurants	Site selection; quality standardisation	Extension of opening hours to include breakfast; product innovation (fish, pizza, salads)
Marks & Spencer	UK	Clothes retailing	Supplier management; value-for-money branding	Diversification into food, furniture, flowers
Sony	Japan	Transistor radios	Production innovation; evaluation of future customer desires	Broad consumer electronics; TV cameras; computer components
NEC	Japan	PABX; Semiconductors	Semiconductor technology	Telecommunications products (mobile phones, faxes, etc.). Laptop computers; office automation
Toyota	Japan	Cars	Flexible manufacturing; quality control	Geographical expansion

Core Competencies: Cautions and Reminders

Because they are generally knowledge-based, capabilities that are company's core competencies become more valuable as they are used over time. For example:

- Sharing knowledge, across people, jobs and organisational functions, may result in an increase in the value of that knowledge in ways that are competitively relevant.
- Core competencies can also become core rigidities (or core incompetencies).
- Core competencies must be strategically relevant, which means that companies must continually strive to develop new competencies.
- New competencies must be developed to meet the changes (and challenges) of the new competitive landscape as both technological and global factors are rapidly changing.

Thus, nurturing existing competencies must be balanced by efforts to encourage the development of new competencies.

Value Chain Analysis

The second framework that companies can use to identify and evaluate the ways in which their resources and capabilities can add value is value chain analysis. This framework is useful because it enables companies to understand which parts of their operations or activities create value by segmenting the value chain into primary and secondary activities as illustrated in Figure 5.4.

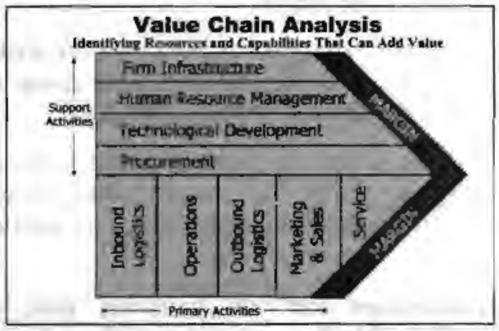


Figure 5.4: The Basic Value Chain

Notes

Figure 5.4 illustrates how the value-creating activities performed by the company can be separated into primary and secondary activities. Primary activities, shown vertically, represent traditional line activities such as inbound logistics, operations, outbound logistics, marketing and sales, and service. Support activities, shown horizontally, are represented by a company's staff activities and include its financial infrastructure, human resource management practices, technological development, and procurement activities.

The first step in value chain analysis is to carefully examine each of the company's primary activities to determine the potential for creating or adding value.

- *Inbound Logistics:* Examine all activities related to the receipt, control, warehousing, inventory, and distribution of raw materials or component parts into the production process.
- *Operations:* Activities to be examined are all those necessary to convert the inputs (raw materials or components) available as a result of inbound logistics into finished products. Examples include machining, assembly, equipment maintenance, and packaging.
- *Outbound Logistics:* This category represents the company's activities involved with the collection, storage, and physical distribution of products to customers. Examples include warehousing or storage of finished products, material handling, and order processing.
- *Marketing and Sales:* Several marketing and sales activities must be completed to both induce customers to purchase products and ensure that products are available. Activities include developing advertising and promotion campaigns; selecting and developing distribution channels; and selecting, training, developing, and supporting a sales force.
- *Service:* These are the activities that a company offers to enhance or maintain a product's value, including installation, product use training, adjustment, repair, and warranty services.

The next step in the value chain analysis process is an examination of the company's support activities to determine any value creating potential in those activities:

- *Procurement:* These are activities that are completed to purchase the inputs needed to produce a company's products, including items consumed or used in the manufacturing process (such as raw materials or component parts), supplies, and fixed assets (machinery, equipment and facilities).
- *Technological Development:* All activities that are completed to either improve a company's products or its production processes. This includes basic research, process and equipment design, product design, and servicing procedures.
- *Human Resource Management:* These activities are related to the recruiting, hiring, training, developing, and compensating (including performance assessment and reward systems) of a company's employees.
- *Company Infrastructure:* These activities support the activities performed in the company's value chain, including general management practices, planning, finance, accounting, legal, and government relations. By performing its infrastructure related activities, a company identifies external opportunities and threats, and internal strengths and weaknesses related to company resources and capabilities, and supports or nurtures its core competencies.

5.6 Outsourcing

Outsourcing describes a company's decision to purchase a value-creating activity from an external supplier. Outsourcing has become important, and may become more important in the future, for two reasons:

First, there are limits to the abilities of companies to possess all of the bundles of resources and capabilities that are required to achieve superior performance (relative to competitors) in all of its primary and support activities.

Second, with limits to their resources and capabilities, companies can increase their ability to develop resources and capabilities to develop core competencies and achieve competitive advantage by nurturing only a few core competencies.

However, outsourcing is yet to pick up in India in a major way.

When outsourcing, a company seeks the greatest value. In other words, a company wants to outsource only to companies possessing a core competence in terms of performing the primary or support activity that is being outsourced. When evaluating resources and capabilities, companies must be careful not to outsource activities in which they can create and capture value. Additionally, companies should not outsource primary and support activities that are used to neutralise environmental threats or complete necessary ongoing organisational tasks.

5.7 Corporate Strategy

Previously the discussion centered around selecting and implementing a business level or competitive strategy – the actions a company should take to compete in a single industry or product market – and the competitive actions and responses that affect the competitive dynamics of a single industry or product market.

In contrast, when a company diversifies its operations by operating business in several industries, corporate level strategy becomes the primary focus. This means that a diversified company has two levels of strategy: business-level (or competitive) and corporate-level (or company-wide) which entails selecting a strategy that focuses on the selection and management of a mix of businesses.

Corporate-level strategies detail actions taken to gain a competitive advantage through the selection and management of a mix of businesses competing in several industries or product markets. The primary concerns of corporate-level strategy are:

- What businesses should the company be in?
- How should the corporate office manage its group of businesses?
- How can the corporation as a whole add up to more than the sum of its business parts?

5.8 Developing Strategic Options based on SWOT Analysis

For each of the businesses the company should do the SWOT analysis of its position to understand its own competitive position.

Corporate top-level managers should consider their company's group or mix of businesses as a portfolio of core competencies. As they attempt to create value by selecting and implementing corporate-level strategy, managers will be challenged to achieve strategic competitiveness and earn above-average returns while competing in a highly competitive global environment that is characterised by high degrees of risk, complexity, uncertainty, and ambiguity.

As you can see from Figure 5.5, the primary approach to corporate-level strategy is diversification, a strategy that requires top-level managers to develop and implement a multi-business effort encompassing a variety of industry environments. Diversification strategy is supported by an assumption that managers of diversified companies possess unique management skills that can effectively be used to craft multi-business strategies and improve a company's strategic competitiveness in the process. This leads to the prevailing theory that companies diversify when they have excess resources, capabilities, and core competencies that have multiple uses.

MARKET GROWTH RATE	WEAK	STRONG
RAPID	STRATEGY OPTIONS (in probable order of attractiveness) • Reformulate single-business concentration strategy (to achieve turnaround). • Acquire another company in the same business (to strengthen competitive position). • Vertical integration (forward or backward if it strengthens competitive position). • Diversification. • Be acquired by/sell out to a stronger rival. • Abandonment (a last resort in the event all else fails).	STRATEGY OPTIONS (in probable order of attractiveness) • Continue single-business concentration • -International expansion (if market opportunities exist). • Vertical integration (if it strengthens the company's competitive position). • Related diversification (to transfer skills and expertise built up in the company's core business to adjacent businesses).
SLOW	STRATEGY OPTIONS (in probable order of attractiveness) • Reformulate single-business concentration strategy (to achieve turnaround). • Merger with a rival company (to strengthen competitive position). • Vertical integration (only if it strengthens competitive position substantially). • Diversification. • Harvest/divest. • Liquidation (a last resort in the event all else fails).	STRATEGY OPTIONS (in probable order of attractiveness) • International expansion (if market opportunities exist). • Related diversification. • Unrelated diversification. • Joint ventures into new areas. • Vertical integration (if it strengthens competitive position). • Continue single-business concentration (achieve growth by taking market share from weaker rivals).

Figure 5.5: Options for an Undiversified Company

Notes

In other words, managers determine that their company's existing inventory of resources, capabilities, and core competencies are being under-used in crafting strategy for a single business and that they can leverage this inventory by diversifying, using these resources, capabilities, and core competencies to create value across multiple businesses or product markets.

Various types of diversification strategies are defined in Table 5.4.

Table 5.4: Alternative Strategies Explained

STRATEGY	DEFINITION
Forward Integration	Gaining ownership or increased control over distributors or retailers.
Backward Integration	Seeking ownership or increared control of a company's suppliers.
Horizontal Integration	Seeking ownership or increased control over competitors.
Market Penetration	Seeking increased market share for present products or services in present markets through greater marketing efforts.
Market Development	Introducing present products or services into new geographic area.
Product Development	Seeking increased sales by improving present products or services or developing new ones.
Concentric Diversification	Adding new, but related, products or services.
Conglomerate Diversification	Adding new, unrelated products or services.
Horizontal Diversification	Adding new, unrelated products or services for present customers.
Joint Venture	Two or more sponsoring companies forming a separate organisation for cooperative purposes.
Retrenchment	Regrouping through cost and asset reduction to reverse declining sales and profits.
Divestiture	Selling a division or part of an organisation.
Liquidation	Selling all of a company's assets, in parts, for their tangible worth.

5.9 Diversification Strategies

Diversified companies vary according to two factors: the level of diversification and connection or linkages between and among business units. Five levels of diversification are listed and each is defined in Figure 5.6.

Companies that follow single or dominant business strategies have low levels of diversification. A single business is a company where more than 90% of its revenues are generated by the dominant business. A dominant business is a company that generates between 70 and 95% of its sales within a single category.

Companies classified as dominant businesses also tend to be vertically integrated to some extent, with many having begun as a single business and evolving over time into a dominant business through vertical integration.

Figure 5.6: Levels of Diversification

A diversified company is one that earns at least 30% of its revenues from sources outside the dominant business and whose units are linked to each other by the sharing of resources, and by product, technological, and distribution linkages. Moderately diversified companies earn at least 30% of their revenues from the dominant business and all business units share product, technological, and distribution linkages, as illustrated in Figure 5.6. Unrelated diversified companies generate at least 30% of their total revenues from the dominant business but there are few linkages between key value-creating activities. Unrelated diversified companies do not share resources or linkages as illustrated in figure. Companies that pursue unrelated diversification strategies are often known as conglomerates.

Conglomerates (companies following unrelated diversification strategies) dominate the private sector economy in several countries such as Latin America, South Korea and India while US has more highly diversified companies.

As has been mentioned earlier in our discussion of diversification, some companies that have pursued unrelated high diversification strategies are restructuring to focus on a less diversified mix of businesses that may reflect an inability to manage high levels of diversification. This is because of the recognition that a lower level of diversification would improve the match between the company's core competencies and environmental opportunities and threats.

Reasons for Diversification

Companies may implement diversification strategies to enhance or increase the strategic competitiveness of the overall organisation. If they are successful, the value of the company increases. Value can be created through either related or unrelated diversification if the strategies enable the company's mix of businesses to increase revenues and/or decrease costs when implementing their respective business-level strategies.

Companies implement diversification strategies for a number of reasons. These can be classified into three broad sets of motives as shown in Box 5.5.

Box 5.5: Reasons for Diversification

Motives to enhance strategic competitiveness:

- economies of scope (related diversification) through activity-sharing and the transfer of core competencies
- market power motives (related diversification) by vertical integration or blocking competitors through multipoint competition
- financial economies motives (unrelated diversification) to improve efficiency of capital allocation through an internal capital market or by restructuring the portfolio of businesses

Motives that are value-neutral with respect to strategic competitiveness:

- to avoid violations of antitrust regulations
- to take advantage of tax incentives
- to overcome low performance
- to reduce the uncertainly of future cash flows
- to reduce overall company risk
- to exploit tangible resources
- to exploit intangible resources

Managerial or value reduction motives:

- to diversify managerial employment risk
- to increase managerial compensation

Incentives for Diversification

However, not all companies diversify to increase the value of the overall company. Some attempts at diversification are implemented to prevent the value of the company from decreasing.

Low Performance

When companies are able to earn above-average or superior returns in a single business, they have little incentive to diversify. However, low performance may provide an incentive for diversification, as a low-performing company may become more risk seeking in an effort to improve overall company performance. On the other hand, it has been shown that lower returns are related to greater (not lower) levels of diversification.

In response to low returns (or poor performance), companies often choose to seek greater levels of diversification. At some point, however, poor performance slows the pace of diversification, often resulting in restructuring divestitures of businesses to lower the level of company diversification.

As Figure 5.7 illustrates, companies exhibiting low performance in their dominant businesses often implement related constrained diversification strategies which, to some point, result in increased performance. In search of even higher performance, related-diversified companies may continue to diversify, but elect to acquire unrelated businesses. Because the company's core competencies do not create value in unrelated businesses, company performance decreases.

Notes

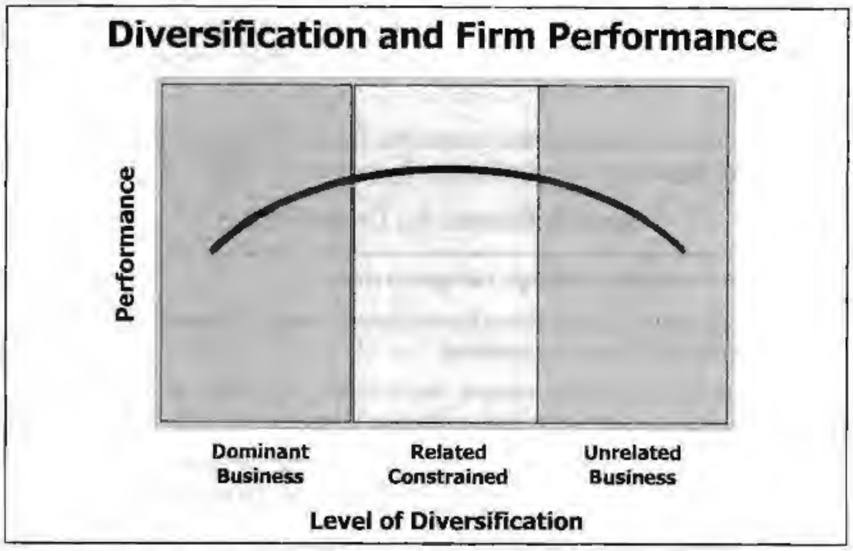


Figure 5.7: Relationship between Diversification and Performance

Uncertain Future Cash Flows

Companies also may implement diversification strategies when their products reach maturity (in the product life cycle) or are threatened by external factors that the company cannot overcome.

Thus, companies may view diversification as a survival strategy. For example, tobacco companies like ITC are diversifying because of future demand uncertainty that resulted from attacks on smoking and the ban on events sponsorships.

Uncertainty can also be derived from supply sources as well as demand conditions.

Company Risk Reduction

As you will recall from the discussion earlier in this unit, companies that diversify in pursuit of economies of scope take advantage of linkages between primary value creating activities to realise synergy from sharing.

Synergy exists when the value created by business units working together exceeds the value tbe units create when working independently. However, these linkages–and the interrelatedness or interdependencies that result–produce joint profitability between business units and the flexibility of the company to respond may be adversely affected, increasing the risk of failure.

To eliminate this risk, companies may do one of two things: (1) operate in more certain environments to reduce the level of technological change and choose not to pursue potentially profitable, yet unproven product lines or (2) constrain or reduce the level of activity sharing, thus foregoing the potential benefits of synergy.

However, these decisions could lead to further diversification to diversify into industries where more certainty exists or to additional, but unrelated diversification.

Resources and Diversification

In addition to having incentives to diversify, a company also must possess the correct mix of resources tangible, intangible, or financial that makes diversification feasible.

However, remember that resources create value when they are rare and mobile. In other words, resources that are not rare, valuable, costly to imitate, and nonsubstitutable, can be more easily duplicated (or acquired) by competitors. Thus, it may not be possible to create value using such resources.

Extent of Diversification

Companies that possess both the incentives and the resources to diversify generally will diversify to a greater extent than will companies that have only the resources but not the incentives, or that have the incentive to diversify but lack the resources. If the company's resources are highly flexible, it is likely that they will be used in unrelated diversification. Conversely, a company that possesses less flexible resources is likely to pursue related diversification.

Unrelated diversification strategies generally will require a smaller corporate office because of the decreased information processing (and coordinating) requirements that normally accompany the inter-unit linkages from activity sharing in related diversification.

Companies having both the incentives and resources to diversify should increase the company's level of diversification until they reach the optimal level of performance for the company. Companies that diversify because of low (real or perceived) performance may have a different optimal performance level than companies that do not diversify for that reason.

5.10 Managerial Motive s to Diversify

In some instances, managers may be motivated to diversify their companies even if there ar e no incentives and a lack of resources should constrain any inclination towards diversification. Managers' motives for diversification include:

Reduction of Managerial Risk

Diversification may enable managers to reduce employment risk (the risks related to the loss of their jobs or a reduction in compensation) because by diversifying the company (by adding a number of additional businesses) managers may be able to diversify their employment risk if profitability does not decline significantly as a result of the diversification.

Desire for Increased Compensation

Diversification also may enable managers to increase their compensation because of positive correlation between diversification, company size, and executive compensation.

This positive correlation may exist because diversification generally results in an increase in the complexity and size of the overall company, and large companies are more difficult to manage. As a consequence, managers of large companies generally are compensated more highly than are managers of small companies.

Managers may be motivated to increase overall company diversification even when the incentives and resources are absent. If this happens, internal and external governance mechanisms generally come into play to discourage diversification that is motivated solely by managerial self-interest. Unfortunately, these mechanisms are not perfect and may give incentives to managers to take strategic actions (to reduce the level of company diversification) that are counter-productive (resulting in lower than-expected performance). For example, Spin-off companies may not realise productivity gains. Business units that are spun off may have unrecognized interdependent linkages with business units that remain in the company.

Ultimately, the appropriate level of diversification should be determined by the market and by individual company resources and capabilities. One signal that the company may be over diversified is when operating diversified businesses reduces rather than improves the overall performance of the company.

Therefore, diversification strategies can be used to enhance a company's strategic competitiveness and enable it to earn above-average returns. However, positive outcomes from diversification are possible only when the company achieves the appropriate level of diversification, given its resources, capabilities, and core competencies, and taking into account the external environmental opportunities and threats.

Notes

5.11 Related Diversification

Companies implement related diversification strategies in order to achieve and exploit economies of scope and build a competitive advantage by building on existing resources, capabilities, and core competencies. For companies that operate in multiple industries or product markets, economies of scope represent cost savings attributed to entering an additional business using capabilities and core competencies developed in another business that can be transferred to a new business without significant additional costs. In other words, companies that successfully transfer core competencies from one business to another without incurring significant additional costs will realise economies of scope.

The two primary operations-related economies through which companies can create value (from economies of scope) are by sharing activities or sharing core competencies. The difference between activity sharing and core competence sharing is based on how different resources are used jointly to create economies of scope. Tangible or physical resources, such as facilities and equipment, may be shared to achieve economies of scope. Intangible resources, such as manufacturing know-how, can be shared to achieve scope economies. A key to creating value through sharing that are essentially separate activities is to share know-how or skills rather than physical or tangible resources.

Box 5.6: Value-creating Strategies of Diversification

Combinations of Economies	Resulting Strategy	Economies for Advantage
High operationall low corporate	Vertical integration	Market power
low operationall low corporate	Unrelated diversification	Financial economies
high operationall high corporate	Both operational and relatedness	Rare capability and can create diseconomies of scope
low operationall high corporate	Related-linked diversification	Economies of scope

Companies seek to create value from economies of scope through two basic kinds of operational economies: sharing activities and transferring skills (corporate core competencies). However, the levels of the two of these will lead to different corporate strategies with different advantages associated with each.

Operational Relatedness

Because all of its businesses share product, technological, and distribution linkages, activity sharing is common among related-constrained diversified companies, such as Proctor & Gamble. P&G's paper towel, napkin, and disposable diaper businesses can share a number of activities because of their common characteristics. Each business uses paper products as a key input, so they are likely to share key facets of procurement and inbound logistics, as well as primary manufacturing activities. Because all three businesses produce consumer products that are sold in similar (if not the same) outlets, they will likely share outbound logistics, distribution channels, and possibly sales forces.

Recall from our discussion of the primary and support activities in a company's value chain, that primary activities (such as inbound logistics, outbound logistics, and operations) might have several shared activities. Companies that are able to develop core competencies through effective (and efficient) sharing of primary activities will achieve a competitive advantage. Examples of activity sharing may include:

- *Inbound logistics:* inventory delivery systems, warehouse facilities, quality assurance practices.

Notes

- *Operations:* assembly facilities, quality control systems, maintenance operations. Outbound logistics: sales force and service management.
- *Support activities:* procurement, technology development.

Companies also must recognise that, while activity sharing is intended to reduce costs through achieving economies of scope, there are incremental costs related to sharing activities (costs that are created by sharing). These costs must be recognised and taken into account when planning activity sharing or economies of scope may not be realised.

Corporate Relatedness

Over time, most companies develop intangible resources (such as know-how) that can become a foundation for capabilities and core competencies that are competitively valuable. In diversified companies, these core competencies generally are made up of managerial and technical knowledge, experiences, and expertise.

A company's marketing expertise is such a core competence, and transferring such a competence between business units may result in reduced costs and an increase in the company's overall strategic competitiveness because any costs related to developing the competence already have been incurred and competencies based on intangible resources, such as marketing know-how, are less visible and therefore, are more difficult for competitors to understand and imitate.

One way that companies can facilitate the transfer of competencies between or among business units is to move key personnel into new management positions in the receiving unit.

Market Power

Companies also may implement related diversification strategies in an attempt to gain market power. Market power exists when a company is able to sell its products at prices above the existing competitive level or decrease the costs of its primary activities below the competitive level, or both. Market power through diversification may be gained through multipoint competition, a condition where two or more diversified companies compete in the same product areas or geographic markets.

If companies compete aggressively with each other in their common markets, excessive competitive activity may wipe out any potential gains. Thus, such companies often may refrain from competition to create value by entering into a condition known as mutual for clearance and gain value through reducing competition in key markets.

Companies also might gain market power by following a vertical integration strategy. Vertical integration exists when a company produces its own inputs (backward integration) or owns its own source of distribution of outputs (forward integration). A vertical integration strategy may be motivated by a company's desire to strengthen its position in its core business relative to competitors by increasing its market power. Vertical integration enables a company to increase market power through savings realised on the cost of acquiring inputs, lowering operations costs, increasing control over processes and activities, avoiding market costs, and protection of technology. Depending on the extent that the company is vertically integrated, companies may be able to reduce transactions costs, eliminate supplier or distributor markups, and improve profit margins.

5.12 Unrelated Diversification

Companies implementing unrelated diversification strategies hope to create value by realising financial economies. Financial economies are cost savings realised through improved allocations of financial resources based on investments inside or outside the company. Financial economics are realised through internal capital allocations (that are more efficient than market-based allocations) and by purchasing other companies and then restructuring their assets.

Notes

Although capital generally is efficiently distributed in a market economy through the capital markets, large diversified companies may be able to distribute capital more efficiently to divisions and thus create value for the overall organi sation. This generally is possible because corporate offices have access to more detailed and accurate information regarding actual division performance as well as future prospects. Investors have only limited access to internal information and generally are able only to estimate performance of particular divisions. One implication of increased access to information means that the internal capital market may be able to allocate resources between alternative investment opportunities more accurately (and at more adequate levels) than the external capital market.

Information disclosed to capital markets through annual reports may not fully disclose negative information, reporting only positive prospects while meeting all regulatory disclosure requirements. Therefore, external capital sources have limited knowledge of the specifics of what is taking place within large, complex organizations. While owners have access to information, full and complete disclosure is not guaranteed. Therefore, an internal capital market may enable the company to safeguard information related to its sources of competitive advantage that otherwise might have to be disclosed. Through disclosure, the information could become available to competitors who might use the information to duplicate or imitate the company's sources of competitive advantage.

5.13 Diversification using Mergers and Acquisitions

Companies often implement corporate-level acquisition strategies to achieve product diversification that can build core competencies. In fact, acquisition strategy is the most common means of implementing diversification. For each strategy discussed in the book, including diversification and merger and acquisition strategies, the company creates value only when its resources, capabilities, and core competencies are used productively.

Companies from different industries decide to use an acquisition strategy for several reasons; however, acquisition strategies are not without problems. When acquisitions contribute to poor performance, a company may deem it necessary to restructure its operations.

Mergers and acquisitions in India are on the increase. Some of the contributing factors include the rapid pace of globalization, techn ological advancements and industry consolidation. Yet according to the Richard Irvine, Price waterhouse Coopers global trends prove that almost 70-80 per cent of all mergers are not successful and do not match up to shareholder expectations. "A lot of factors playa part in this. There's too much focus on simply getting deals done as opposed to dealing wi th its wider implications. Decisions taken at the top level rarely take into account the repercussions at the ground level. Most acquisitions destroy, rather than create, shareholder value," says Irvine.

A majority of deals fail to thrive due to post-deal issues, as organizations are unable to harness their synergies. A Harvard study indicates that in 59 percent of the deals, market adjusted return of the company went down. First India witnessed acquisitions in the consumer and industrial products sector. Last year, telecom and ICE were predom inant sectors. Oil and gas will probably be the upcoming sector for acquisitions in the coming year. Private equity is still not very mature in India – a departure from the global trend.

A number of acquisitions took place during boom time. Given current market conditions, many organizations that relied on their soaring stock prices for doing big deals are facing tough circumstances. Only those deals that have a strong potential to shorten time-to-market and increase market share will survive.

Notes

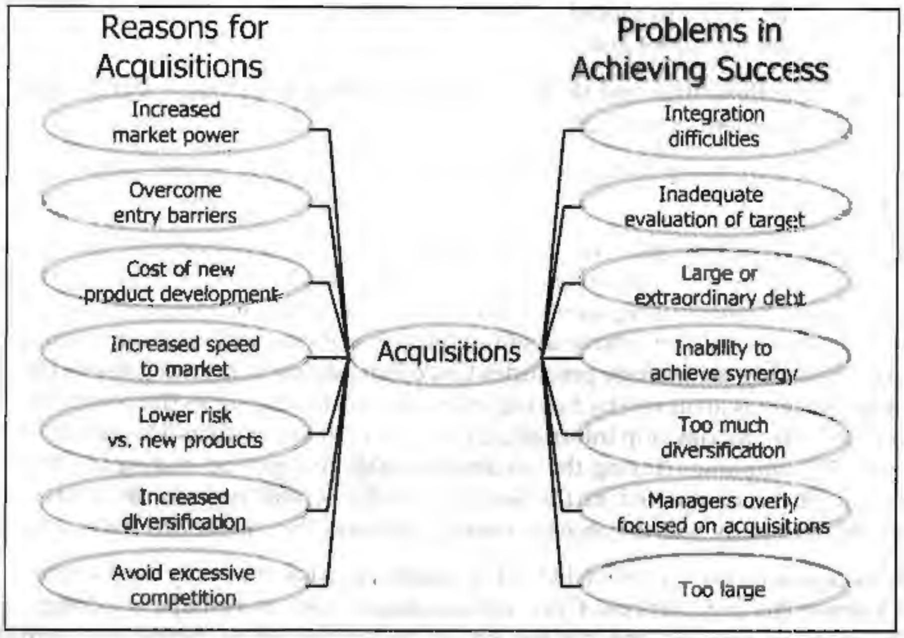


Figure 5.8: Acquisition Strategies: Reasons and Problems

Successful Acquisitions

Research has identified attributes that appear to be associated consistently with successful acquisitions.

Successful acquisitions generally are characterised by:

- target and acquire having complementary assets and/or resources which results in a high probability of achieving synergy and gaining competitive advantage.
- making friendly acquisitions to facilitate integration speed and effectiveness and reducing any acquisition premium.

Box 5.7: Attributes of Successful Acquisitions

Attributes of Effective Acquisitions

- Complementary Assets or Resources
- Friendly Acquisitions
- Careful Selection Process
- Maintain Financial Slack
- Low-to-Moderate Debt -Flexibility
- Emphasise Innovation

- when targets were selected and "groomed" by establishing a working relationship prior to acquisition (e.g., through strategic alliances).
- target selection and negotiation processes which result in the selection of targets having resources and assets that are complementary to the acquiring company's core business, thus avoiding overpayment.
- maintaining financial slack to make acquisition financing less costly and easier to obtain.

- maintaining a low to moderate debt position which lowers costs and avoids the trade-offs of high debt and lowers the risk of failure.
- possessing flexibility and skills to adapt to change to facilitate integration speed and achievement of synergy.
- continuing to invest in R&D and emphasizing innovation to maintain competitive advantage.

For example, let us take the case of Cisco Systems. Cisco provides the hardware and software that are behind state-of-the-art Internet networks, generating over $12 billion in annual sales. Contributing significantly to Cisco's strategic competitiveness and its ability to consistently earn above-average returns is its successful acquisition strategy because advancing technology precludes Cisco from doing everything itself. Therefore, corporate growth is achieved by buying products and technologies the company cannot (or does not want to) develop internally. Cisco is very active with its acquisition strategy, acquiring 51 companies during the six and one-half year period ending in March 2000 (with 21 of those completed in the last 12 months of that period). By midyear 2000 figures, the company was on pace to complete at least 25 acquisitions for the year.

Of all its acquisitions, Cisco's CEO John Chambers says that only two or three have failed to meet his expectations. Cisco uses its acquisitions to reshape the company and to fill gaps in its product line, but the key to the success of its merger and acquisition strategy rests on its strict adherence to five guidelines.

- ***Shared vision:*** The acquiring company and the target company must be in agreement regarding where the industry is going and the role each party is to play in the industry's anticipated future.
- ***Creating short-term wins:*** Employees see a culture that is attractive to them, identifying an opportunity to really do with Cisco what they were doing before, or even more.
- ***The target's strategy can blend with Cisco's:*** That is, when integrated with Cisco's operations, the acquired company will create value.
- ***Cultural similarity and compatibility:*** Chambers and his colleagues are skeptical of acquisitions that hope to integrate cultures that differ dramatically from one another.
- ***Geographic proximity:*** The target company must be close to the parts of Cisco's current operations with which it would be the most closely associated, preventing operational inefficiencies due to distance.

Cisco's integration team facilitates compliance with the five guidelines by helping "newcomers" fit into the Cisco family. Because of the pre-acquisition work of this group, negotiations between Cisco and target companies tend to be very brief.

5.14 Restructuring

Restructuring refers to changes in the composition of a company's set of businesses and/or financial structure. A restructuring approach to creating value in an unrelated diversified company involves the buying and selling of other companies (and their assets) in the external market.

Following a restructuring strategy generally implies buying a company and selling unnecessary or expensive assets (such as the corporate headquarters facility) and terminating corporate staff members. Following the asset sale and lay-offs, underperforming divisions (those acquired in the purchase) are sold to other companies and remaining divisions are placed under strict budgetary controls accompanied by the reporting of cash inflows and outflows to the corporate office.

Success in implementing unrelated diversification strategies usually requires that companies focus on companies in mature, low technology industries and avoid service businesses because of their client or sales-orientation.

Restructuring can take several forms:

- downsizing, primarily to reduce costs by laying off employees or eliminating operating units.
- downscoping to reduce the level of company unrelatedness.
- leveraged buyouts to restructure the company's assets by taking it private (not practised in India; yet).

In other words, restructuring strategies often were implemented in response to poor performance and overdiversification. The next section of the unit reviews some of the more common restructuring strategies.

1. Downsizing has been one of the most common restructuring strategies adopted internationally. Downsizing represents a reduction in the number of employees, and sometimes in the number of operating units, but mayor may not represent a change in the composition of the businesses in the corporation's portfolio.
2. Downscoping refers to the divestiture, spin-off, or other means of eliminating businesses that are unrelated to the company's core business. In other words, downscoping represents establishing a focus on the company's core businesses. While downscoping often includes downsizing, the former is targeted so that the company does not lose key employees from core businesses (because such losses can lead to the loss of core competencies).

   As the discussion of overdiversification earlier in this unit indicated, reducing the diversity of businesses in the portfolio enables top-level managers to manage the company more effectively because the company is less diversified as a result of downscoping and top-level managers can better understand the core and related businesses.

   Indian companies use downscoping as a restructuring strategy quite often. Both the parent and spin-off company usually show increases in shareholder value and accounting performance following the spin-off; however, this is not always the case.
3. Leveraged Buyouts (LBO) refer to a restructuring action, whereby the management of the company and/or an external party buys all of the assets of the business, largely financed with debt, and thus takes the company private. Often, LBOs are used as a restructuring strategy to correct for managerial mistakes or because managers are making decisions that primarily serve their personal interests rather than those of shareholders. In other words, a few (new) owners using a significant amount of debt (in a highly leveraged transaction) purchase a company and the company's stock is no longer traded publicly.

5.15 Cooperative Strategies

Strategic alliances represents a shift from achieving strategic competi tivene ss and above- average returns through competitive strategy (establishing strong positions against external challenges, minimizing weaknesses, and maximizing core competencies) to achieving them through cooperative strategies.

There are a number of justifications or rationales for strategic alliances. These reasons vary by market situation-slow-cycle, standard-cycle or fast-cycle and are given in Box 5.8.

A strategic alliance is the primary cooperative strategy and represents a partnership between companies whereby companies' resources, capabilities, and core competencies are combined to pursue mutual interests to develop, manufacture, or distribute goods or services. They represent explicit forms of relationships between companies.

There are three basic types of explicit strategic alliances:

1. A joint venture is an alliance where a new, independent company is formed from two or more partners, with each partner company contributing assets.

Notes

2. An equity strategic alliance is an alliance where partner companies own unequal shares of equity in the venture and are considered to be superior at passing on know-how between companies because they are closer to hierarchical control than non-equity alliances. For example, Ford Motor Company and Mazda Motor Corporation formed a long-standing equity strategic alliance.

Box 5.8: Reasons for Entering into Strategic Alliances

Reasons for entering into alliances in slow-cycle markets
- gaining access to a market that is not open to other entry strategies
- establishing a franchise in a new market
- maintaining market stability

Reasons for entering into alliances in standard-cycle markets
- gaining market power
- gaining access to complementary resources
- overcoming trade barriers
- meeting competitive challenges from other competitors . pooling resources for very large capital projects
- learning new business techniques

Reasons for entering into alliances in fast-cycle markets
- speeding up the development of goods/services
- speeding up new market entry
- maintaining market leadership
- forming an industry technology standard
- sharing risky R&D expenses
- overcoming uncertainty

3. A non-equity strategic alliance is an alliance where a contract is given to supply, produce, or distribute a company's products without any equity sharing. Other types of non-equity strategic alliances include licensing, distribution agreements, supply contracts, and marketing agreements (such as code-sharing agreements among airlines). For example, OPEC seeks to manage the price and output of oil companies in member countries.

These strategic alliances represent explicit alliances. However, there also are implicit cooperative alliances such as tacit collusion, which exists when several companies in an industry tacitly cooperate to reduce industry output below the potential competitive level to maintain higher-than-competitive-level prices. Another form of tacit collusion is mutual forbearance, which is a recognition of interdependence. These forms of cooperative alliances are illegal unless regulated by the government, which is currently the case in the power industry.

5.16 Competitive Strategies

Competitive advantage is what sets an organisation apart; its competitive edge. But as one organisation attempts to develop competitive advantage, other organisations are also doing so. And an organisation's competitive advantage can be eroded easily and quickly by competitors' imitations. Competition is everywhere. Some have described today's business climate as one of hyper competition, which is a situation with very intense and continually increasing levels of competition.

Competition is organisations fighting for the same desired object or outcome typically customers, market share, survey ranking, or needed resources. Among other things, the intensity of competition is going to vary depending on economic supply and demand.

Who are an organisation's competitors? One approach could be to use an industry perspective or a marketing perspective. The industry perspective identifies competitors as organisations that are making the same product or service. The marketing perspective identifies competitors as organisations that satisfy the same customer need. Another approach to identifying competitors is to look at strategic group, which is a group of companies essentially following the same strategy in a particular market or industry. Within a single industry, you might find few or several strategic groups depending on which strategic factors are important to different groups of customers. Some possible strategic dimensions for identifying strategic groups include price, quality, level of vertical integration, geographic scope, market share, profits, and so forth.

There are several key questions to ask before we can identify and understand our competitors as given in Box 5.9 below.

No matter how we define our competitors, the fact remains that there are other organisations working hard to secure customers, resources, and other desired outcomes. Each of these organisations has resources and capabilities it's attempting to exploit.

The question is what makes some organisations more successful than others? Every organisation has resources and work systems/processes to do whatever it's in business to do. However, not every organisation is able to effectively exploit the resources or capabilities it has or to obtain the resources or capabilities it needs but doesn't have. Organisations will develop strategies to exploit their current resources and capabilities or to vie for needed-but-not-owned resources and capabilities in order to pursue and attain desired outcomes such as customers, market share, resources, and so forth. As organisations strive for a sustainable competitive advantage, the stage for competition is set.

Box 5.9: Key Questions about Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, geographic, political, governmental, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new companies entering and old companies leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit ran kings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationship in this industry?
12. To what extent are substitute products or services a threat to competitors in this industry?

5.17 Traditional Approaches to Competitive Strategies

There are three traditional approaches to defining competitive strategy: Miles and Snow's adaptive strategies, Abell's business definition framework and Mintzberg's competitive strategies.

Miles and Snow's Adaptive Strategies

Miles and Snow's adaptive strategies approach is based on the strategies that organisations use to successfully adapt to their uncertain competitive environment. They identify four strategic postures: prospector, defender, analyser and reactor.

1. The prospector competitive strategy is a strategy in which an organisation continually innovates by finding and exploiting new product and market opportunities. They're constantly "prospecting" for new directions to pursue.

Notes

2. The defender competitive strategy is a strategy characterised by the search for market stability and producing only a limited product line directed at a narrow segment of the total potential market.

3. The analyser competitive strategy is a strategy in which organisations compete by analysing and imitating the successes of other organisations.

4. The reactor competitive strategy is a strategy characterised by the lack of a coherent strategic plan or apparent means of competing. It's almost a "nonstrategy" type position because obviously it's not a preferred or recommended competitive strategy for developing a sustainable competitive advantage.

Strategy research on Miles and Snow's adaptive strategies verify that these four competitive types are theoretically sound and can be used to describe what competitive strategies organisations are using.

Abell's Business Definition Framework

Abell's business definition framework proposes that a business can be defined by using three dimensions: customer groups (who we're going to serve), customer needs (what customer need we're attempting to meet), and technology or distinctive competencies (how we're going to meet that need). This approach strongly stresses understanding customers and not on an industry and its products or services. Based on these three dimensions, Abell's competitive strategy classification scheme proposed that a business could be defined by its competitive scope (broad or narrow) and by the extent of competitive differentiation of its product/service offerings.

Abell's strict marketing emphasis limits his business definition framework as a widely used and general approach to describing organisations' competitive strategies. But it did provide clues to two important aspects of competitive strategy: competitive scope and level of product differentiation.

Mintzberg's Competitive Strategy

Henry Mintzberg has developed an alternative typology of competitive strategies that he believed better reflected the increasing complexity of the competitive environment. He proposed six possible competitive strategies. These include differentiation by price, differentiation by marketing image, differentiation by product design, differentiation by product quality, differentiation by product support, and undifferentiated.

These models give you some idea of how to tackle the market-place full of competition. But the dynamics of today's market-place are changing so fast that several other factors are becoming very important. Let us take a look.

5.18 Today's Competitive Scenario

There are several things that can be said about today's competitive scenario. This competitive scenario is more volatile and unpredictable. Environmental changes are likely to be discontinuous. There is a declining emphasis on single domestic markets and an increasing emphasis on global markets as more industries globalise. Companies find that they must compete differently to achieve strategic competitiveness and earn above-average or superior returns. There will be a need for managers to make significant and even painful decisions to achieve strategic competitiveness.

Therefore, the need of the hour is that the companies must learn to compete differently if they are to achieve strategic competitiveness in the new competitive scenario. New ways of competing may include the following:

1. Bringing new goods and services to market more quickly
2. The use of new technologies

3. Diversifying the product line
4. Shifting product emphasis
5. Consolidation
6. Combining online selling with physical stores.

Thus, the new competitive scenario has changed from the old and familiar. Reasons for this change include factors such as:

- Increased attention to global markets with less emphasis on the domestic market;
- Recognition of and reaction to different forms of competitive actions from new, global competitors;
- Advances in information and communications technology enabling more effective communication across multiple markets, faster decision making, and rapid competitive responses;
- Improvements in quality and rapid time-to-market for new products enabled by sophisticated technologies;
- An increased emphasis on innovation that is changing the nature of competition in many industries;
- Cooperation between former competitors in the development of new technology or the formation of strategic alliances to compete against other competitors.

5.19 A Model of Competitive Rivalry

Competitive rivalry exists when companies jockey with one another in the pursuit of an advantageous market position. This means that, when one or more companies competing in an industry feel the pressure to act or perceive an opportunity to improve their competitive position, competitive rivalry occurs as various companies initiate a series of actions and responses.

Competitive rivalry exists because of competitive asymmetry, which describes the fact that companies differ from one another in terms of their resources, capabilities, and core competencies, and the opportunities and threats in their competitive environments and industries.

It is also important that companies recognise that competition results in mutual interdependence among companies in the industry as each company tries to establish a sustainable competitive advantage. As companies strive to achieve strategic competitiveness and earn above average returns, they must recognise that strategies are not implemented in isolation from competitors' actions and responses. The strategic management process represents companies taking a series of actions, fending off counter actions or responses and developing responses of their own.

This is important because the pattern of competitive rivalry and competitive dynamics in the market(s) in which companies compete affects strategic competitiveness and returns. Figure 5.9 provides a model of competitive rivalry.

We can make a number of observations from the model in Figure 5.9:

- Competitive rivalry or competitive dynamics begin with an assessment of competitors' awareness and motivation to attack and/or respond to competitive moves.
- Market commonality and resource similarity are affected by a company's awareness, and motivation affects the likelihood of attack or response.
- The likelihood of attack and response result in competitive outcomes, with outcomes moderated by a company's ability to take strategic actions or responses.

Notes

- Feedback from competitive outcomes will affect future competitive dynamics by affecting the nature of a company's awareness, motivation, and ability for action/response.

If companies overlap in a number of markets, multipoint competition—a situation where companies compete against each other simultaneously in a number of geographic or product markets generally results. Interestingly, a high level of commonality reduces the likelihood of competitive interaction. Since the major airlines are in so many common markets, there generally is competitive peace. However, when one company makes a competitive move, the others are compelled to respond rapidly.

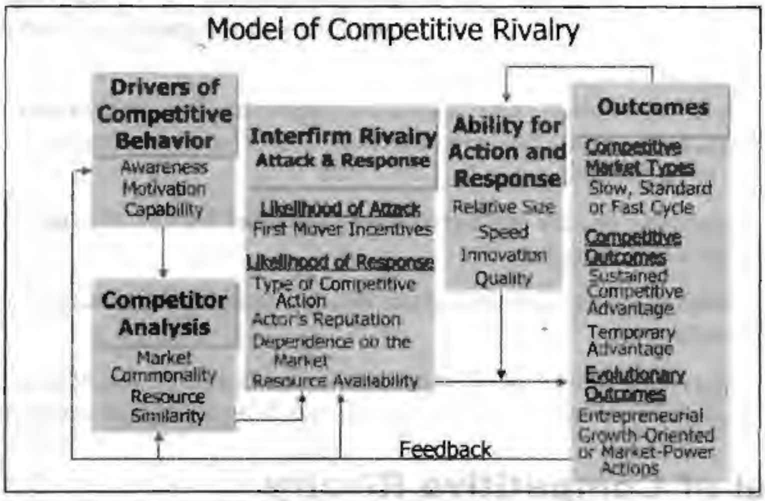


Figure 5.9: A Summary Model of Competitive Rivolry

The intensity of competitive rivalry in an industry often is based on the potential for response. As a result, attackers generally are not motivated to target a rival that is likely to retaliate. In other words, in most cases, dissimilar resources may increase the likelihood of an attack while companies with similar resources (overlap between their resource portfolios) will be less likely to attack because resource similarity increases the likelihood of retaliation.

Attack Possibilities

As indicated in the model of competitive rivalry, a company's awareness and motivation are developed primarily from competitor analysis of market commonality and resource similarity. However, if a potential attacking company believes that it can win, it has an incentive to be the first mover in a competitive battle.

Competitive actions represent significant competitive moves taken by a company that are designed to gain a competitive advantage in a market. Some competitive actions are large and significant; others are small and designed to help fine-tune or implement a strategy. A first mover may be able to gain an advantage from the ability to enjoy above-average returns while competitors consider how to respond and having sufficient time to consolidate its position so that it can deter a counterattack or competitive response.

First, Second and Late Movers

The timing of competitive actions and responses also influences an industry's competitive dynamics. Companies taking competitive actions can be classified as first, second or late movers.

Any advantage gained generally will vary based on the type of competitive action and type of industry as also to the extent to which the action is difficult to imitate because of the difficulty of imitation, first mover actions based on core competencies should be sustainable for longer periods than actions based on other factors.

Notes

There also are dangers or disadvantages of being a first mover. There are three major ones:

1. There are risks related to being first because of the inability to predict success of the action.
2. Second movers through reverse engineering or imitation can avoid high development costs.
3. Extent and range of market place competition yields greater potential risk.

In some instances, companies that delay their response to a competitive action fail to compete effectively and their performance suffers. However, that may not always be true since it may be more appropriate to be a second or late mover.

Second movers are companies that respond to a first mover's competitive action, often through imitation or a move designed to counter the effects of the (first mover's) action. How fast a second mover responds may influence its results. Before following the first mover, a second mover should evaluate initial customers' reactions to the first movers actions and analyse markets to identify critical issues.

Late movers are companies that respond to a competitive action, but only after considerable time has elapsed after the first mover's action and the second mover's response. And there is a danger in moving late as a late mover's performance generally suffers relative to the performance of first and second movers. As late movers are the last ones to respond to the first and second movers' actions, late movers tend to be poor performers and often are weak competitors.

Competitive Response

Once a competitive action has been taken, the likelihood and nature of the competitive response generally determine its success. A competitive response is a move that is taken to counter the effects of a competitor's action. Thus, companies considering making of competitive move should recognise the potential that competitors will respond.

The probability of a competitor's response to a competitive action is based on four factors:

1. The type of action.
2. The reputation of the competitor taking the action.
3. The competitor's dependence on the market.
4. Competitor resource availability.

Remember, competitive actions are significant competitive moves taken by a company that are designed to gain a competitive advantage in a market with the type of competitive action taken based on the company's strategy. Competitive actions can be classified based on the scope or breadth and significance of the action. Strategic actions are designed to help implement a company's business-level strategy and represent significant commitments of specific and distinctive organizational resources and are difficult to implement and to reverse. Tactical actions are taken to fine-tune a strategy. They involve fewer and more general organizational resources and are relatively easy to implement and reverse, if necessary.

Abilities that Enable Response

As discussed, the characteristics of individual companies affect the probability of competitive responses to actions taken. Four other factors influence an industry's competitive rivalry and competitive dynamics:

1. Relative size of a company within a market or industry.
2. Speed of competitive actions and responses.

3. The extent of innovation by companies in the industry.
4. Quality of the company's products.

Notes

1. *Relative Size of Company within a Market or Industry:* The relationship between company size and competitive dynamics at first may appear to be contradictory; the larger the company, the greater the company's market power relative to its competitors.

   Size usually reflects more than market power since a company's market share often reflects the general level of its resources. These resources may even include its R&D capabilities and the perceived quality of its products. Market power and resources of competitors also shape a focal company's responses.

2. *Speed of Competitive Actions and Competitive Responses:* Time to market and speed are of increasing importance in the new global market-place. The speed with which companies are able to initiate competitive actions—to be a first mover and responses-to be a fast second mover—appear to play a major part in their success. To establish a competitive advantage and earn above average profits in global markets, it is critical that companies are able to reduce the time required to develop new products and bring them to market.

   For example, Japanese automakers have shown that it is possible to develop and bring a new model to market in 2 to 3 years. In the past, US companies often have required 5 to 8 years. This means that Japanese companies often have been able to design and bring 2 or 3 new automobiles to market while US manufacturers were still developing their first new model. However, US automakers are improving, thus reducing the Japanese's time-to-market advantage.

3. *The extent of Innovation by Companies in an Industry:* Research indicates that product and process innovations are also important for strategic competitiveness. If the company is competing in a high technology industry, it may be critical to the company's long-term success to make significant allocations to its research and development (R&D) function. And as the number of competitors increases in an industry, so does the level of innovation.

4. *Quality of the Company's Products:* Product quality shapes the competitive dynamics in many industries. In fact, product quality is no longer a competitive issue but a necessary or mandatory product attribute if companies expect to successfully implement any of the generic business strategies discussed in unit 4—low cost, differentiation, focus, or integrated cost leadership/differentiation. Quality involves meeting or exceeding customer expectations in the products and/or services offered. In the long run, it costs less to make quality products or to offer quality services than it does to make or offer defective ones (because of the costs related to repairing defects or correcting service errors).

Box 5.10: Quality Dimensions of Products and Services

Quality Dimensions of Products

Performance	Operating characteristics
Features	Important special characteristics
Flexibility	Meeting operating specifications over time
Durability	Amount of use before performance deteriorates
Conformance	Match with pre-established standards
Serviceability	Ease and speed of repair or normal service
Aesthetics	How a product looks and feels
Perceived quality	Subjective assessment of characteristics (product image)

Contd...

Quality Dimensions of Services

Timeliness	Performed in promised period of time
Courtesy	Performed cheerfully
Consistency	Giving all customers similar experiences
Convenience	Accessibility to customers
Completeness	Fully serviced, as required
Accuracy	Performed correctly each time

Several guidelines or standards are available to companies as they strive for quality and global strategic competitiveness.

Total Quality Management (TQM) represents a managerial innovation that emphasises an organisation total commitment to the customer and to continuous improvement of every process through the use of data driven problem solving approaches based on the empowerment of employee groups and teams.

5.20 Competitive Rivalry Outcomes

Recall that Figure 5.10 illustrates the potential outcomes of competitive rivalry. Because one of the key determinants of whether or not a company's competitive advantage is sustainable is the extent to which its products are imitable, it is useful to review various market types and the extent to which product imitability is either shielded or not shielded.

In slow-cycle markets, resources and capabilities are very difficult to imitate and products or services reflect strongly shielded resource positions. Therefore, competitive pressures do not readily penetrate a company's sources of strategic competitiveness and profitability. This means that a company might hold a monopoly position or a unique set of product attributes or complex product design. Examples include the IBM's historical dominance of the mainframe computer industry, Boeing's dominant position in larger, commercial jet aircraft (especially if the Airbus superjumbo jet initiative is unsuccessful) and Microsoft's dominant position in the market for personal computer operating system software (though diminished by recent court decisions and a swell of new competitors).

The sustainability of competitive actions in slow-cycle markets is illustrated in Figure 5.10.

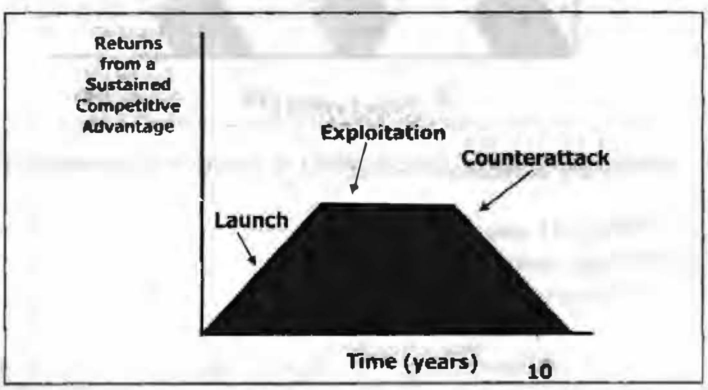


Figure 5.10: Erosion of Sustained Competitive Advantage in a Slow-cycle Market

As indicated by Figure 5.10, a company operating in a slow-cycle market may be able to retain its competitive advantage over time. Returns from the competitive action increase during the early, launch years of the strategy. When returns level out, the company exploits its position. Competitors counterattack or launch strategies that cause the first company's bases for competitive advantage to erode. As a result, returns are competed away.

Notes

In standard cycle markets, a company's strategy and organisation are designed to serve high volume or mass markets. The focus is on coordination and market control, such as in the automobile industries. Extended market dominance (or even global leadership) is possible through continuing capital investment and superior learning. Generally, it is difficult to enter standard-cycle markets because of competitive intensity. However, competitors may be able to imitate a company's source of advantage and increase the level of competition.

To this point, the focus has been on creating and sustaining a competitive advantage in slow and standard-cycle markets. As described in Figure 5.11, this process consists of an entrepreneurial or launch stage, a period of exploitation, and finally, a period of counterattack where the source of competitive advantage erodes.

In fast-cycle markets, attempting to sustain a competitive advantage based on one set of resources and competencies may lead to competitive inertia (or result in the company nurturing inappropriate competencies) and the company's position may be overrun by aggressive global competitors.

In fast-cycle markets, the key to successfully sustaining a competitive advantage may be to take small steps and launch a counterattack before the source of advantage is eroded. For example, even though Maruti Udyog has economies of scale, a huge advertising budget, an efficient distribution system, a depreciated plant and slack resources, many of its advantages have been eroded by global competitors.

The focus of this basis of competition is competitive disruption, an approach where competition is based on one set of resources and then shifted to another. In other words, using price as a first step toward sustaining a competitive advantage, then shifting to quality, then to speed, then to innovation, and so on. The principle is that the primary basis of the competitive advantage is shifted as the company disrupts – and changes-the rules of the game.

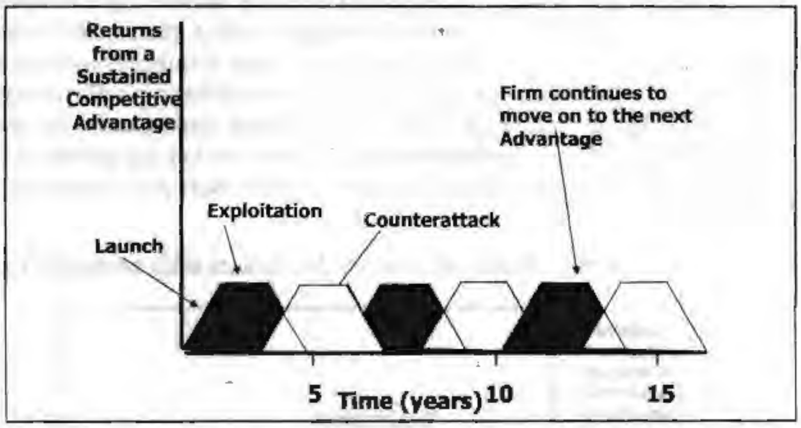


Figure 5.11: Temporary Advantages Leading to Sustained Advantage Over Time

As illustrated in Figure 5.11 one way in which companies might sustain a competitive advantage is to move continuously from advantage to advantage. This is accomplished by moving from one source of advantage to another, never allowing competitors to catch up.

There are four steps to implementing the step-by-step or incremental approach to sustaining competitive advantage.

1. *Disrupt the status quo:* A company should identify new opportunities to meet customer needs, thereby shifting or changing the basis of competition.

2. *Create a temporary advantage:* The temporary advantage should be based on improved knowledge of customers' needs, innovative application of technology, and an attempt to define the future basis of customer satisfaction.

Notes

3. *Seize the initiative:* Move aggressively and rapidly, forcing competitors to play catch up; taking a proactive approach while leaving competitors to be reactive.

4. *Sustain the momentum:* Continue to develop new sources of advantage; don't wait for competitors to catch up; stay one step ahead.

As industries evolve or move through their life cycle, the structure of the industry changes. And, because industry structure changes, so do the competitive dynamics and competitive strategies necessary for success. Three stages of the industry life cycle are particularly relevant to the study of competitive dynamics: new emerging entrepreneurial industries, larger growth-oriented industries, and mature industries. Relationships between company resources and market strength, time, and stage-of industry evolution are illustrated in Figure 5.12.

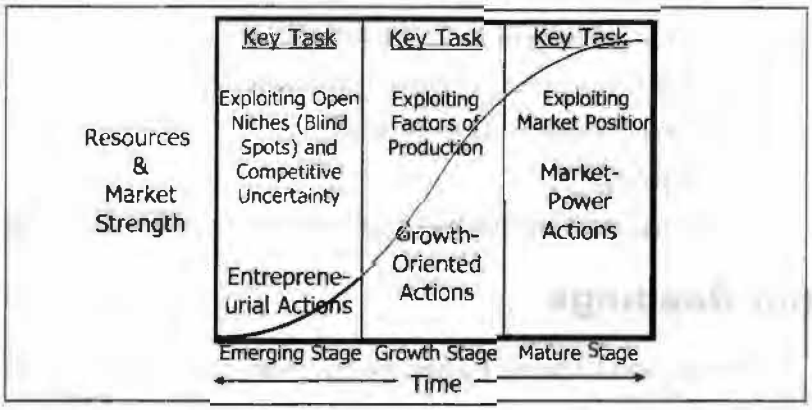


Figure 5.12: An Action based Model of the Industry Life Cycle

The model in Figure 5.12 illustrates that as an industry emerges, in its earliest stage, it is characterised by slow growth; the key task is to discover and exploit unserved market niches and competitive uncertainty. As time progresses and the growth rate increases, the industry enters a rapid growth phase; the key task is to exploit the laftors of production and take growth oriented actions. After a longer period, growth slows and begins to flatten as the industry enters the mature phase; the key task is to exploit the company's market position by taking market power actions.

5.21 Summary

While many companies may concentrate their efforts on tangible assets or develop strategies that focus purely on external factors such as competitive moves and countermoves, there are some companies who recognize the potential competitive advantage of their brands and use them to create a competitive advantage.

To sustain a competitive advantage, companies must be able to manage current core competencies while simultaneously developing new competencies. In other words, strategists must continuously make investments that will both enhance the value of current competencies while striving to develop new ones. Failure to develop or sustain a competitive advantage, or at least to maintain competitive parity, means that a company is likely to go out of business.

5.22 Keywords

Tangible Resources: Tangible resources are those that can be seen (such as plants), touched (such as equipment), documented (such as contracts with suppliers of raw materials), or quantified.

Externalisation: This is the process used to convert tacit knowledge into explicit terms, a type of metaphorical model-building.

Core Competencies: Resources and capabilities serve as the foundation upon which companies formulate and implement value-creating strategies so that the company can achieve strategic competitiveness and earn above-average returns.

Restructuring: Restructuring refers to changes in the composition of a company's set of businesses and/or financial structure.

5.23 Review Questions

1. What are the key components of internal environment of a business?
2. Explain the key factors affecting the managerial decisions.
3. Define core competencies.
4. What are the key activities of value chain analysis?
5. Define the importance of building corporate strategies.
6. What are the key reasons of diversification?
7. Define restructuring.
8. What are the major advantages and disadvantages of an integrative strategy?

5.24 References and Further Readings

- *Hitt, M. A., Ireland, R. D., &Hoskisson, R. E. (2020). Strategic management: Competitiveness and globalization (13th ed.). Cengage Learning.*
- *Wheelen, T. L., Hunger, J. D., Hoffman, A. N., & Bamford, C. E. (2018). Strategic management and business policy: Globalization, innovation, and sustainability (15th ed.). Pearson.*
- *Rothaermel, F. T. (2021). Strategic management (5th ed.). McGraw-Hill Education.*

Unit 6 Generic Tools of Analysis

Notes

Unit Structure

6.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Describe Decision Trees
- Define SWOT Analysis
- Understand PESTLE Analysis
- Explain Case Analysis
- Know Definitions and Terminology
- Explain Portfolio & Other Analytical Models

6.1 Introduction

Every organization needs to understand how changes will impact its business. It has to evolve strategies to deal with these changes to ensure continued survival. In order to do so, a number of techniques have been developed to analyze where the organization is going. Good management is about tools that are used to identify and focus on the performance of the organization.

6.2 Decision Trees

Decision Trees are the most commonly used tools in business. A decision tree takes as input an object or situation described by a set of properties, and outputs a yes/no decision. Decision trees therefore represent Boolean functions. They can be extremely simple or highly complex.

They are excellent tools for helping you to choose between several courses of action. They provide a highly effective structure within which you can lay out options and investigate the possible outcomes of choosing those options. They also help you to form a balanced picture of the risks and rewards associated with each possible course of action.

You start a Decision Tree with a decision that you need to make. Draw a small square to represent this towards the left of a large piece of paper. From this box draw out lines towards the right for each possible solution, and write that solution along the line. Keep the lines apart as far as possible so that you can expand your thoughts.

At the end of each line, consider the results. If the result of taking that decision is uncertain, draw a small circle. If the result is another decision that you need to make, draw another square. Squares represent decisions, and circles represent uncertain outcomes. Write the decision or factor above the square or circle. If you have completed the solution at the end of the line, just leave it blank.

Starting from the new decision squares on your diagram, draw out lines representing the options that you could select. From the circles, draw lines representing possible outcomes. Again make a brief note on the line saying what it means. Keep on doing this until you have drawn out as many of the possible outcomes and decisions as you can see leading on from the original decisions.

6.3 Issue Trees

Strategic thinking is a method that focuses on the critical issues. Suppose we have a general idea of what the critical issue may be, we can pinpoint it without wasting time, using an issue or hypothesis tree.

Issue trees help to structure the conclusions or identify the key issues or questions that a problem should address, and break it down into its smaller component parts. The trees are a useful reference point providing context and showing how each thought fits into the whole.

In this, the overall issue is divided into two or more mutually exclusive and collectively exhaustive sub-issues; and the process is repeated for the sub-issues that emerge, until a level is reached that each of the sub-items are individually manageable. Before embarking on the detailed thinking, some time should be spent thinking through the issues we are attempting to analyze. An issue tree starts with one statement. Each level of the issue tree is linked with the answers "yes" or "no". In this way, a very large problem is gradually broken down into a series of smaller issues.

6.4 Profit Trees

Starting from the assumption that the costs of a given product are too high; the issue diagram gave us a tool for analyzing the possible reasons. But suppose the problem was being tackled from the wrong end. We know that selling Product A in the existing market by present sales methods is proving unprofitable. But we do not know the reason. It has not been established that high product costs are the problem. To diagnose this phenomenon, we must move back slightly closer to fundamentals.

This time let us start from the question; to what extent can Product A's profitability be improved? There are three variables that determine profit: selling price, cost, and sales volume. In order to diagnose the problem and attain our objective of improving profitability, during the initial stages we must look into all the three variables.

As the initial step in the project, we have drawn up the diagrams set out in Figure 6.1. Because these diagrams apply to most products and are directly related to profit, we have called them profit diagrams. They can perhaps also be called issue trees. These diagrams can be used to advantage in this case.

There are two basic issues involved in increasing the profitability of Product A, (a) Can more profit be gained externally? (i.e., from the market), and (b) Can product profitability be improved at the present selling price by raising efficiency internally? (i.e., through cost reduction)

Notes

The first issue can be further divided, as Figure 6.1 shows, into two sub-issues.

- Can sales volume be increased?
- Can the price be raised?

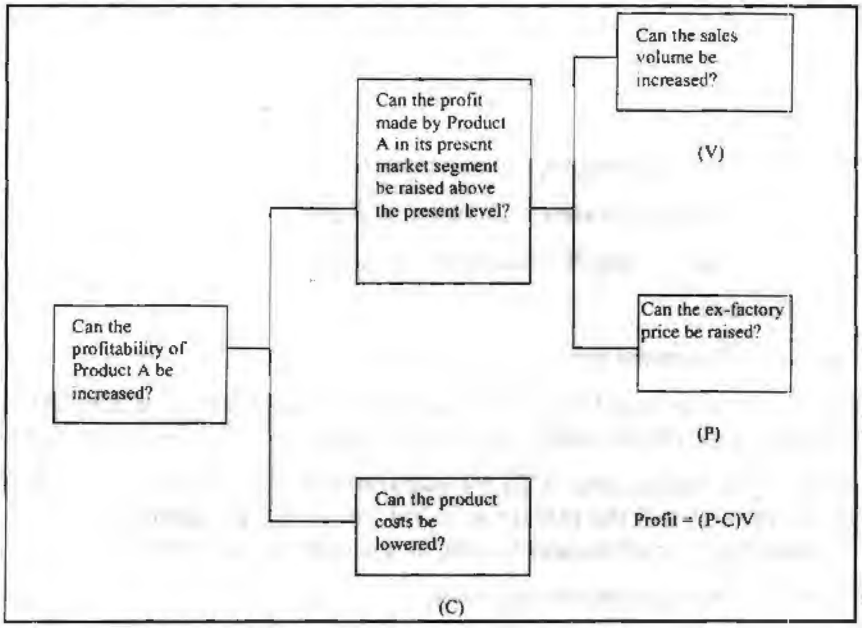


Figure 6.1: The Starting Point of a Profit Diagram

When we look at the question whether sales volumes can be increased, we can examine a number of options. These are shown in Figure 6.2.

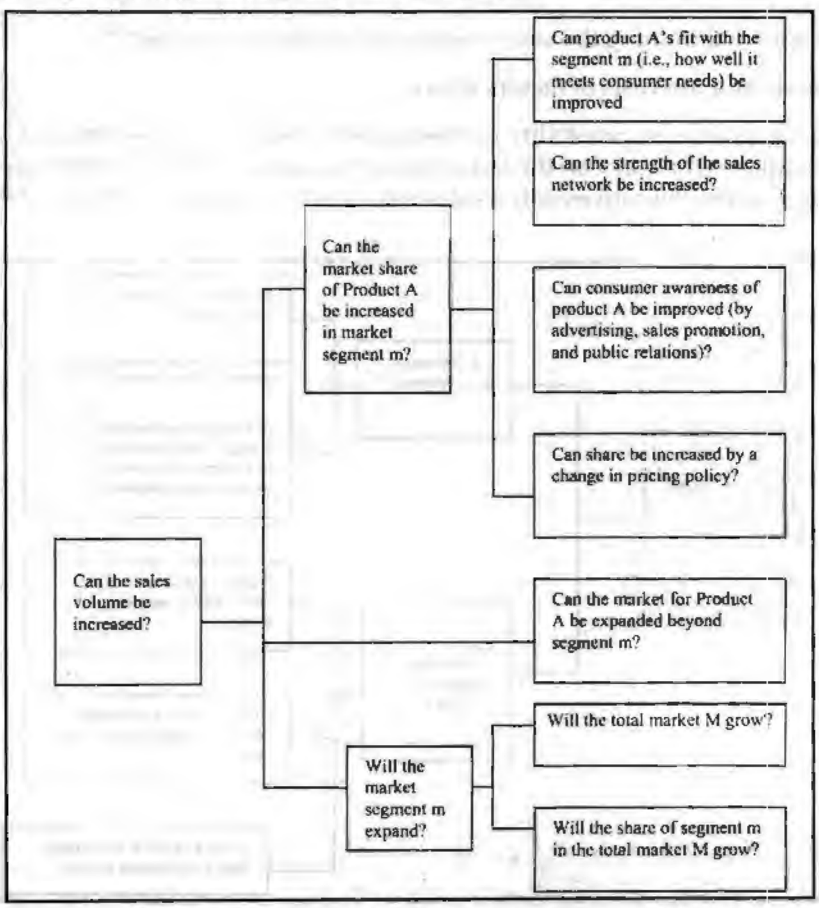


Figure 6.2: Can Sales Volume be Increased?

The first option that we need to examine is 'Can we increase our market share in segment 'm'?' There are obviously four different possibilities. In order to examine these possibilities, we need market information. The information needs have been identified next:

- Basic consumer needs
- Analysis of value (real and perceived) offered by competing products
- Trends in sale channel and geographical coverage
- Comparison of servicing capability, delivery time
- Survey of customer awareness in brand and product
- Analysis of purchasing decision-making process
- Price elasticity
- Influence of payment terms and trade-in conditions.

It is apparent that in order to find the answers to these questions, more detailed analysis is needed. Information of this nature should be available in a professional organization.

The next two possibilities are, 'Can the market for the product be expanded beyond segment 'm' or/and will the marker segment 'm' grow? The information sets that we require in making an analysis and finding an answer are given below:

- Possibility of geographical expansion
- Possibility of expansion in final customers outside the segment
- Cost-benefit analysis of expansion
- Anticipated demand (3-5 years ahead) for product constituting the total market M
- Factors determining the size of segment m within the market M
- Trends and forecasts of factors above

Figure 6.3 explores the possibility of raising the ex-factory price of product 'A''. There are two angles to this, (a) Can the factory price be raised, or (b) Can distributor margins be reduced. Both alternatives will result in the effective increase in the realization of the company.

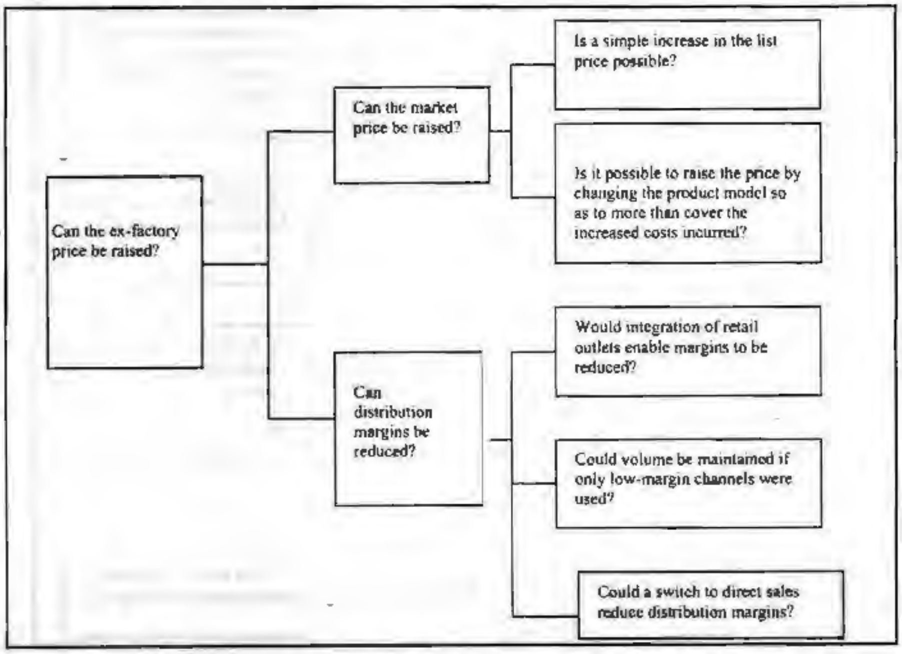


Figure 6.3: Can the ex-factory price be raised?

Hypothesis Trees

Hypothesis Trees are similar to Issue trees and help to structure the solution based on a hypothesis and then questioning the validity of the hypothesis through questions. This allows the problem to be broken down into its smaller component parts, thereby leading to a solution. The trees are a useful reference point providing context and showing how each thought fits into the whole.

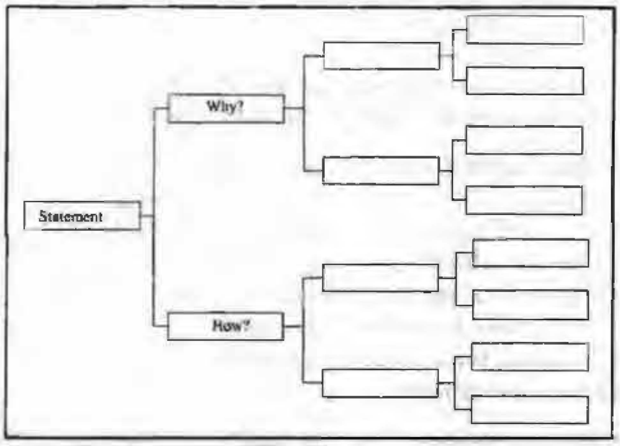


Figure 6.4: Hypothesis Tree

The first step to find a solution using a hypothesis tree is to spend some time to think through the hypothesis we are attempting to analyze, before embarking on the detailed thinking. A hypothesis tree starts with one statement. Each level of the hypothesis tree is linked with the questions "why?" or "how?" This ensures that the lower level hypotheses together answer the higher level hypothesis.

An example of this might be: higher level hypothesis: "Our organization can effectively increase productivity through providing support to workers by ensuring availability of out-of-school childcare in the local area". For example, the next layer in the tree might comprise two further hypotheses:

- The Government can provide local area child care.
- The organization best supports parents in accessing these forms of childcare.

The answers to these two hypothesis should provide the answer to the original, higher level hypothesis. These two hypotheses will then be further broken down, and so on, until a level of hypothesis is reached that address the fundamental root causes of the original issue. Specific analysis can then be designed to address each one. A schematic diagram of a hypothesis tree is given as Figure 6.4.

6.5 SWOT Analysis

It is a popular tool for audit and analysis of the overall strategic position of a business and its environment. The acronym "SWOT" represents "Strengths", "Weaknesses", "Opportunities", and "Threats". The environmental factors internal to the firm usually can be classified as strengths (S) or weaknesses (W), and those external to the firm can be classified as opportunities (O) or threats (T). The process diagram for a SWOT analysis is shown in Figure 6.5.

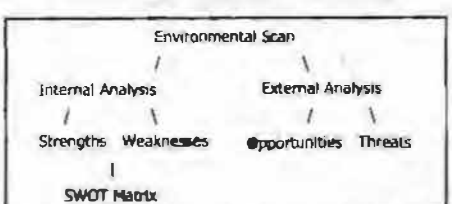


Figure 6.5: SWOT Analysis Framework

Analysis of our Firm against Competition

The first step is to identify our competition. Every business has competitors. Our competitors are those who could provide our customers a product or service that fills the same need as ours does. Even if our product or service is truly innovative, we need to look at what else our customers would purchase to accomplish this task.

The second step is to analyze strengths and weaknesses of our competitors. Determine their strengths and find out what their vulnerabilities are. Why do customers buy from them? Is it price? Value? Service? Convenience? Reputation? Focus as much on "perceived" strengths and weaknesses as we do on actual ones. This is because customer perception may actually be more important than reality.

Step 3 is to look at opportunities and threats. Strengths and weaknesses are often factors that are under a company's control. But when we're looking at our competition, we also need to examine how well prepared we are to deal with factors outside our control. Opportunities and threats fall into a wide range of categories. It might be technological developments, regulatory or legal action, economic factors, or even a possible new competitor. An effective way to do this is to create a table listing our competitors and the outside factors that will impact our industry. We will then be able to tell how we can deal with opportunities and threats.

Step 4 is to determine our position. Once we figure out what our competitors' strengths and weaknesses are, we need to determine where to position our company with respect to competition. Rank our company in the same categories that we ranked our competitors. This will give us a clear picture of where our business fits in the competitive environment. It will also help us determine what areas we need to improve, and what characteristics of our business we should take advantage of to gain more customers.

The bottom line: look for ways to leverage our strengths and take advantage of our competitors' weaknesses.

The SWOT Matrix

The relationships in a SWOT analysis are generally represented by a 2 × 2 matrix. The "Strengths" and "Opportunities" are both positive considerations. "Weaknesses" and "Threats" are both negative considerations. The final results of an analysis could be listed in the matrix given in Figure 6.6. The matrix identifies the Strengths, Weaknesses, Opportunities and Threats of a firm.

This information can be used by the company in many ways in evolving its options for the future. In general, the company should attempt to:

- Build its strength
- Reverse its weakness
- Maximize its response to opportunities
- Overcome its threat

A firm should develop a competitive advantage by identifying a fit between the firm's strengths and upcoming opportunities. In some cases, the firm can overcome a weakness in order to prepare itself to pursue a compelling opportunity. SWOT analysis is often used to develop strategies The SWOT strategy matrix is shown in Figure 6.6.

Notes

	Positive	Negative
Internal Factors	**Strengths** Patents Strong brand names Good reputation among customers Cost advantages from proprietary know-how Exclusive access to high grade natural resources Favorable access to distribution networks	**Weaknesses** Lack of patent protection A weak brand name Poor reputation among customers High cost structure Lack of access to the best natural resources Lack of access to key distribution channels
External Factors	**Opportunities** An unfulfilled customer need Arrival of new technologies Loosening of regulations Removal of international trade barriers	**Threats** Shifts in consumer tastes away from the firm's products Emergence of substitute products New regulations Increased trade barriers

Figure 6.6: The SWOT Matrix

S-O strategies pursue opportunities that are a good fit to the company's strengths.

W-O strategies overcome weaknesses to pursue opportunities.

S-T strategies identify ways that the firm can use its strengths to reduce its vulnerability to external threats.

W-T strategies establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats.

6.6 PESTLE Analysis

An in-depth investigation and analysis of our competition is one of the most important components of environmental scanning. PESTLE analysis, like the PEST analysis involves identifying the political, economic, socio-cultural and technological influences on an organization – and providing a way of auditing the environmental influences that have impacted on an organization or policy in the past and how they might do so in future.

Increasingly when carrying out analysis of environmental or external influences, legal factors have been separated out from political factors. The increasing acknowledgement of the significance of environmental factors has also led to Environment becoming a further general category, hence 'PESTLE analysis' becoming an increasingly used and recognized term, replacing the traditional' PEST analyses:

PESTLE is an acronym for:

- P – Political
- E – Economic
- S – Socio-cultural
- T – Technological
- L – Legal
- E – Environmental

Notes

Like the SWOT analysis, the PESTLE analysis is simple, quick, and uses four key perspectives. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

The PESTLE Matrix

The construction of the PESTLE matrix is similar to that of the SWOT analysis. The PESTLE matrix is shown in Figure 6.7.

The first step is to identify the issue. Remember, focus is very important. Make up your own PESTLE questions and prompts to suit the issue being analyzed and the situation. Shortlist those that are important.

On the basis of these, it should be possible to identify a number of key environmental influences, which are in effect, the drivers of change. These are the factors that require to be considered in the matrix. Then transpose the final items that we have identified from your list to a PESTLE matrix.

Political • Ecological/environmental issues • Current legislation • Future legislation • Regulatory bodies and processes • Government policies • Government term and change • Trading policies	**Economic** • Economy situation & trends • Taxation specific to products • Market and trade cycles • Specific industry factors • Customer/end-user drivers • Interest and exchange rates
Social • Lifestyle trends • Demographics • Consumer attitudes and opinions • Brand, company, technology image • Consumer buying patterns • Ethnic/religious factors	**Technological** • Replacement technology/solutions • Maturity of technology • Manufacturing maturity and capacity • Innovation potential • Technology access, licensing, patents
Legal • International Law • Employment Law • Competition Law • Health & Safety Law • Regional legislation	**Environmental** • Environmental impact • Environmental legislation • Energy consumption • Waste disposal

Figure 6.7: The PESTLE Matrix

Making it more Scientific

The PESTLE analysis can be converted into a more specific instrument of measurement by giving a weightage and a score to the items in each of the sections for each of the identified options that the firm has to consider. For each of the items in each segment of the PESTLE chart, we can give a score on a scale of 1 to 100. Some factors will be more important than the others. Make sure the total weights add up to 100. In case we are looking at options, the next step is to list all the options that we are considering. Give marks to each specific option. Multiply the marks with the weightage factor and then add the total score for each option.

Each option will have a score. The higher the score is, the more attractive the option. The final results will give an indication of the attractiveness of the various options and should be the basis for short listing viable options.

6.7 Case Analysis

Strictly speaking, case analysis is not a management tool but a management learning tool. Case analysis has been used in Management Studies from 1908, when the Harvard Business School was set up. Case analysis requires us to apply the concepts taught in different areas of business study and use the concepts to analyze the organization or the problem.

A case study presents an account of what happened to a business or industry over a number of years. It chronicles the events that managers had to deal with and provides a detailed insight into various aspects of business life, such as changes in the competitive environment, and charts the managers' response, which usually involved changing the business—or corporate-level strategy. It is normally written from the point of view of the decision maker. Each case is different because each organization is different.

Analyzing a Case

The purpose of a case study is to help us apply the concepts of Strategic Management to a real life-like situation. We are expected to analyze the issues facing a specific organization. Therefore to analyze a case, we must closely examine the issues confronting the organization. Most often we will need to read the case several times. The first reading is to grasp the overall picture of what is happening to the organization. We should read the case several times more till we are certain we have discovered and grasped the specific problems of the organization.

The steps we can take to analyze case material is given below to help in formulating a scientific approach to case analysis. There are a number of steps that are given below in 3 parts, as described below.

- Historical & SWOT analysis
- Analysis of Strategies
- Recommendations & Discussions

Historical and SWOT Analysis

The first part is to familiarize ourselves with the history of the organization. This will normally provide the information that will be the basis for the complete analysis. This is followed by the SWOT analysis. The SWOT analysis provides a brief summary of the organization's condition; a good SWOT analysis is the key to all the analyses that follow.

1. ***Analyze the organization's history:*** Analyze the organization's history, development, and growth. Identify events that were the most unusual or the most essential for its development into the organization it is today. This should help us understand how an organization's past strategy and structure affect it in the present.

   Some of the events that we will identify will have to do with its founding, and its initial products. Understand how it makes new-product market decisions, and how it developed and chose functional competencies to pursue. Important milestones are entry into new businesses and shifts in its main lines of business.

2. ***Examine the internal environment:*** The historical profile is best followed up with an analysis to identify the company's internal strengths and weaknesses. As we have already identified the milestones in the historical investigation, the critical incidents should provide an insight of the organization's strengths and weaknesses.

   Examine each of the functions of the organization, and identify the functions in which the organization is currently strong and currently weak, e.g., the organization may be strong in marketing or in research and development; it may be weak in production functions, etc. Make lists of these strengths and weaknesses.

3. *Examine the external environment:* After having analyzed the internal environment, the external environment has to be examined to identify environmental opportunities and threats. Identify which factors in the macro environment, for instance, economic or environmental factors, are relevant for the organization in question. We must apply our mind to determine how these factors affect the competitive environment.

Analysis of Strategies

The SWOT analysis will bring up some questions that we may like to examine: Is the organization in an overall strong competitive position? Can it continue to pursue its current strategies profitably? What can the organization do to turn weaknesses into strengths and threats into opportunities? Can it develop new strategies to accomplish this change?

1. *Analyze corporate-level strategy:* We have to start by defining the organization's mission and objectives. We may have to infer them from available information. This information includes such factors as the organization's business, the nature of its subsidiaries and acquisitions. If it has more than one business, it is important to analyze the relationship among the company's businesses. For example, we know that Escorts Limited operates in more than one business. The questions we need answers to are: How do its businesses connect? Do they trade or exchange resources? Are there gains to be achieved from synergy? Is the company just running a portfolio of investments?

2. *Debate the merits:* Using SWOT analysis, debate the merits of the strategies that we have identified. Are the strategies appropriate in the given environment of the organization? Could a change in strategies provide new opportunities or transform a weakness into strength? For example, should the company focus on improving its production capability or on Research & Development; should it diversify from its core business into new businesses? We should also consider how and why have the organization's strategies changed over time? What was the rationale for these changes, if any?

3. *Analyze business-level strategy:* If the organization has a single business, its business-level strategy is identical to its corporate-level strategy. If the organization is in many businesses, each business will have its own business-level strategy. The next step is to identify the company's business-level strategy. In order to do so, we will need to identify the company's generic competitive strategy-differentiation, low cost, or focus. We will also have to determine its relative competitive position and the stage of the life cycle of the products – this should give us an insight into the investment strategy of the organization. The organization may market different products using different business-level strategies. For example, Maruti Udyog offers a low-cost product – the Maruti 800 – and a line of differentiated products catering to different economic segments. Give a full account of a company's business-level strategy to show how it competes.

4. *Analyze structure and control systems:* Identify what structure and control systems the organization is using to implement its strategy and to evaluate whether that structure is the appropriate one for the organization. Different corporate and business strategies require different structures. For example, does the organization have the appropriate number of levels in the hierarchy or does it have a decentralized control? Does it use a functional structure when it should be using a product structure? Similarly, is the company using the right integration or control systems to manage its operations? Are managers being appropriately rewarded? Are the right rewards in place for encouraging cooperation among divisions? These are all issues to consider.

In the last part, we make our recommendations. We need to examine the strengths and weaknesses of the organization.

Notes

Recommendations and Discussions

We also need to consider the corporate strategy and the business level strategy and see how they fit into the strengths and weaknesses we have identified. We also need to see the efficacy of strategy implementation, or the way the organization tries to achieve its strategy.

1 *Make recommendations:* The thoroughness with which we prepared the case analysis will reflect in the quality of our recommendations. Our recommendations should be in line with our analysis and should follow logically from the analysis we have prepared. Recommendations are directed at solving whatever strategic problem the organization is facing and increasing the organization's future profitability.

2 *Class discussion:* The emphasis of the process of the case study is that we must be involved in the case to the maximum extent possible and we should feel the responsibility of decision making. The professor assumes the role of the facilitator. Therefore, the final action in a case analysis is a class discussion or a presentation of our ideas to the class. Both these formats are used depending on our professor's decision. Remember that we must tailor our analysis to suit the specific issue discussed in our case.

Conclude the Analysis

Different cases give different types of information about the situation and circumstances. Depending on the case study and what is required of us, we might completely omit one or more of the steps in the analysis, as it may not be relevant to the situation we are considering. We must be sensitive to the needs of the case and not apply the framework blindly. The framework is meant only as a guide, not as an outline. In some cases, there will be little information on many issues, whereas in others there will be a lot. In analyzing each case, focus on information on salient issues only.

The information given may include facts about the industry, the competitive conditions, the nature of products and their markets, the physical facilities, the work climate and organizational culture, the organizational structure, financial and other economic data, etc. Keeping in view the information available, be systematic and logical.

It is important to remember that no one knows what the right answer is in a case analysis. All that managers can do is to make the best guess. In fact, it is believed that if we are right only half the time in solving strategic problems, we are pretty good.

Effective business strategy cannot be built on fragmentary knowledge or analysis. Analyses done to fit into your preconceived notions do not lead to creative solutions. If such a strategy happens to produces good results, this is due to luck or inspiration. Strategy requires the combination of analytical method and mental elasticity that is often called strategic thinking. For the strategic mind to work creatively, it needs the stimulus of a good, insightful analysis. The strategist has to come up with the right questions and phrase them as solution oriented issues. In order to use your intuition, tools are a means, while information is the raw material of analysis.

6.8 Definitions and Terminology

'Issue and Profit Trees' are popular tools used to break up an issue into logical steps so that the analysis is simplified. The overall issue is divided into two or more mutually exclusive and collectively exhaustive sub-issues; and the process is repeated for the

Notes

sub-issues that emerge, until a level is reached that each of the sub-items are individually manageable.

'Hypothesis Trees' are similar to Issue trees and help to structure the solution based on a hypothesis, thereby setting the stage for testing the validity of the hypothesis through questions. This allows the problem to be broken down into its smaller component parts, thereby leading to a solution.

'SWOT Analysis' is a popular tool for audit and analysis of the overall strategic position of a business and its environment that examines the "Strengths", "Weaknesses", "Opportunities", and "Threats" in the environment.

'PESTLE' is an acronym for Political, Economic, Social, Technological, Legal and Environmental factors. PESTLE analysis is an analytical tool in the form of a grid, comprising of six sections. Weightage can be added to the different factors so that the results are more specific.

'Case Analysis' is an interactive learning tool that documents an actual or imaginary business situation and invites the student to take a view and discuss it with the class.

To Recapitulate

A number of simple models are used for analysis of the organization. Some of them are: Issue Trees; Profit Trees; Hypothesis Trees; SWOT Analysis and PESTLE Model.

Issue trees help to structure the conclusions or identify the key issues or questions that a problem should address, and break it down into its smaller component parts. A hypothesis tree and a profit tree are extensions of an issue tree.

SWOT Analysis: SWOT is a popular tool for audit and analysis of the overall strategic position of a business and its environment. The acronym "SWOT" represents "Strengths", "Weaknesses", "Opportunities", and "Threats". Used in conjunction with other established strategic management tools, for example the PESTLE analysis, the SWOT Analysis can provide information that is helpful to the firm in strategy formulation and selection.

6.9 Portfolio & Other Analytical Models

A number of techniques have been developed for displaying a diversified organization's operations as a portfolio of businesses. The techniques provide simple frameworks for reviewing the performance of multiple Strategic Business Units (SBUs') collectively. A SBU is a business that can be planned separately from others, has its own set of Competitors, and is managed as a Profit Centre. Techniques of portfolio analysis have their greatest applicability in developing strategy at the corporate level. It charts and characterizes the different businesses in the organization's portfolio and helps in determining the implications for resource allocation.

A business portfolio is the collection of Strategic Business Units (SBU) that makes up a corporation. The optimal business portfolio is one that fits perfectly to the company's strengths and helps to exploit the most attractive industries or markets. A SBU can either be an entire mid-size company or a division of a large corporation. It normally formulates its own business level strategy and often has separate objectives from the parent company.

The aim of a portfolio analysis is:

1. Analyze its current business portfolio and decide which SBUs should receive more or less investment.
2. Develop growth strategies for adding new products and businesses to the portfolio.
3. Decide which businesses or products should no longer be retained.

BCG Matrix

Notes

The Boston Consulting Group Matrix (BCG Matrix) is the best-known portfolio planning framework. The BCG growth share matrix is directly derived from the experience curve. The experience curve essentially provides a pattern of cash flow.

The breakthrough came while working for a major manufacturer of semiconductors. The Boston Consulting Group were able to collect the evidence on which to build the experience curve concept. The wide variety of semiconductors, that were a part of the study, offered them a chance to compare differing growth rates and price decline rates in a similar environment. Price data supplied by the Electronic Industries Association was compared with accumulated industry volume.

Two distinct patterns emerged:

- In one pattern, prices, in current dollars, remained constant for long periods and then began a relatively steep and long continued decline in constant dollars.
- In the other pattern, prices, in constant dollars, declined steadily at a constant rate of about 25 percent each time accumulated experience doubled.

All of the products of a company can be shown on a single growth share matrix as a product portfolio. Each product can be plotted on its own growth and share coordinates. The size of the product can be indicated by a circle in proportional scale. Great care must be taken in product-market segmentation before drawing such charts. It is quite possible for a company to be the largest in the industry and be a leader in no single segment.

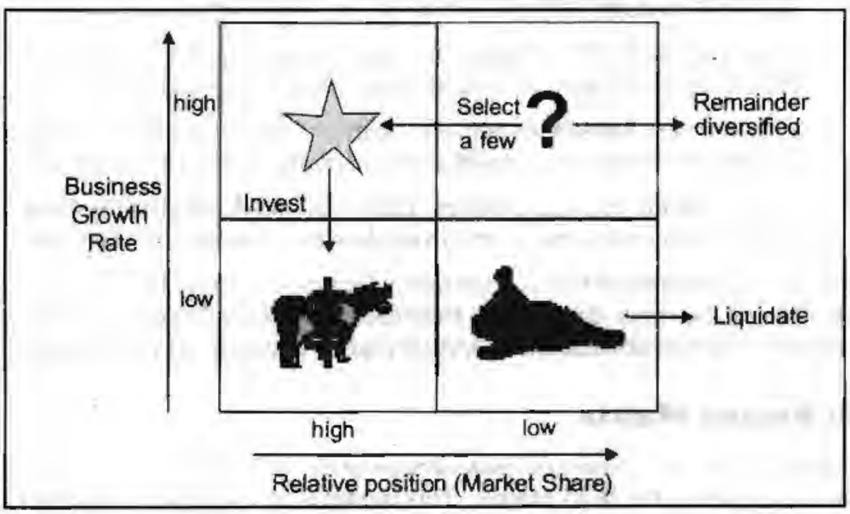


Figure 6.8: The BCG Matrix

The BCG matrix reflects the contribution of the products offered by the firm to its cash flow. Based on this analysis, products are classified as 'stars', 'cash cows', 'question marks' and 'dogs'.

1. ***Stars (high growth, high market share):*** Stars are in the upper left quadrant of the matrix.
   (a) They grow rapidly
   (b) They use large amounts of cash
   (c) Are leaders in the business so they should also generate large amounts of cash.
   (d) There is generally a balance on net cash flow.

   Over time, all growth slows. Therefore, stars eventually become cash cows if they hold their market share. If they fail to hold market share, they become dogs.

Notes

2. *Cash cows (low growth, high market share):* Cash cows are in the lower left quadrant of the matrix.
   (a) Such products are profitable and cash generation is high,
   (b) Because of the low growth, investments needed should be low.
   (c) Keep profits high
   (d) They form the foundation of an organization.

   Cash cows pay the dividends, pay the interest on debt and cover the corporate overhead.
3. *Dogs (low growth, low market share):* Dogs are in the lower right quadrant.
   (a) These products need to be avoided. You should try to minimize the number of dogs in a company.
   (b) Beware of expensive 'turn around plans'.
   (c) As soon as they stop delivering cash, they should be phased out or otherwise liquidated

   They are essentially worthless and are generally cash traps.
4. *Question marks (high growth, low market share):* They are in the upper right quadrant.
   (a) These products have the worst cash characteristics of all, because high demands and low returns due to low market share.
   (b) If nothing is done to change the market share, question marks will simply absorb great amounts of cash and later, as the growth stops, turn into dogs.
   (c) Either invest heavily or sell off; or invest nothing and generate whatever cash it can. Either you should increase market share or deliver cash.

   Question marks are the real gambles. Their cash needs are great because of their growth. Yet, their cash generation is very low because their market share is low.

The strategic implications of this categorization appear obvious. The cash cows become the financiers of the other developing businesses of the organization. One funds the 'stars', decides what to do with the 'question marks' and gets rid of the dogs.

GE/McKinsey Matrix

GE's Business screen is a more complex version of the BCG, however, it is derived from the same principles as the BCG Matrix. This model is an example of highly centralized planning specialists. This matrix is a model to perform a business portfolio analysis on the Strategic Business Units of a corporation. Strategic Business Units (SBUs) are portrayed as a circle plotted in the Matrix. Here the size of the circles represent the Market Size; the size of the pies represent the Market Share of the SBUs, and arrows represent the direction and the movement of the SBUs in the future. This is shown in Figure 6.9.

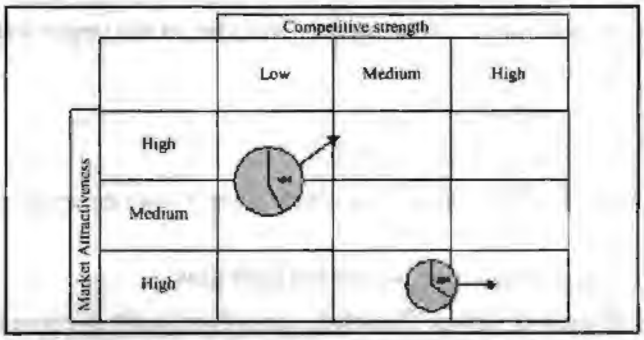


Figure 6.9: GE/McKinsey Matrix

Notes

The GE/McKinsey Matrix is a later and more advanced form of the BCG Matrix in three aspects, which are discussed below.

In this model, market growth is replaced by market (Industry) attractiveness as the dimension of industry attractiveness. Porter identified market growth as just one of the parameters of market attractiveness. Market Attractiveness includes a broader range of factors other than just the market growth rate that can determine the attractiveness of an industry/market. Depending on the product characteristics, different parameters can be selected to measure 'market attractiveness'.

Typical factors that affect 'Market Attractiveness' are called 'drivers' and can be:

- Market size
- Market growth rate
- Market profitability
- Pricing trends
- Competitive intensity/rivalry
- Overall risk of returns in the industry
- Opportunity to differentiate products and services
- Demand variability
- Segmentation
- Distribution structure

Directional Policy Matrix

The Directional Policy Matrix is another matrix similar to the BCG Matrix. It measures the health of the market and the organization's strengths to pursue it to indicate the direction for future investment. The vertical axis is market attractiveness (as opposed to business Growth rate in the BCG Matrix) and the horizontal axis is Industry Attractiveness (as opposed to Market Share in the BCG Matrix). The recommendations are similar to that of the BCG Matrix, i.e., invest, grow, harvest or divest. The 'directional policy matrix' is shown in Figure 6.10.

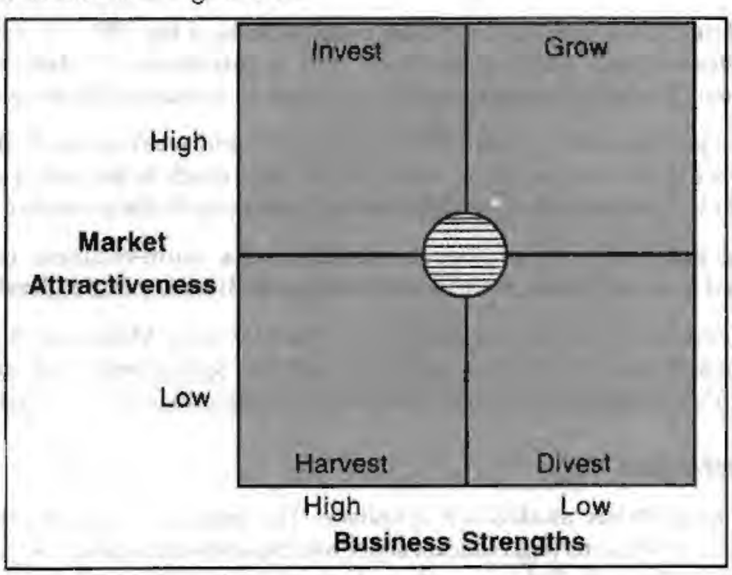


Figure 6.10: Directional Policy Matrix

Business Strengths

Expert systems are used to determine the organizational strength of the organization. The position of the enterprise on the chart based upon the assessment of the following factors:

- Supplier Bargaining Power
- Threat of Substitutes
- Threat of New Entrants
- Competitive Rivalry
- Buyer Bargaining Power
- Product Quality
- Product Value
- Relative Market Share
- Reputation
- Customer Loyalty
- Staying Power
- Experience

Advantages & Disadvantages of Matrix Models

The degree of applicability of the portfolio model depends on the relative importance and the manner in which the models are used. One has to be careful in the use of matrix analyses. The advantages and disadvantages of using matrixes for decision making are given below:

Advantages

1. ***Key areas:*** These models highlight certain aspects of business that are considered essential to success or failure.
2. ***Cash flows:*** They focus on cash flow requirements of the SBU's and help identify the different cash flow implications and requirements of different business activities. This helps management to carry out its resource allocation function.
3. ***Balance portfolio:*** They help identify strengths and weaknesses in the portfolio, the gaps that need to be filled; when a new SBU needs to be added or when one needs to be removed; and the duplicative businesses in the portfolio.
4. ***Diverse perspective:*** The diverse activities of a multi-business company are analyzed in a systematic manner and enterprise diversity highlighted.
5. ***Flexible comparisons:*** Some matrices, like the McKinsey Matrix, are highly flexible in being able to select different factors for different industries. This kind of analysis can provide coverage of a wide number of strategically relevant variables.

Disadvantages

1. ***Too simple:*** Matrix models are simplistic. The important factors are reduced to only two dimensions (e.g., market share and business attractiveness) other factors are necessarily excluded or lose their distinctiveness in the collapsed dimensions.
2. ***Market share:*** Market share, though used widely, may not be the best measure of a company's success. For example, product differentiation for a particular market segment may have low market share but produce high success within a market segment.

3. *Market share and cash flow mismatch:* High market share in a low-growth industry does not necessarily result in large positive cash flow characteristics of a "cash cow" business.

4. *Market share and cost savings mismatch:* The connection between relative market share and economies of scale may also not be a direct relationship.

Notes

Student Activity

Fill in the blanks:

1. .... represent Boolean functions.
2. The .... are a useful reference point providing context and showing how each thought fits into the whole.
3. Each level of the .... is linked with the answers "yes" or "no".

6.10 Summary

Many techniques have been developed to identify problems and provide a solution through a step-by-step progression to reach the end product. These tools help us move there efficiently. Some tools included in this unit permit us to understand the issues or hypothesis involved in the operations of the business, project management as well as the broad aspects of the business environment.

We will start this unit by discussing some simple and popular tools:

- Decision Trees
- SWOT Analysis
- PESTLE Analysis

6.11 Keywords

The bottom line: look for ways to leverage our strengths and take advantage of our competitors' weaknesses.

Case Analysis: 'Case Analysis' is an interactive learning tool that documents an actual or imaginary business situation and invites the student to take a view and discuss it with the class.

PESTLE: 'PESTLE' is an acronym for Political, Economic, Social, Technological, Legal and Environmental factors.

6.12 Review Questions

1. What are the key tools to analyse the changes in business environment?
2. Write a note on:
   (a) Decision Trees
   (b) Issue Trees
   (c) PESTLE analysis
3. Define SWOT analysis.
4. Describe BCG Matrix.
5. How to develop GE/McKinsey Matrix?
6. Explain the advantages and disadvantages of Matrix models.

Notes

6.13 Further Readings

- Grant, R. M. (2021). Contemporary strategy analysis (11th ed.). Wiley.
- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage (22nd ed.). McGraw-Hill Education.
- Johnson, G., Whittington, R., Scholes, K., Angwin, D., &Regnér, P. (2020). Exploring strategy: Text and cases (12th ed.). Pearson.
- Dess, G. G., Lumpkin, G. T., Eisner, A. B., & McNamara, G. (2022). Strategic management: Text and cases (9th ed.). McGraw-Hill Education.

Unit 7 Implementing Strategic Management

Unit Structure

7.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Explain the role of strategic leadership in strategy implementation
- Define effective strategic leadership
- Identify the importance of partnerships for managing change
- Define innovation, entrepreneurship and intrapreneurship
- Describe organization structure and strategy implementation
- State the process of implementing business-level strategies and functional strategies

7.1 Introduction

N. R. Narayan Murthy, Infosys, is a celebrated leader because of the value he has added over his tenure at the company. One of the great legacies he will leave with Infosys is a strong management development program that builds management talent that other companies want and that will fill in managerial gaps after his retirement. Mr. Murthy whom some consider the master strategic leader, truly focuses on developing human capital.

Mr. Dhirubhai Ambani, Reliance Group, is an ikon in himself because of his ability to conceptualise and communicate sweeping strategies, knowledge of operations to reach financial goals, and proficiency in implementing a new vision for the company. Mr. Ambani is an excellent strategic leader because he is able to provide clear direction for the company and his strong interpersonal skills that inspire loyalty among employees.

Compared to these highly successful strategic leaders, there are clearly several that have been less successful.

The charges confronting strategic leaders above provide obvious examples of the importance of strategic leadership, their effects on organizational outcomes, and the great challenges faced by strategic leaders. This indicates that effective strategic leaders must be able to use the strategic management process effectively by guiding the company in ways that result in the formation of strategic intent and strategic mission, facilitating the development of appropriate strategic actions and providing guidance that results in strategic competitiveness and earning above-average returns.

7.2 Role of Strategic Leadership in Implementation

In the today's competitive landscape, strategic leaders are challenged to adapt their frames of reference so that they can deal with rapid, complex changes. A managerial frame of reference is the set of assumptions, premises, and accepted wisdom that bounds (frames) a manager's understanding of the company, the industry(ies) in which it competes, and the core competencies that it exploits in the pursuit of strategic competitiveness (and above-average returns). In other words, a manager's frame of reference is the foundation on which a manager's mind set is built.

The importance of a manager's frame of reference can be seen if we perceive that competitive battles are not between companies or products but between mindsets or managerial frames. This implies that effective strategic leaders must be able to deal with the diverse and cognitively complex competitive situations that are characteristic of today's competitive landscape.

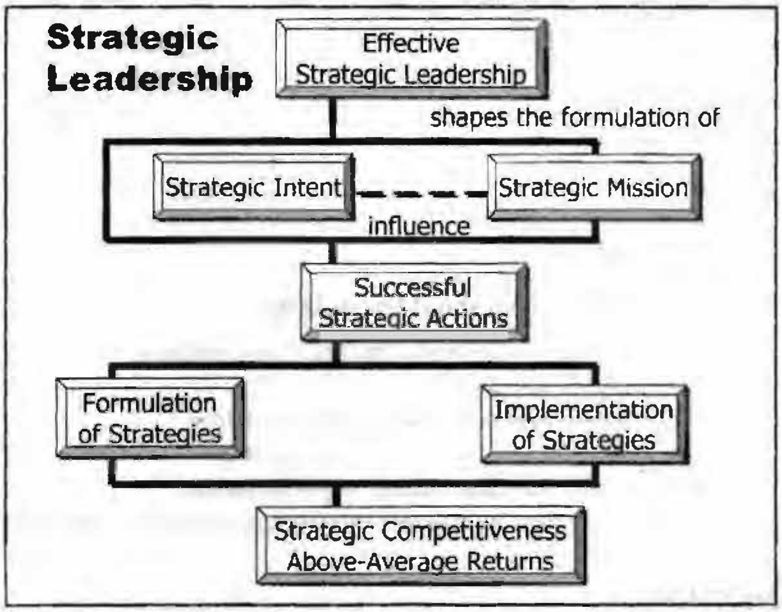


Figure 7.1: Effective Strategic Leadership

The strategic leader has several responsibilities, including the following.

- Managing human capital (perhaps the most critical of the strategic leader's skills).
- Effectively managing the company's operations.
- Sustaining high performance over time.
- Being willing to make candid, courageous, yet pragmatic, decisions.
- Soliciting corrective feedback from their peers, superiors, and employees about the value of their difficult decisions.
- Seeking feedback through face-to-face communications.
- Having decision-making responsibilities that cannot be delegated.

Notes

Thus, the strategic leadership skills of a company's managers represent resources that affect company performance. And these resources must be developed for the company's future benefit.

7.3 Effective Strategic Leadership

Figure 7.2 highlights the six most critical actions that strategic leaders must perform:

- Determining strategic direction
- Exploiting and maintaining core competencies
- Developing human capital
- Sustaining an effective corporate culture
- Emphasising ethical practices
- Establishing balanced controls.

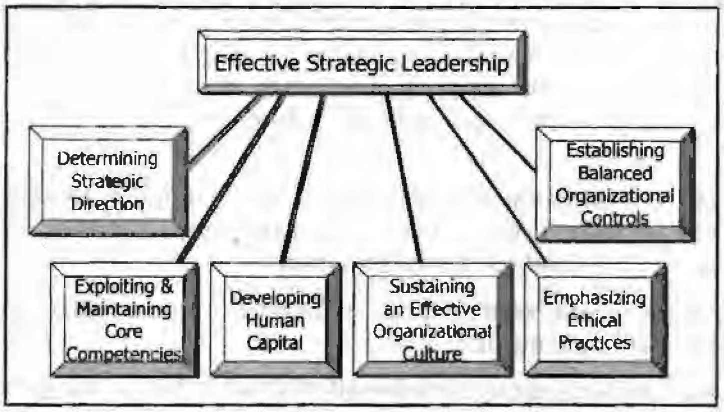


Figure 7.2: Exercise of Effective Leadership

Determining Strategic Direction

Determining the strategic direction of the company refers to the development of a long-term vision of the company's strategic intent. The time horizon for the strategic direction is long-term in nature. This means that a company's managers must think beyond the current period to develop a "future" direction for the company. Normally, this direction is envisioned for a period of 5 to 10 years into the future.

The ideal long-term vision has two parts-core ideology and envisioned future. Core ideology motivates employees through the company's heritage, but the envisioned future encourages employees to go beyond their expectations and requires significant change and progress. The envisioned future serves as a guide to the company's strategy implementation process, including motivation, leadership, employee empowerment, and organizational design.

Exploiting and Maintaining Core Competencies

Core competencies are those organizational skills that represent the strengths of the company around which a competitive advantage may be built. These core competencies relate to a company's functional skills and abilities, such as manufacturing, finance, marketing, and research and development. The key is that core competencies must enable the company to produce and deliver products and services to customers in ways that create value for them.

Notes

Developing Human Capital

Human capital refers to the knowledge and skills of the company's workforce. This means that employees must be viewed as capital resources. Remember that people and people-related competencies—the workforce and its capabilities (a company's human capital)—historically have contributed more to company (and economic) success than investment in capital equipment.

One significant problem companies face is the lack of adequate human capital to run a company effectively. As a remedy, many companies hire temporary employees, while others are trying to improve their recruiting and selection techniques. Solving the problem requires more than "temp hiring" since this limits management's ability to build effective commitment to organizational goals.

Sustaining an Effective Organisational Culture

Organisational culture represents a set of complex ideologies, symbols, and core values that is shared throughout a company and that influences the way that it conducts business. These ideologies, symbols, and core values represent what members of the company believe in and thus serve as regulators of employee actions and behaviour. Because it influences how the company conducts its business and helps regulate and control employee behaviour, organisational culture can be a source of competitive advantage.

However, given the importance of innovation for a company to achieve strategic competitiveness in today's competitive landscape, organisational culture should encourage an entrepreneurial spirit and innovation.

Corporate culture characteristics and managerial actions that encourage an entrepreneurial orientation include:

- ***Autonomy:*** Enabling employees to be self-directed in the pursuit of entrepreneurial opportunities.
- ***Innovation:*** Encouraging the pursuit of new ideas, experimentation, and creative processes that will find new ways to add value.
- ***Risk-taking:*** Promoting the willingness of both employees and the company to accept risk in the pursuit of new market opportunities.
- ***Proactiveness:*** Being a market leader rather than a market follower by anticipating the market's future needs and being the first to satisfy them.

Emphasising Ethical Practices

The effectiveness of strategy implementation processes increases when they are based on ethical practices. Ethical companies encourage and enable people at all organisational levels to exercise ethical judgement, but unethical practices become like a contagious disease if they evolve in a company. To properly influence employee judgement and behaviour, ethical practices must shape the company's decision-making process and be an integral part of a company's culture. Research has found that a value-based culture is the most effective means of ensuring that employees comply with the company's ethical standards.

In the absence of ethical requirements, managerial opportunism allows managers to make decisions that are in their own best interests, but not in the best interests of the company or its stakeholders. These actions might include engaging in questionable hiring practices, committing fraud by misstating write-offs so that earnings are not reduced or pursuing excessively high levels of executive-level (CEO) compensation.

Establishing Balanced Organisational Controls

Organisational controls, which we will discuss in detail later, are necessary to help ensure that companies meet desired outcomes: strategic competitiveness and above average returns. Controls are the formal, information-based routines and procedures used by managers to maintain or alter patterns in organisational activities to help strategic leaders build credibility. They demonstrate the value of the company's strategies to stakeholders, promote and support organisational change by providing the parameters within which strategies are implemented and corrective actions taken when implementation-related adjustments are needed.

Strategic controls represent those control systems that focus on the content of actions rather than on outcomes. This is in contrast to financial controls that focus on short-term financial outcomes (or results) rather than on the appropriateness of strategic actions that have been taken.

7.4 Teams as an Organizational Resource

Top-level managers represent an important resource for the company as they attempt to formulate and implement strategies effectively because of top-level mangers' roles in designing the company and the performance outcomes that result from using that design.

Thus, it is important for the companies to have a top management team with superior managerial skills. As managers make strategic decisions—including organisational design and the formulation and implementation of strategies—they must operate within a set range of discretion (in other words, within the latitude of alternative actions). And how managers use their discretion may be critical to a company's success as they attempt to achieve a competitive advantage. Other critical roles played by top-level managers include implementing an appropriate organizational structure, implementing the company's reward systems, shaping the company's culture and influencing what happens in the company.

Top-level managers must be able to grant empowerment and facilitate innovation. Effective strategic leaders focus their work on the key issues that ultimately shape the company's ability to earn above-average returns.

Similar to the need to match a company's internal strengths or core competencies with its intended strategies, it is important that the company's top management team possess a certain mix of expertise and skills that match the requirements of the strategy selected.

7.5 Identifying Ke y Strategic Tasks for Implementation

The foundation for strategy implementation is a clear and sharp understanding of business's strategic tasks. Strategic leader can use the process of defining the strategic task and communicating it widely to develop a partnership with employees in realigning the company. Strategic tasks are simple statements of what has to get done in a business to create or sustain a competitive advantage in the marketplace.

The accomplishment of a given strategic task depends on the company's ability to accomplish certain key work processes. For example, developing high quality and lower-cost products rapidly is strongly dependent on a process that translates a technical innovation in engineering into a manufacturable and commercially viable product. This process involves many trade-offs among marketing, engineering, and manufacturing.

Strategic tasks can be defined at any organisational level. Within a manufacturing plant, accomplishing the strategic task of improving product quality requires coordinated effort across the various parts of the plant. Corporate strategic tasks are accomplished through work processes that span multiple businesses. These tasks define ways in which the corporation as a whole contributes to the competitive advantage of its various businesses through such work processes as multidivisional sales to large customers, or through the transfer of technologies from domestic to overseas businesses.

7.6 Partnerships for Managing Change

Research has shown us that the most successful implementation occurs when sophistication in analysis and design was combined with appropriate involvement of employees in organisational analysis and change. Three tasks are of crucial importance successful completion of which is vital to the effective implementation of strategy. Strategic leaders must:

1. Develop a partnership with company members to implementation of strategy.
2. Assess the company's capability to implement its business strategy.
3. Orchestrate change initiatives that will realign the company with its business strategy in such a way that commitment builds and learning occurs.

Innumerous cases suggest that the foundation for effective strategy implementation is a partnership with the employees. A way must be found to rally employees in different levels and parts of the company around the task of implementing strategy.

Competition is forcing most companies to find ways to improve coordination among various parts of the company. Few sources of sustainable competitive advantage can be realised through the efforts of anyone function. Product quality and cost are affected not just by manufacturing but also by R&D, where the product is designed for manufacturability. An important role is played by the purchasing and logistics functions, which ensure that raw materials consistently meet specifications. In fact, partnership must go beyond the boundaries of the company to include its suppliers and customers.

Partnership is necessary not just in the newly aligned company but also in the change process itself. Why? Employees in various parts of the company who must coordinate their efforts know better than those at the top what type of coordination is needed and where the barriers to coordination exist.

Developing a Partnership

To develop a partnership for strategy implementation, a company begins by building a consensus around the business's strategic tasks. Strategic tasks are whatever has to be done to create or sustain a competitive advantage in the marketplace. This consensus must be created both within the senior management team and in the larger company. To develop this consensus key individuals must be convinced that certain actions are good for both the overall business and for them.

Barrier of Fear

One of the barriers to developing a partnership is that those who have the most to contribute also have the most to lose. This is most apparent when the strategic objective is cost reduction. It is difficult to ask managers to recommend reductions in their budgets, and virtually impossible to ask them to eliminate their jobs. Yet, these managers may know more than anyone else about the impact of alternative cost-reduction strategies effectiveness.

Barrier of Old Assumptions

It is often difficult for the managers who know the company best to go beyond their deep-seated assumptions, especially if the company has been successful in the past. It is hard to accept that what worked before may not work in the future. Executives fear that those who know the most will have the greatest difficulty breaking the frame of "how we have always done things around here." This concern leads executives, intent on implementing a radically different strategic approach, to go it alone.

Notes

7.7 Aligning Organizational Capabilities

Just as successful strategy formulation requires a comprehensive scanning and assessment of the external competitive environment, effective strategy implementation demands an equally rigorous assessment of the company's internal environment. The analysis should answer whether the company possesses the capabilities it needs to achieve the chosen strategy, and, if not, what barriers are preventing the development of these capabilities. The most effective managers continuously conduct this assessment intuitively, tracing back organisational problems to their root causes. The resulting causal map is valuable in determining what must change to implement business strategy.

Unfortunately, many managers do not apply rigorous analysis to the questions of how and why their company is not implementing strategy effectively. One reason is that they do not possess an analytic framework for asking the right questions. Figure 7.3 is a systemic framework for making an organisational diagnosis. In the following sections, we discuss each element in the framework, using a series of questions managers must answer to make an assessment of organisational capability. Given the requirement for partnership outlined above, the answers to these questions ideally should be developed by the top team with the involvement of the larger company.

The model, summarised in Figure 7.3, is based on a few simple premises:

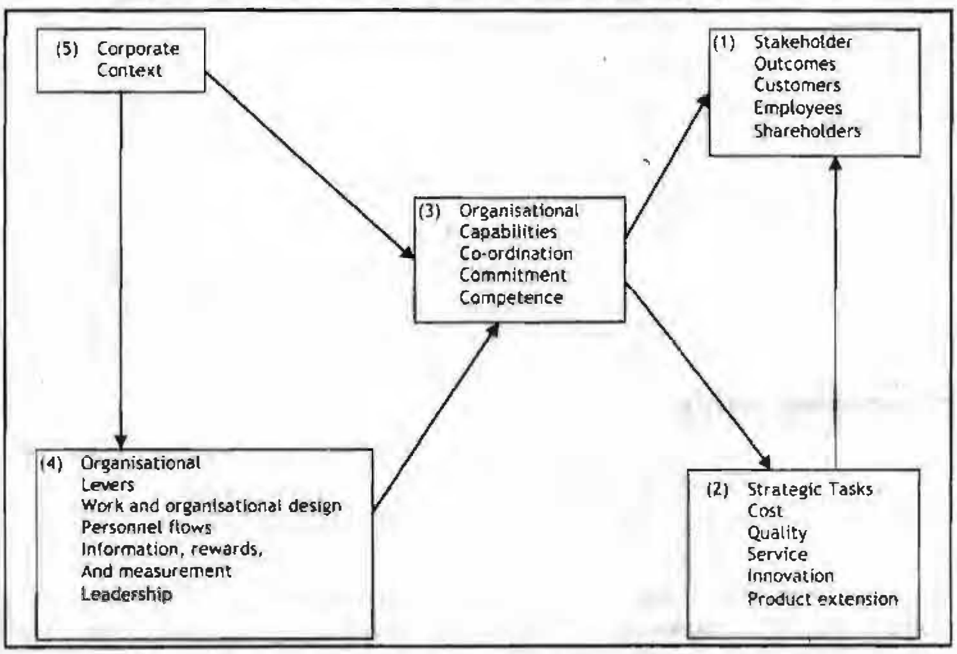


Figure 7.3: Assessing the Readiness to Implement Strategy

1. Companies can continue to exist only if they anticipate and meet the needs of their stakeholders – customers, employees and shareholders.
2. Business strategies must be articulated in actionable terms. What are the key tasks the company must accomplish to satisfy stakeholder needs?
3. The ability of the business to accomplish its strategic tasks is dependent on three organisational capabilities:
   (a) *Coordination* among parts of the company that must work together to accomplish the strategic task.
   (b) *Commitment* of individuals and groups to accomplishing the strategic task.
   (c) *Technical and managerial competence* to solve problems and coordinate solutions.

Notes

4. The organisational capabilities are related to how the company is designed and managed – its structure and systems; who has a say over key decisions; the types of individuals who are hired and promoted; its information, rewards, and measurement systems; the character and behaviour of its leaders.
5. How the company is designed and managed, as well as its capabilities are in part determined by the nature of the larger corporation of which the business unit may be a part?

7.8 Innovation, Entrepreneurship and Intrapreneurship

In many (especially global) industries, innovation is related to a company's strategic competitiveness and ability to earn above-average returns. This is happening because characteristics of the global economy make it increasingly easy to commoditise products.

Innovation

Innovation has an impact on company outcomes. Innovation is a key source of competitive success for companies competing in the global economy. Innovation is intended to enhance a company's strategic competitiveness and financial performance. Research shows that companies competing in global industries that invest more in innovation also achieve the highest returns.

Companies generally engage in one of three types of innovative activity:

- ***Invention***, the act of creating or developing a new product (good or service) or process idea.
- ***Innovation***, or the process of creating a commercialisable product from invention. However, the company can create value from innovation only when a company' develops and sells a product that satisfies customers' current or unmet needs.
- ***Imitation***, or the adoption of innovation by a population of similar companies, which typically results in standardisatioo of the product or process idea.

Entrepreneurship

Schumpeter called entrepreneurship "creative destruction"-a process through which existing products or methods of production are destroyed and replaced with new ones. Thus, the focus of entrepreneurship is on the discovery and exploitation of opportunities that may prove profitable.

At one time, entrepreneurship was defined as any form of new venture creation, which is certain to lead to self-employment, a new business, or the growth of an existing business. Thus, entrepreneurship creates change and helps companies adapt to changes.

Many organisations, as they became successful, also became much bigger, more complex and excessively bureaucratic. In a research by Accenture, bureaucratic problems were identified by three-quarters of Indian executives as one of the main impediments to entrepreneurship. One way in which corporations across the world are tackling this problem is following the dictum 'be big, work small'. Large corporations are creating the feel of a small organisations without sacrificing the benefits of size by breaking the organisation down into smaller units, overseen by a compact corporate centre.

Intrapreneurship

Intrapreneurship, a specific form of entrepreneurship, can be defined as a situation where individuals work within an existing company to create a new company or promote innovation within that company. In other words, intrapreneurship is the sum of a company's innovation, renewal, and venturing efforts.

When managed well, intrapreneurship practices use a company's strategic management process to harness the ingenuity of employees and reward them for it, though some rewards of these efforts will be retained for the benefit of shareholders.

Notes

All this requires entrepreneurs. Entrepreneurs are agents of economic growth that introduce new products, new production methods, and other innovations that stimulate economic activity. These individuals sense opportunities before others and take the risks necessary to establish new markets, develop new products, or form innovative production processes or service delivery mechanisms.

Organisational entrepreneurs engage in intrapreneurship within the context of the company by taking risks, acting aggressively and acting proactively in their companies.

Encouraging Intrapreneurship

Innovation is a necessary but insufficient condition to competitive success. Having processes and structures in place through which the company can successfully implement the outcomes of internal corporate ventures is as vital as are the innovations themselves.

IBM is creating a network of centres to facilitate implementation of product innovations and to identify opportunities to engage in still more value-creating innovation. These centres are focused on IBM's e-commerce services, but they are designed to foster collaborative relationships among IBM personnel, technologists, business experts, and customers to form and implement product innovations.

One way that companies may be able to achieve cross-functional integration is to emphasise the company's horizontal structure rather than its vertical structure. Cross-functional teams group product development stages into parallel or overlapping processes, which allows the company to tailor its product development efforts to its unique core competencies and to the needs of the market. The cross-functional integration resulting from the work of cross-functional teams helps a company learn how to mass-produce a successful product innovation.

Using Strategic Alliances for Innovation

Our previous discussion was centred on how companies can achieve strategic competitiveness and earn above-average returns through internal innovation processes. However, few companies may possess all of the knowledge necessary to compete successfully in all of their product areas over the long term. In addition, many companies may not possess the resources, capabilities, and core competencies that are required to effectively and efficiently pursue internal innovation.

An alternative to internal innovation is to tap the resources available in other companies for the following reasons:

- Knowledge is increasing at an ever-increasing rate, making it difficult for companies to keep up-to-date.
- This vast knowledge base also is becoming increasingly specialised.
- Some companies may possess the knowledge needed to commercialise goods and services.
- Some countries may have access to resources and capabilities that enable companies located there to create specialised products.

Buying Innovation through Acquisitions

In addition to developing the ability to produce and manage innovation through joint ventures and strategic alliances, these abilities can also be acquired outright through the acquisition of other companies or through investment.

Notes

While companies can buy innovation and innovative capabilities outright through acquisition, it may reduce the company's ability to produce and manage innovation internally as acquisitions are substituted for internal innovation processes.

However, research shows an over-reliance on acquiring innovation often results in reductions in R&D expenditures as a percentage of sales and the number of patents as a percentage of sales.

In the long-term, this may mean that companies will lose strategic control over their businesses-both new and acquired-as they emphasise financial controls following large acquisitions and substitute acquisitions for the internal innovation process.

As an alternative to the outright acquisition of innovation through acquiring other companies, companies may choose to invest in companies or businesses (that either mayor may not be in the company's own portfolio of businesses) with high growth potential.

7.9 Creating a Learning Organization

The 'learning organisation' as a concept was postulated several years ago by Peter Senge, and several management thinkers have worked on it. In the words of Peter Senge "... a learning organisation is one that is continually expanding its capacity to create its future.; For such an organisation, it is not enough merely to survive. 'Survival learning', or what is more often termed as 'adaptive learning', is important - indeed it is necessary. But for a learning organisation, 'adaptive learning' must be joined by 'generative learning'; learning that enhances our capacity to create."

From old-world stalwarts Birlas, Tatas and Mahindras to new-economy companies like Infosys and Wipro, everyone's trying to build a learning organisation. It's not a new fad; it's been around for a while. But as employees demand 'learningful' careers in organisations, Indian companies are trying everything from good old training to newer tools like coaching and mentoring. They're also looking at everything from plugging gaps in skill sets to teaching executives about, say, practical creativity.

The shift in employee thinking is from 'learning because I'm taught' to 'learning because I'm given a challenge'. Factors like compensation are amply taken care of in the bigger companies, so the distinguishing factor now is how much learning the organisation provides. And a right mix is necessary.

7.10 Implementing Strategies II: Org anizational Issues

Organization Structure and Stra tegy Implementation

A competitive advantage is created when there is a proper match between strategy and structure. Ineffective strategy/structure matches may result in company rigidity and failure, given the complexity and need for rapid changes in today's competitive landscape. Thus, effective strategic leaders seek to develop an organisational structure and accompanying controls that are superior to those of their competitors.

Selecting the organisational structure and controls that result in effective implementation of chosen strategies is a fundamental challenge for managers, especially top-level managers. This is because companies must be flexible, innovative, and creative in the global economy if they are to exploit their core competencies in the pursuit of marketplace opportunities. Companies must also maintain a certain degree of stability in their structures so that day-to-day tasks can be completed efficiently.

As indicated by Figure 7.4, company structure evolves from simple to functional to multidivisional. This evolution is caused by sales growth and/or coordination and control problems that prevent the company from efficiently implementing its formulated

Thus, as implementation efforts falter due to growth or other problems, the company may need to change its organisational structure to achieve an appropriate fit between strategy and structure.

Notes

Simple organisational structure is most appropriate for companies that follow a single-business strategy and offer a line of products in a single geographic market. The simple structure also is appropriate for companies implementing focused cost leadership or focused differentiation strategies. A simple structure is an organisational form in which the owner-manager makes all major decisions directly and monitors all activities, while the company's staff merely serves as an executor.

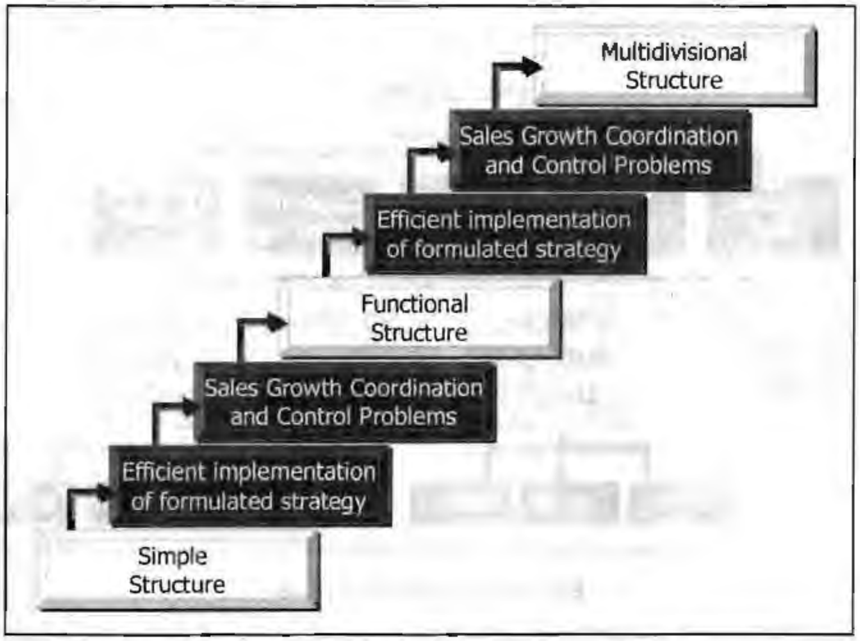


Figure 7.4: Strategy and Structure Growth Patterns

The functional structure consists of a chief executive officer or a managing director and limited corporate staff with functional line managers in dominant functions such as production, accounting, marketing, R&D, engineering, and human resources. The functional structure enables the company to overcome the growth-related constraints of the simple structure, enabling or facilitating communication and coordination.

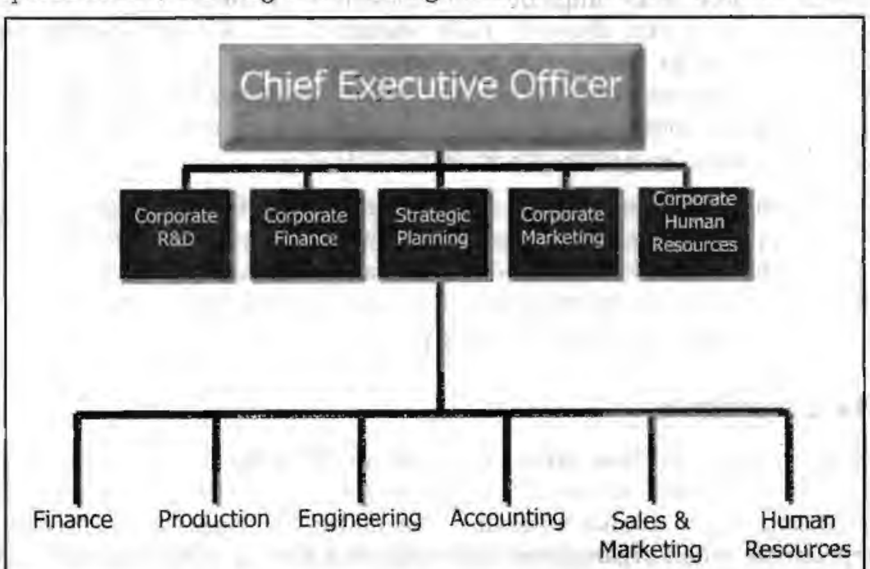


Figure 7.5: Functional Organisation Structure

Notes

Strategic Business Unit Structure

Because of limits to an individual chief executive officer's ability to process complex strategic information, problems related to isolation of functional area managers, and increasing diversification, the structure of the company needs to change. In these instances, the SBU structure is most appropriate.

The SBU structure is composed of operating units where each unit represents a separate business to which the top corporate officer delegates responsibility for day-to-day operations and business unit strategy to its managers. By such delegation, the corporate office is responsible for formulating and implementing overall corporate strategy and manages SBUs through strategic and financial controls.

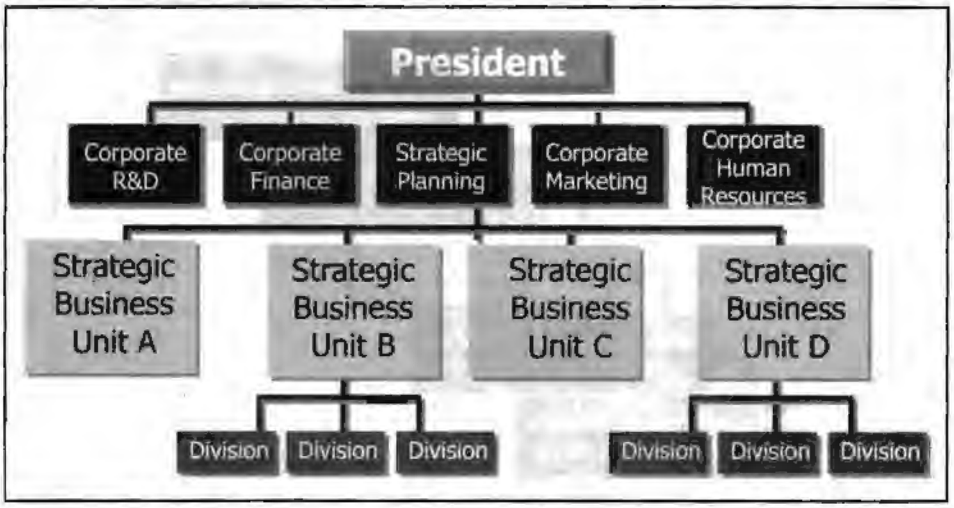


Figure 7.6: SBU Structure

This enables the company to more accurately monitor the performance of individual businesses, simplifying control problems. It also facilitates comparisons between divisions, improving the allocation of resources and can be used to stimulate managers of poorly performing divisions to seek ways to improve performance.

Newer Forms of Organization Structures

As companies successfully implement business-level strategies and achieve above average returns, they may diversify their operations by offering different products or following a product diversification strategy or offering the same or additional products in new markets or by following a market diversification strategy. Following such diversification, companies generally formulate and implement a corporate-level strategy and business-level strategies for individual units.

However, the structural and control characteristics of the functional structure do not adequately support the successful implementation of corporate-level strategies that call for diversification beyond the single- or dominant-business level. Increased levels of diversification call for newer structures that enable fast decision making and where other structures do not seem to be working properly.

Matrix Structure

Most organisations find that organising around either functions (in the functional structure) or around products and geography (in the divisional structure) provides an appropriate organisational structure. The matrix structure, in contrast, may be very appropriate when organisations conclude that neither functional nor divisional forms, even when combined with horizontal linking mechanisms like strategic business units, are right for their situations. In matrix structures, functional and product forms are combined simultaneously at the same level of the organisation. Employees have two superiors, a product or project manager and a functional manager. The "home" department—that is, engineering, manufacturing, or sales—is usually functional and is reasonably permanent. People from these functional units are often assigned temporarily to one or more product units or projects. The product units or projects are usually temporary and act like divisions in that they are differentiated on a product-market basis.

Pioneered in the aerospace industry, the matrix structure was developed to combine the stability of the functional structure with the flexibility of the product form. The matrix structure is very useful when the external environment (especially its technological and market aspects) is very complex and changeable. It does, however, produce conflicts revolving around duties, authority, and resource allocation. To the extent that the goals to be achieved are vague and the technology used is poorly understood, a continuous battle for power between product and functional mangers is likely. The matrix structure is often found in an organisation or within an SBU when the following three conditions exists: (1) Ideas need to be cross-fertilised across projects or products, (2) Resources are scarce and (3) Abilities to process information and to make decisions need to be improved.

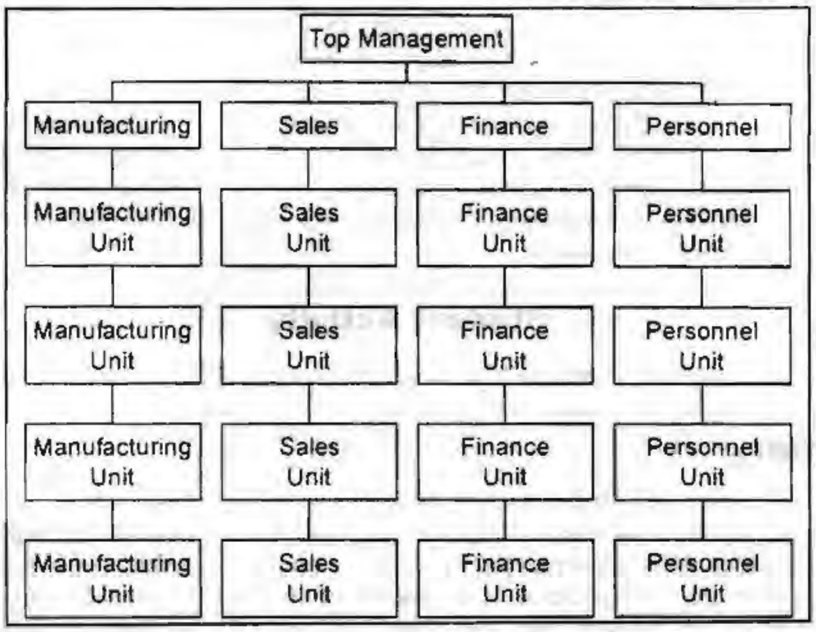


Figure 7.7: Matrix Organization Structure

Davis and Lawrence, authorities on the matrix form of organisation, propose that three distinct phases exist in the development of the matrix structure:

1. ***Temporary cross:*** Functional task forces are initially used when a new product line is being introduced. A project manager is in charge as the key horizontal link. Chrysler has extensively used this approach in product development.

2. ***Product/brand management:*** If the cross-functional task forces become more permanent, the project manager becomes a product or brand manager and a second phase begins. In this arrangement, function is still the primary organisational structure, but product or brand managers act as, the integrators of semipermanent products or brands. Considered by many a key to the success of Procter & Gamble brand management has been widely imitated by other consumer products firms around the world.

3. ***Mature matrix:*** The third and final phase of matrix development involves a true dual-authority structure. Both the functional and product structures are permanent. All employees are connected to both a vertical functional superior and a horizontal product manager. Functional and product managers have equal

authority and must work well together to resolve disagreements over resources and priorities.

Notes

However, the matrix structure is not very popular because of difficulties in implementation and trouble in managing.

7.11 Network Structure

A newer and somewhat more radical organisational design, the network structure is an example of what could be termed a "nonstructure" by its virtual elimination of inhouse business functions. Many activities are outsourced. A corporation organised in this manner is often called a virtual organisation because it is composed of a series of project groups or collaborations linked by constantly changing non-hierarchical, cobweb-like networks. The network structure becomes most useful when the environment of a firm is unstable and is expected to remain so. Under such conditions, there is usually a strong need for innovation and quick response. Instead of having salaried employees, it may contract with people for a specific project or length of time. Long-term contracts with suppliers and distributors replace services that the company could provide for itself through vertical integration. Electronic markets and sophisticated information systems reduce the transaction costs of the marketplace, thus justifying a "buy" over a "make" decision. Rather than being located in a single building or area, an organization's business functions are scattered worldwide. The organisation is, in effect, only a shell, with a small headquarters acting as a "broker," electronically connected to some completely owned divisions, partially owned subsidiaries, and other independent companies. In its ultimate form, the network organisation is a series of independent firms or business units linked together by computers in an information system that designs, produces, and markets a product or service.

Student Activity

Develop an organisational structure for a business house.

7.12 Summary

In today's competitive landscape, the ability to compete successfully in a global marketplace will be critical to a company's success. This means that strategic leaders must be provided with opportunities to work in nations other than the home country. Therefore, managing inpatriation (the process of transferring host-country or third country national managers into the home or domestic market of multinational companies) is an important means of building global core competencies.

Strategic leaders must build the skills necessary to help develop human capital (a challenge, since most strategic leaders need to enhance their human resource management abilities). Companies that value human resources and have effective reward plans for employees, obtain higher returns in initial public offerings.

7.13 Keywords

Autonomy: Enabling employees to be self-directed in the pursuit of entrepreneurial opportunities.

Innovation: Encouraging the pursuit of new ideas, experimentation, and creative processes that will find new ways to add value.

Competitive Aggressiveness: Taking actions that enable the company to consistently and significantly outperform the competition.

Intrapreneurship: Intrapreneurship is the sum of a company's innovation, renewal, and venturing efforts.

7.14 Review Questions

1. Why has strategy evaluation become so important in business today?
2. What types of quantitative and qualitative criteria do you think Mr N R Narayan Murthy, Chairman, Infosys Technologies, uses to evaluate the company's strategy?
3. As owner of a local, independent company, explain how you would evaluate the company's strategy.
4. Under what conditions are corrective actions not required in the strategy evaluation process?
5. Identify types of organisations that may need to evaluate strategy more frequently than others. Justify your choices.
6. "Strategy evaluation allows an organization to take a proactive stance toward shaping its own future." Discuss the meaning of this statement.
7. Identify guidelines that you think are most important for using strategic management effectively in organisations. Justify your answer.
8. Explain the role of strategic leaders in the implementation of strategy.

7.15 References and Further Readings

- Porter, M. E. (2019). Competitive strategy: Techniques for analyzing industries and competitors (2nd ed.). Free Press.
- De Kluyver, C. A., & Pearce, J. A. (2021). Strategy: A view from the top (6th ed.). Pearson.
- Kaplan, R. S., & Norton, D. P. (2020). The balanced scorecard: Translating strategy into action. Harvard Business Review Press.
- Saloner, G., Shepard, A., &Podolny, J. (2022). Strategic management (2nd ed.). John Wliley & Sons.

Unit 8 Implementing Business-level Strategy

Unit Structure

8.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Identify the business-level strategy
- State the key decisions required for implementing functional strategies
- Explain the role of budget
- Define strategic evaluation and control
- Describe strategic audit

8.1 Introduction

As mentioned earlier, an organisation structure is selected so that the company can effectively use its resources, capabilities, and core competencies as it implements its formulated strategy. Effective implementation of cost leadership, differentiation, and integrated cost leadership/differentiation strategies occurs when the functional structure is modified based on the unique attributes of the individual business-level strategies.

8.2 Types of Business-level Strategy

Cost Leadership Strategy

Before a company can achieve a competitive advantage by following a cost leadership strategy, its operations must operate at optimal efficiency. In most cases, this means standardised products are produced at a low per unit cost. This means that successful companies are large relative to their competitors because it requires access to resources that may not be available to competitors. A primary objective is to achieve economies of scale, therefore, efficient production capacities are increased incrementally and market share goals are important if market demand increases with price concessions.

Differentiation Strategy

Companies offering products that are considered unique by customers usually are following a differentiation strategy. A differentiation strategy requires that people learn to coordinate and integrate activities to get into a consensus-style decision making. It places its emphasis on marketing and manufacturing functions, which need quick response, based on ambiguous and incomplete data. This calls for a relatively flat organisation and flexible and less structured jobs.

Integrated Cost Leadership/Differentiation Strategy

Some companies may attempt to simultaneously implement both the cost leadership and differentiation strategies by providing value through low cost relative to a differentiated company's products and/or differentiated features relative to features offered by cost leadership companies' products.

8.3 Implementing Functional Strategies

Each functional unit of the organisation has a strategy for achieving its own mission and for helping the organisation reach its overall vision. Functional strategies are the goal directed decisions and actions of the organisation are various functional units that are designed for the short term (less than a year).

Marketing Strategies

The major categories of decisions linked to marketing strategy are as follows:

- Marketing intelligence, corresponding to the effort conducted by the firm to decipher competitors' standing and to anticipate their future moves. Important issues are product introductions, marketing approaches, changes in segmentation practices, price policies, product liabilities, new distribution channels, and improved services approaches.
- Defining and analysing markets, for generating inputs to guide the product positioning of the firm, through an appropriate market segmentation and a finer definition of product-market segments, so as to capture the different preferences and needs of customers. In each of those segments, an analysis of the behaviour of consumers and organisational buyers is conducted, as well as of the overall strategic competitive situation.
- Product strategy, including decisions on: product offering, breadth of product lines, mix, building, target markets, establishing strategic objectives for products (market share, profit contribution), and selecting a branding strategy.
- New product development and introduction, mainly: ideas generation, screening and evaluation of ideas, business analysis, development of a prototype and testing, formulation of a marketing approach, market testing in pilot regions, adjustment of administrative and support systems, and new products introduction.
- Distribution strategy, involving selection of a distribution channel (whether direct or via retailers, wholesalers, or agents), design and management of the physical distribution system (including customer service, demand forecasting, inventory control, materials handling, order processing, parts and service support, warehousing and storage, procurement, packaging, returned goods handling, and traffic and transportation), and push vs. pull mode of operation of the distribution and sales systems.
- Price strategy, considering the product competitive positioning, its product mix, brand strategy, product quality and features, and distribution, advertising and sales force strategies.

Notes

- Promotion and advertising strategies based on advertising, presentation and promotion of ideas, goods, or services by an identified sponsor; personal selling, sales promotion, and publicity.
- Marketing organisation and managerial infrastructure, considering: the development of an organisational structure; planning, control and information systems; and rewards and incentives systems in accordance with the culture of the firm and the marketing strategy.

Financial Strategies

The major categories of decisions linked to finance strategy are as follows:

- Financial intelligence, oriented at understanding the current characteristics and future trends of financial and capital markets around the world, such as: the enormous array of financial opportunities, changes in legislation, fluctuations of exchange rates, and the alternative options for risk management through financial transactions.
- Capital budgeting, mainly: criteria for deciding on the goodness of investments, requests for capital appropriation by type of investment, and the budget for total capital expenditures.
- Mergers, acquisitions, and divestments, including: identification and evaluation of opportunities, ownership alternatives, joint ventures, international expansions, and, in general, guidelines for addressing these issues with a corporate perspective.
- Equity management and dividend policy integrating: retained earnings as source of financing, share repurchasing, new equity issues, stock splits and policies concerning dividends and bonuses.
- Long-term debt financing, which is central for determining the capital structure of the firm and the debt rating, and is mainly geared at: opening new sources of long-term debt, establishing the most convenient debt terms, and managing the debt portfolio.
- Working capital management, dealing with all decisions linked to the shortterm financing of the firm; basically: cash management, credit management, and inventory management.
- Pension fund management, encompassing all decisions pertaining to the management of funds contributed by the firm and its employees for retirement purposes.

Human Resources Management Strategies

The major categories of decisions linked to human resources management strategy are as follows:

- Human resources management intelligence, oriented at understanding the practices of management prevailing in human resources markets, and the expected changes in them. Important issues are: reward structures, levels or compensations for different positions and jobs, alternatives for training and capacities development, changes in legislation related to human resources management, trends in unionisation, external focuses of attraction of key specialists, obsolescence of skills in lower level personnel, and retraining practices.
- Selection, promotion and placement, for managing the flow of people in, through, and out of the organisation, and matching available human resources to jobs in the organisation.

- Appraisal, for evaluating the performance of people within the organisation, thus enabling the proper allocation of rewards, the design of effective management development programs, the maintenance of current inventory of talent, and the proper promotion and placement of personnel.
- Rewards, providing compensation in different forms, such as: monetary, promotion, management praise, career opportunities, appreciation from customers, personal sense of well-being, opportunities to learn, security, responsibility, respect and friendship with co-workers.
- Management development, creating mechanisms to enhance skills, promotional opportunities, and career paths.
- Labour/employee relations aimed at establishing a cooperative climate between managers and employees.

Procurement Strategies

The major categories of decisions linked to procurement strategy are given below:

- Procurement intelligence, geared at understanding the common practices prevailing in markets that are factors of production for the firm, and trying to anticipate transformations that may affect the performance of the procurement function. Important issues are: alternative sources of supply from around the world, legislative changes, cartelisation of suppliers, general health and competitive standing of key suppliers, technological changes that may affect procurement, distribution patterns, and material management practices and innovations.
- Selection, evaluation, and development of suppliers, for: finding, selecting, evaluating, developing, administering and motivating suppliers able and willing to provide consistent quality, service, and competitive prices; maintaining a healthy relationship with suppliers subcontracting, buying inside the company, and make vs. buy decisions.
- Quality management of purchased goods, which includes: defining the proper quality specifications of the procured goods, inspection of the purchased items to ensure conformance with the stated specification, and even establishing a quality control process at the suppliers plant.
- Materials management of purchased goods, dealing with the flow of all of the purchased goods into the organisation, mainly: materials planning and control, order processing, incoming traffic, inventory control, receiving, in-plant materials movements, and scraps and surplus disposal.
- Value analysis, price/cost analysis, and standardisation, to confront with ample information the difficult trade-offs among price, quality, design, manufacturability, standardisation, and cost. Value analysis is a systematic effort directed at analysing the functional requirements for achieving the lowest attainable cost, consistent with the needed performance, reliability, quality, and maintainability of a product.
- Procurement organisation and managerial infrastructure.

Manufacturing Strategies

The major categories of decisions linked to manufacturing strategy are as follows:

- Manufacturing intelligence, to observe the practices and trends of manufacturing in the industry, such as: changes in competitors' facilities, technological developments in process technologies, new raw materials or components, standardisation, capital investment practices, and environmental legislation.
- Facilities, mainly the number of plants, their sites and location, and most importantly, how specialised or focused facilities are and the degree of flexibility they possess.

Notes

Technology Strategies

The major categories of decisions linked to technology strategy are given below:

- Technology intelligence, basically oriented at: gathering information concerning the current and future state of technology development, identifying the strategic technologies used by the company evaluating the technological strength in comparison to key competitive firms, and detecting the locus of innovation by key product area (users, manufacturers, suppliers, others).
- Selection of technologies, in which the firm will concentrate its efforts, to innovate in processes and products, in each stage of the business life cycle.
- Timing of new technology introduction, mainly decisions as to whether to lead or to lag competitors in process and product innovations, identifying the benefits and risks associated with a leadership and followership strategy, and assuring the congruency of the selected technology strategy with the business strategies of the firm.
- Modes of technology acquisition, by relying on its own internal efforts or resorting to external sources. Options available are: internal development, acquisition, licensing, internal ventures, joint ventures or alliances, venture capital, and education acquisitions.
- Technology horizontal strategy, identifying and exploiting technological interrelationships that exist across distinct but related businesses, to enhance the competitive advantage of the firm through: common product technologies, common process technologies, common technologies in other value added activities, one product incorporated into another, and interface among products.
- Project selection, evaluation, resource allocation, and control, including: criteria for resource allocation, project-oriented resources versus loosely controlled funds to support and plan projects, the degree of fluctuation in technology funding, and the magnitude in the profit gap to be filled by new products.

Research and Development (R&D) Strategies

An organisation's research and development (R&D) strategies should reflect its philosophy about innovation. A summary of possible R&D strategies is given below:

- Decisions about R&D emphasis strategies involve basic scientific research, product development, or process development.
- R&D timing strategies involve decisions about being a first mover or a follower.
- Product and process development strategies involve decisions about "who" and "how."

Current R&D strategies being used by organisations include employee suggestion systems and organisational cultures that encourage innovation and risk-taking.

8.4 Role of the Budget

The budget can be defined as a financial plan showing how the company will acquire resources and use them in operations during a specified time period, usually one year. A budget takes the form of a proforma set of financial statements and supporting schedules. Proforma means that figures are expected amounts as opposed to actual historical amounts. The budget is typically compiled on a monthly basis. Budgets are explained by detailed descriptions of what managers expect to do in the short run.

1. ***Helps Enforce Planning:*** The most important advantage of budgeting is, of course, that it forces managers to plan ahead. As a result of the corporate restructuring in

the 1990s and early 2000s, many managers have had to make, and are still making, many changes in their day-to-day operations.

2. *Better Coordinate Activities:* As you know, companies are composed of many segments covering many functions and programs. During the budgeting process the plans and related financial budgets of the various segments are brought together in one place.

3. *Helps in Evaluating Performance:* Performance evaluation is not an easy task. Obviously, managers desire a fair evaluation of their performance. They want to know what is expected of them in advance.

4. *Helps in Controlling:* Successful companies create a control environment. They have an effective set of internal controls to assure compliance with management's policies and procedures. Controls must assure compliance by employees at all levels. Managers must understand and follow the limits on their authority to expend the company's resources.

5. *Helps in Allocating Resources:* During the budget-planning phase many resource allocation decisions are made. A good example is capital expenditures. The various segments of a company will request a budgeted rupee amount for these expenditures. Invariably, the total amount requested exceeds the company's ability to finance that total. Consequently, a capital rationing process is used.

6. *Helps in Motivating:* Management to motivate managers and employees can use budgets. If managers participate in the planning process and budget preparation, they are likely to develop more of a commitment to achieving the budget's objectives. In the process they also realise more fully that their piece of the budgets is important in coordinating the overall plan. If a company can develop a fair budget review process (and a fair performance evaluation process), managers will be motivated to achieve desired results. Conversely, if these processes are not perceived as fair, the budgetary system will have a negative effect on motivation.

Process of Budgeting

A variety of approaches can be used to administer the budget. They vary with the way top management controls the budget process. Most large companies use some type of budget committee format. Another important ingredient is a budget manual, which describes policies and procedures and the all-important timetable for completion.

Most large companies appoint a budget committee. The advantage of having a budget committee is that members can be selected from the various functional areas of the company. Since a basic purpose of the committee is to coordinate activities throughout the company, members of the committee must have expertise in the various functional areas. These areas should include marketing, production, personnel, finance, and accounting.

The budget director, who has ultimate responsibility for formulating the budget, chairs the committee. The budget director's position in the company and the responsibilities assigned will affect the perceived importance of the budget by company members. In some companies the budget director has significant strategic authority.

Such a blend can be described as follows:

1. Top management sets forth in broad terms, and sends to the operating unit managers, an overview of the environment, the corporate goals for the year, and the resource constraints.

2. Each operating unit manager formulates in broad terms the unit's operating plans, performance targets, and resource requirements.

3. Top management collects, combines, and evaluates information from all the operating units.

4. Top management assesses and revises targets and resource availabilities, and assigns preliminary estimates to each operating unit.
5. Operating unit managers plan their activities in detail, determine their resource needs, and prepare their final budgets, which are sent to top management.
6. Top management combines these unit budgets, tunes them where necessary, approves them, and sends them back to the operating unit managers for implementation.

8.5 Strategic Evaluation and Control

Evaluating Strategies

Evaluation is simply putting a value on something. In order to put a value on a strategy, you need to understand and describe what will happen if you decide to pursue it. One way to evaluate strategies is to rate them, giving either an A, B or C rating, depending on how well they meet certain conditions or criteria.

For each strategy, you need to assess the:

1. Competitiveness of a strategy, you need to identify how exclusively you are able to deliver this strategy when compared with your potential competitors. Will your organization stand out against the competition?
2. Compatibility of a strategy, you will need to weigh up the team's skills, knowledge and motivation, to ensure that the strategy 'fits' with the organizations's resources and morale. Technical and professional skills and knowledge may be needed, in addition to skills and knowledge of how to work together as a team.
3. Controllability that an organization has over a strategy, you will need to assess the balance between the amount of control the organization normally requires, and the extent to which the contribution of the strategy to the mission could really be controlled.
4. Feasibility of a strategy indicates the ease with which the strategy could be implemented. You will need to think about the time, effort and money involved.
5. Impact of a strategy is the extent to which it would impact on, or contribute to, the organization's mission and objectives.
6. Risks of a strategy; you will need to think about the kind of things that could go wrong, the chances that they might go wrong and the extent of the consequences if they did go wrong.

If all of these criteria are met, you have a strategy that is right for you. This is as much as can be asked. There is no such thing as a good strategy in any absolute, objective sense.

8.6 Strategic Audit

The strategic audit provides a checklist of questions, by area or issue that enables a systematic analysis of various corporate functions and activities to be made. It is a type of management audit and is extremely useful as a diagnostic tool to pinpoint corporative problem areas and to highlight organizational strengths and weaknesses. The strategic audit can help determine why a certain area is creating problems for a corporation and help generate solutions to the problem.

Notes

Box 8.1: The Strategic Management Process Audit

1. To what extent do you feel top management has been committed to the pursuit of stated corporate strategy?
2. To what extent do you feel committed to the pursuit of stated corporate strategy?
3. Has top management's decision making been consistent with stated corporate strategy?
4. Has decision making been more or less centralised than anticipated?
5. Do you feel you have received sufficient resource support (financial and human) to pursue your stated plans?
6. Do everyday, operational plans seem to support the overall corporate strategy?
7. How would you rate the extent and quality of the coordination of plans among functional areas/departments/divisions?
8. How would you rate the extent and quality of the communication of plans to lower organizational levels?
9. Does the reward system (pay, promotions, etc.) seem to be tied to your strategic planning efforts?
10. Do the written plans seem to adequately represent the actual goals toward which managers seem to be working?
11. How complex is the present strategic planning process?
12. How formal is the present strategic planning process?
13. Do you feel you have the right types and amounts of external information to fulfill your strategic planning responsibilities?
14. Do you feel you have the right types and amounts of internal information to fulfill your strategic planning responsibilities? If not, what other internal information do you feel you need?
15. Would any other training help you do a better job of strategic planning? If yes, what other specific training would help?
16. Who are the major problems of the current strategic planning system?
17. How might the strategic planning process be improved upon?

Source: "Auditing the Planning Process," C. Aaron Kelly, Managerial Planning 32, no.4 (January February 1984).

The strategic audit is not an all-inclusive list, but it presents many of the critical questions needed for a detailed strategic analysis of any business corporation. Some questions or even some areas might be' inappropriate for a particular company; in other cases, the questions may be insufficient for a complete analysis. However, each question in a particular area of the strategic audit can be broken down into an additional series of subquestions.

Current Situation

Current Performance

How did the corporation perform the past year overall in terms of return on investment, market share, and profitability?

Strategic Posture

What are the corporation's current mission, objectives, strategies, and policies?

1. Are they clearly stated or are they merely implied from performance?
2. *Mission:* What business(es) is the corporation in? Why?

Notes

3. *Objectives:* What are the corporate, business, and functional objectives? Are they consistent with each other, with the mission, and with the internal and external environments?
4. *Strategies:* What strategy or mix of strategies is the corporation following? Are they consistent with each other, with the mission and objectives, and with the internal and external environments?
5. *Policies:* What are they? Are they consistent with each other, with the mission, objectives, and strategies, and with the internal and external environments?
6. Do the current mission, objectives, strategies, and policies reflect the corporation's international operations - whether global or multidomestic?

Corporate Governance

Board of Directors

1. Who are they? Are they internal or external?
2. Do they own significant shares of stock?
3. Is the stock privately held or publicly traded? Are there different classes of stock with different voting rights?
4. What do they contribute to the corporation in terms of knowledge, skills, background, and connections? If the corporation has international operations, do board members have international experience?
5. How long have they served on the board?
6. What is their level of involvement in strategic management? Do they merely rubber-stamp top management's proposals or do they actively participate and suggest future directions?

Top Management

1. What person or group constitutes top management?
2. What are top management's chief characteristics in terms of knowledge, skills, background, and style? If the corporation has international operations, does top management have international experience? Are executives from acquired companies considered part of the top management team?
3. Has top management been responsible for the corporation's performance over the past few years? How many managers have been in their current position for less than 3 years? Were they internal promotions or external hires?
4. Has it established a systematic approach to strategic management?
5. What is its level of involvement in the strategic management process?
6. How well does top management interact with lower level managers and with the board of directors?
7. Are strategic decisions made ethically in a socially responsible manner?
8. Is top management sufficiently skilled to cope with likely future challenges?

External Environment: Opportunities and Threats (SWOT)

Societal Environment

1. What general environmental forces are currently affecting both the corporation and the industries in which it competes? Which present current or future threats? Opportunities?

   (a) Economic
   (b) Technological
   (c) Political-legal
   (d) Socio-cultural

2. Are these forces different in other regions of the world?

Task Environment

1. What forces drive industry competition? Are these forces the same globally or do they vary from country to country?
   (a) Threat of new entrants
   (b) Bargaining power of buyers
   (c) Threat of substitute products or services
   (d) Bargaining power of suppliers
   (e) Rivalry among competing firms
   (f) Relative power of unions, governments, special interest groups, etc.
2. What key factors in the immediate environment (that is, customers, competitors, suppliers, creditors, labour unions, governments, trade associations, interest groups, local communities, and shareholders) are currently affecting the corporation? Which are current or future threats? Opportunities?

Summary of External Factors

Which of these forces and factors are the most important to the corporation, and to the industries in which it competes at the present time? Which will be important in the future?

Internal Environment: Strengths and Weaknesses (SWOT)

Corporate Structure

1. How is the corporation structured at present?
   (a) Is the decision-making authority centralised around one group or decentralised to many units?
   (b) Is it organized on the basis of functions, projects, geography, or some combination of these?
2. Is the structure clearly understood by everyone in the corporation?
3. Is the present structure consistent with current corporate objectives, strategies, policies, and programmes as well as with the firm's international operations?
4. In what ways does this structure compare with those of similar corporations?

Corporate Culture

1. Is there a well-defined or emerging culture composed of shared beliefs, expectations, and values?
2. Is the culture consistent with the current objectives, policies, and programmes?
3. What is the culture's position on important issues facing the corporation (that is, on productivity, quality of performance, adaptability to changing conditions, and internationalisation)?

Notes

4. Is the culture compatible with the employees' diversity of backgrounds?
5. Does the company take into consideration the values of each nation's culture in which the firm operates?

Corporate Resources

1. *Marketing*
   (a) What are the corporation's current marketing objectives, strategies, policies and programmes?
      (i) Are they clearly stated, or merely implied from performance and/or budgets?
      (ii) Are they consistent with the corporation's mission, objectives, strategies, policies, and with internal and external environments?
   (b) How well is the corporation performing in terms of analysis of market position and marketing mix (that is, product, price, place, and promotion) in both domestic and international markets? What percentage of sales comes from foreign operations?
      (i) What trends emerge from this analysis?
      (ii) What impact have these trends had on past performance and how will they probably affect future performance?
      (iii) Does this analysis support the corporation's past and pending strategic decisions?
      (iv) Does finance provide the company with a competitive advantage?
   (c) How well does this corporation's marketing performance compare with that of similar corporations?
   (d) Are financial managers using accepted marketing concepts and techniques to evaluate and improve product performance? (Consider product life cycle, market segmentation, market research, and product portfolios).
   (e) Does finance adjust to the conditions in each country in which it operates?
   (f) What is the role of the marketing manager in the strategic management process?
2. *Research and Development (R&D)*
   (a) What are the corporation's current financial objectives, strategies, policies, and programmes?
      (i) Are they clearly stated or merely implied from performance and/or budgets?
      (ii) Are they consistent with the corporation's mission, objectives, strategies, policies, and with internal and external environments?
      (iii) What is the role of technology in corporate performance?
      (iv) Does R&D provide the company with a competitive advantage?
   (b) What return is the corporation receiving from its investment in R&D?
   (c) Is the corporation competent in technology transfer? Does it use concurrent engineering and cross-functional work teams in product and process design?
   (d) What role does technological discontinuity play in the company's products?

(e) How well is the corporation performing in terms of financial analysis? (Consider ratios, common size statements, and capitalization structure.)

(f) Does R&D adjust to the conditions in each country in which the company operates?

(g) What is the role of the R&D manager in the strategic management process?

3. *Operations and Logistics*

(a) What are the corporation's current manufacturing/service objectives, strategies, policies, and programmes?

   (i) Are they clearly stated or merely implied from performance and/or budgets?

   (ii) Are they consistent with the corporation's mission, objectives, strategies, policies, and with internal and external environments?

(b) What is the type and extent of operations capabilities of the corporation? How much is done domestically versus internationally? Is the amount of outsourcing appropriate to be competitive? Is purchasing being handled appropriately?

   (i) If product-oriented, consider plant facilities, type of manufacturing system (continuous mass production, intermittent job shop, or flexible manufacturing), age and type of equipment, degree and role of automation and/or robots, plant capacities and utilisation, productivity ratings, availability and type of transportation.

   (ii) If service-oriented, consider service facilities (hospital, theatre, or school buildings), type of operations systems (continuous service over time to same clientele or intermittent service over time to varied clientele), age and type of supporting equipment, degree and role of automation and/or use of mass communication devices (diagnostic machinery, videotape machines), facility capacities and utilisation rates, efficiency ratings of professional/service personnel, availability and type of transportation to bring service staff and clientele together.

(c) Are manufacturing or service facilities vulnerable to natural disasters, local or national strikes, reduction or limitation of resources from suppliers, substantial cost increases of materials, or nationalization by governments?

(d) Is there an appropriate mix of people and machines, in manufacturing firms, or of support staff to professionals, in service firms?

(e) How well does the corporation perform relative to the competition? Is it balancing inventory costs (warehousing) with logistical costs (just-in-time)?

   Consider costs per unit of labour, material, and overhead; downtime; inventory control management and/or scheduling of service staff; production ratings; facility utilisation percentages; and number of clients successfully treated by category (if service firm) or percentage of orders shipped on time (if product firm).

   (i) What trends emerge from this analysis?

   (ii) What impact have these trends had on past performance and how will they probably affect future performance?

   (iii) Does this analysis support the corporation's past and pending strategic decisions?

   (iv) Does operations provide the company with a competitive advantage?

(f) Are operations managers using appropriate concepts and techniques to evaluate and improve current performance? Consider cost systems, quality control and reliability systems, inventory control management, personnel scheduling, TQM, learning curves, safety programmes, and engineering programmes that can improve efficiency of manufacturing or of service.

(g) Does operations adjust to the conditions in each country in which it has facilities?

(h) What is the role of the operations manager in the strategic management process?

4. ***Human Resources Management (HRM)***

(a) What are the corporation's current HRM objectives, strategies, policies, and programmes?

(i) Are they clearly stated, or merely implied from performance and/or budgets?

(ii) Are they consistent with the corporation's mission, objectives, strategies, policies, and with internal and external environments?

(b) How well is the corporation's HRM performing in terms of improving the fit between the individual employee and the job? Consider turnover, grievances, strikes, layoffs, employee training, and quality of work life.

(i) What trends emerge from this analysis?

(ii) What impact have these trends had on past performance and how will they probably affect future performance?

(iii) Does this analysis support the corporation's past and pending strategic decisions?

(iv) Does HRM provide the company with a competitive advantage?

(c) How does this corporation's HRM performance compare with that of similar corporations?

(d) Are HRM managers using appropriate concepts and techniques to evaluate and improve corporate performance? Consider the job analysis programme, performance appraisal system, up-to-date job descriptions, training and development programmes, attitude surveys, job design programs, quality of relationship with unions, and use of autonomous work teams.

(e) How well is the company managing the diversity of its workforce?

(f) Does HRM adjust to the conditions in each country in which the company operates? Does the company have a code of conduct for HRM in developing nations? Are employees receiving international assignments to prepare them for managerial positions?

(g) What is the role of the HRM manager in the strategic management process?

5. ***Information Systems (IS)***

(a) What are the corporation's current is objectives, strategies, policies, and programmes?

(i) Are they clearly stated, or merely implied from performance and/or budgets?

(ii) Are they consistent with the corporation's mission, objectives, strategies, policies, and with internal and external environments?

(b) How well is the corporation's IS performing in terms of providing a useful database, automating routine clerical operations, assisting managers in making routine decisions, and providing information necessary for strategic decisions?

(i) What trends emerge from this analysis?

(ii) What impact have these trends had on past performance and how will they probably affect future performance?

(iii) Does this analysis support the corporation's past and pending strategic decisions?

(iv) Does IS provide the company with a competitive advantage?

(c) How does this corporation's IS performance and stage of development compare with that of similar corporations?

(d) Are IS managers using appropriate concepts and techniques to evaluate and improve corporate performance? Do they know how to build and manage a complex database, conduct system analyses, and implement interactive decision-support systems?

(e) Does the company have a global IS? Does it have difficulty with getting data across national boundaries?

(f) What is the role of the IS manager in the strategic management process?

Notes

Summary of Internal Factors

Which of these factors are the most important to the corporation and to the industries in which it competes at the present time? Which will be important in the future?

Analysis of Strategic Factors (SWOT)

Situational Analysis

What are the most important internal and external factors (Strengths, Weaknesses, Opportunities, Threats) that strongly affect the corporation's present and future performance? List five to ten strategic factors.

Review of Mission and Objectives

1. Are the current mission and objectives appropriate in light of the key strategic factors and problems?
2. Should the mission and objectives be changed? If so, how?
3. If changed, what will the effects on the firm be?

Strategic Alternatives and Recommended Strategy

Strategic Alternatives

1. Can the current or revised objectives be met by the simple, more careful implementing of those strategies presently in use (for example, fine-tuning the strategies)?
2. What are the major feasible alternative strategies available to this corporation? What are the pros and cons of each? Can corporate scenarios be developed and agreed upon?

   (a) Consider cost leadership and differentiation as business strategies.

   (b) Consider stability, growth, and retrenchment as corporate strategies.

Notes

(c) Consider any functional strategic alternatives that might be needed for reinforcement of an important corporate or business strategic alternative.

Recommended Strategy

1. Specify which of the strategic alternatives you are recommending for the corporate, business, and functional levels of the corporation. Do you recommend different business or functional strategies for different units of corporation?
2. Justify your recommendation in terms of its ability to resolve both long- and short-term problems and effectively deal with the strategic factors.
3. What policies should be developed or revised to guide effective implementation?

Implementation

1. What kinds of programmes (for example, restructuring the corporation or instituting TQM) should be developed to implement the recommended strategy?
   (a) Who should develop these programmes?
   (b) Who should be in charge of these programmes?
2. Are the programmes financially feasible? Can pro forma budgets be developed and agreed upon?
   (a) Are priorities and timetables appropriate to individual programmes?
   (b) Will new standard operating procedures need to be developed?

Evaluation and Control

1. Is the current information system capable of providing sufficient feedback on implementation activities and performance? Can it measure critical success factors?
   (a) Can performance results be pinpointed by area, unit, project, or function? Is the information timely?
   (b) Is the information timely?
2. Are adequate control measures in place to ensure conformance with the recommended strategic plan?
   (a) Are appropriate standards and measures being used?
   (b) Are reward systems capable of recognizing and rewarding good performance?

Remember strategy formulation, implementation and evaluation are not separate watertight compartments, they interact with each other and carry on simultaneously. Evaluation is done at every point of strategy process and it would be unjustified to say that control can occur at the end only for it is a part of evaluation.

Just remember even after full care has been taken to do the best you can, something can still go wrong as it was unforeseen and has just crept up at the last moment.

Final Comments

In other words, even when the intentions are good, the financial results may be bad and vice versa! There is no magic formula that can be applied anywhere and everywhere. The only thing we can say is that following the process and keeping your eyes fully open and ears to the ground will take you farther in your journey rather than just fire fighting when problems arise.

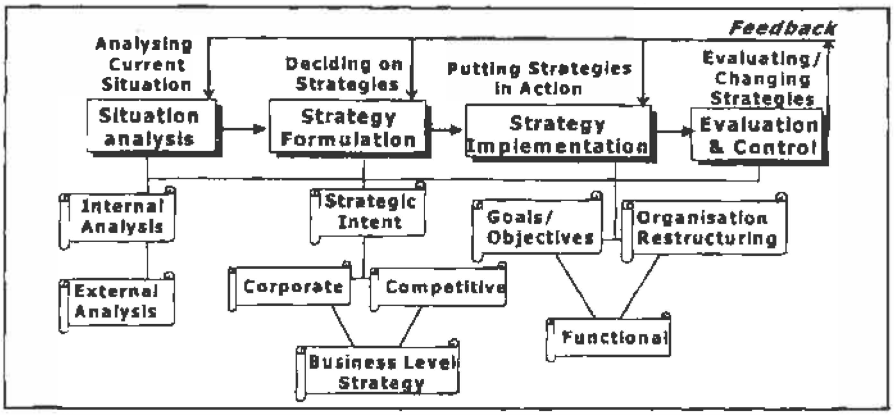


Figure 8.1: Strategic Management Process

As seen in the figure 1.2, which is reproduced as figure 8.1 above, we have come to the end of the journey. Now it is left to you to reflect back on the process and possibly provide us the feedback on it. Remember your journey has just begun.

Student Activity

Fill in the blanks:

1. A .... requires that people learn to coordinate and integrate activities to get into a consensus-style decision making.
2. .... is oriented toward the satisfaction of consumer needs, and includes all the logistics of distribution and after-sales services.
3. .... involves monitoring the implementation of plans through performance reviews.

8.7 Summary

There are just two common categories of strategic decisions for all functions: the capturing of external intelligence, and the development of the appropriate managerial infrastructure. The first deals with the understanding of the external environment and the second with the mechanisms to be put in place for the proper implementation of selected strategies. Also, horizontal strategy is an option that should be kept in mind for all functions because there is always the possibility of special economies of scale or scope, or of a unique form of interrelationship among functions. We have chosen to stress horizontal strategy only within the realm of technology, but there are additional horizontal opportunities in all of the other functions. Now, we comment briefly on each one of the seven functions.

8.8 Keywords

Differentiation Strategy: Companies offering products that are considered unique by customers usually are following a differentiation strategy.

Functional Strategies: Functional strategies are the goal directed decisions and actions of the organisation are various functional units that are designed for the short term (less than a year).

Budget: The budget can be defined as a financial plan showing how the company will acquire resources and use them in operations during a specified time period, usually one year.

Physical Facilities: Physical facilities are the resource whose strategic influence is perhaps most frequently misunderstood.

8.9 Review Questions

1. What are the different types of business-level strategy?
2. What are the key decisions related to marketing strategies?
3. Define financial strategies.
4. Describe the key decisions required to implement functional strategies.
5. Explain the role of budget.
6. What is the process of budgeting?
7. Write a note on strategic audit.

8.10 References and Further Readings

- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage (22nd ed.). McGraw-Hill Education.
- Hill, C. W. L., Schilling, M. A., & Jones, G. R. (2019). Strategic management: Theory and cases: An integrated approach (13th ed.). Cengage Learning.
- Grant, R. M. (2021). Contemporary strategy analysis (11th ed.). Wiley.

Unit 9 Operational Strategy

Notes

Unit Structure

9.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Formulate operational strategies
- Define product-service mix
- State capacity planning
- Define technology and facilities planning
- Describe TQM tools and techniques

9.1 Introduction

The operations function plays a very important role in implementing strategy. It establishes the level of quality as a product is manufactured or as a service is offered. For example, the decision whether to stress high quality regardless of cost, lowest possible cost regardless of quality or some combination of the two has numerous important implications. A highest possible quality strategy dictates state of the art technology and strict adherence to design and material requirements. A combination strategy may require lower grade technology and less concern about product design and materials specifications. If the firm decides to upgrade the quality of its products but lacks production capabilities and does not have the resources to replace its technology, it becomes difficult to reach the new standards. Therefore, just as strategy affects operations management, so too does operations management affect strategy. Operations decisions must always be consistent with corporate strategy so that the full potential of operations, resources can be harnessed in pursuit of the company's goals.

9.2 Formulating Operations Strategy

In order to carry out operations strategy successfully, it is necessary to design and implement well-conceived operating systems. The primary operating systems that are used in operations management are discussed:

Notes

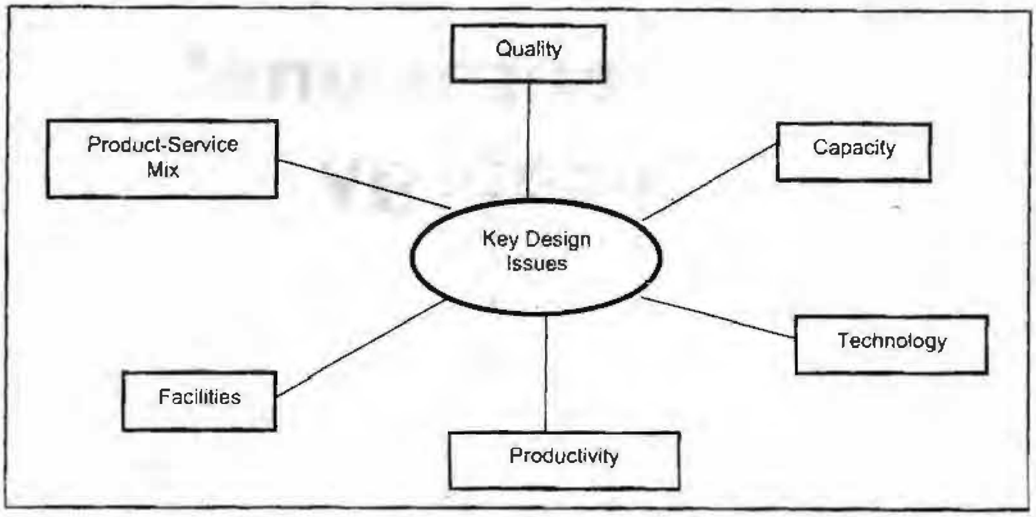


Figure 9.1: Designing Operating Systems

9.3 Product-service Mix (What to Produce?)

Initially every firm should decide about the product-service mix (how many and what kinds to offer), keeping the following objectives in mind.

- *Productivity:* It is the degree to which a product or service can actually be manufactured for the customer within the firm's operational capacity.
- *Cost efficiency:* It is the sum total of all materials, labour and overhead expenses associated with a product or service. Striving for simplicity and few parts keeps product and service designs within reasonable limits. A company that stresses cost efficiency will keep its operating costs low relative to those other, similar companies.
- *Quality:* It is the excellence of the product or service – the serviceability and value that customers gain by purchasing the products. A company that stresses quality will consistently try to provide a level of quality that is significantly superior to that of its competitors, even if it has to pay something extra to do so.
- *Reliability:* It is the degree to which the customer can count on the product or service to fulfill its intended function. The product should work as designed for a reasonable length of time.
- *Flexibility:* It is the degree to which a company can respond to changes in product design, product mix or product volume.

9.4 Capacity Planning (How many to Produce?)

Capacity planning is a process of forecasting demand and then deciding what resources will be required to meet that demand. Demand forecasting is the process of estimating the future demand that can be expected for the organisation's various offerings under an array of different market conditions. According to Mcclain and Thomas, capacity planning involves the following sequential steps.

- *Predict future demands and competitive reactions:* The company must estimate customer reaction to the products offered by it and also take care of potential countermoves by competitors.
- *Translate above estimates into capacity needs:* Based on forecasts, management must decide the amount of each offering that can be manufactured keeping input limitations such as plant, equipment, human resources, etc., in mind.

- *Create alternate capacity plans:* Depending on what the market might absorb and what the organisation can produce, management should come out with alternate capacity plans for various products/services that are offered to customers.
- *Evaluate each alternative:* As the firm adds to the variety of its offerings (or volume), costs tend to go up. Such additional costs should be carefully evaluated in terms of expected payoffs, identifying the opportunities and threats associated with each choice.
- *Select and execute a particular capacity plan:* The capacity plan that best serves corporate objectives and strategies should be picked up and implemented.

9.5 Technology and Facilitie s Planning (How to Produce?)

Process selection and facilities planning (which determines how the product or service will be produced) involves several important decisions (Stoner).

- *Major technological choice:* The operations manager, at this stage, should pay attention to questions such as, - does technology exist to produce the products? Are there competing technologies among which to choose? Should the company import technology through collaborations and joint ventures or develop it indigenously? etc.
- *Process planning:* Here the operations manager is concerned with evaluating transformation processes for costs and for consistency with desired product and capacity plans. Basically there are two options available: repetitive processing and batch processing. Repetitive processing moves the flow of materials through a continuous transformational process. Batch processing calls for work to be done on materials in batches or separate orders. Once the basic transformational process is identified, the decision then shifts to the physical arrangements to be made within the process.
- *Facilities Location Planning:* This deals with the selection of the preferred location for a production or service facility. Every firm has its own criteria for choosing a particular site for locating a new facility. In addition to cost considerations associated with purchasing and building a new site, many other factors must be evaluated including the supply of skilled labour, access to raw materials and supplies, access to transportation and communications systems, governmental incentives, etc.
- *Facility Layout Planning:* It establishes the manner in which workspace is to be arranged for each operation. For virtually any type of operation, management must determine the most effective way to layout the physical facilities. Among the traditional approaches are product layouts, process layouts and fixed-position layouts.
- *A Product Layout* is one in which the components are arranged according to the progressive steps by which the product is made. Conceptually, the flow is an unbroken line from raw material input to finished goods. This type of layout is exemplified in automobile assembly, food processing and furniture manufacture.
- *A Process Layout* (or functional layout) is one in which the components are grouped according to the general function they perform, without regard to any particular product. Custom job shops, department stores and hospitals are generally arranged in this manner.
- *A Fixed-position Layout* is one in which the product by virtue of its bulk and weight, remains at one location. The equipments required for product manufacture are moved to the product rather than vice versa. Sound stages on a movie set, aircaraft assembly shops and shipyards typify this mode of layout.

Notes

- *Purchasing Management:* Purchasing management is concerned with buying the materials and resources needed to create products and services. The purchasing manager, often has to perform a tight-rope walk while taking purchasing decisions. Buying too much locks up capital and increases storage costs. Buying too little might lead to shortages and high ordering costs. While buying materials and supplies, the purchasing manager must also make sure that the quality of what is purchased meets the firm's requirements, that the supplier is reliable and that the best financial terms are negotiated.
- *Inventory Management:* It deals with the proper management of the organisation's inventory comprising of raw materials, work-in-process, financial goods and in-transit goods.

9.6 TQM Tools and Techniques

Managers can use several tools and techniques for improving quality. Some of the important techniques are discussed below:

- *Benchmarking:* It is the process of learning how other firms (the toughest competitors or those recognised as industry leaders) do exceptionally high-quality things. The key to successful benchmarking lies in analysis. Starting with its own mission statement, a company should look into its current procedures and mark areas for improvement. Then the company should carefully pick up competitors worthy of copying.
- *Outsourcing:* It is the process of self-contracting services and operations to other firms that can do them cheaper or better (or both). By farming out activities in which they do not have expertise, such as human resource or inventory management, firms can cut down costs on employee benefits and free existing personnel for other duties.
- *Quality circles:* A quality circle is a small group of employees who meet periodically to solve quality problems related to their jobs. The reason for using quality circles is to push decision making to an organisation level at which the people who do the job and know it can make recommendations better than anyone else.
- *Statistical quality control:* Managers, traditionally, use inspection to control product quality. Inspection is simply examining and grading finished products, components or products at any stage of production. The purpose of inspection is to discard products or components that do not meet reestablished quality standards. Managers must generally determine not only what products or product components to inspect but also how many units or components to inspect. One way of addressing this question is called statistical quality control (SQC). SQC is a process used to determine how many units of a product should be inspected to calculate a probability that the total number of units meets organisational quality standards. Although managers limit inspection costs by not examining all units, they must take care to see that the number of units inspected gives an accurate measurement of the quality of the products being manufactured.

Student Activity

1. "Successful strategy implementation depends upon cooperation among all functional and divisional managers in an organisation" (F R David). Discuss.
2. Operations managers are involved in implementing and supporting strategy but not in formulating it. Why?
3. 'TQM is anchored to organisational culture because successful TQM is deeply embedded in virtually every aspect of organisational life'. Explain.

Notes

9.7 Summary

In order to carry out operations strategy successfully, it is necessary to design and implement well-conceived operating systems. The primary operating systems that are used in operations management are discussed below:

- Product service Mix
- Capacity planning
- Technology and facility planning

9.8 Keywords

Functional Plans: These are operational plans and tactics to make a strategy work.

Functional Strategy: The strategy followed by each functional area of a business unit.

Operations Management: The management of the productive processes that convert inputs into goods and services.

Operations Strategy: The recognition of the important role of operations in organisational success and the involvement of operations managers in the organisations strategic planning.

Total Quality Management (TQM): TQM is a strategic commitment by top management to change its whole approach to business to make quality a guiding factor in everything it does.

9.9 Review Questions

1. Is operations management most closely linked to corporate level, business level or functional strategies? Why and in what way?
2. Explain the following terms briefly:
   (a) TQM
   (b) Productivity Management
   (c) Inventory Management
   (d) Facility Planning.
3. Do you believe that operations management can influence competitive strategy? Discuss.
4. How might the six criteria of vendor selection help you buy an extensive item (for example, a sound system, car or bicycle)?
5. What are the major components of operations systems? How are they designed?
6. Why is product design getting so much attention today?
7. Do you think that the concept of zero defect is a good one? Explain your reasoning.
8. How does operations management help organisations meet customer's competitive priorities?
9. What is productivity? How can it be improved?
10. What is the role of operations management in modern organisational strategy?

Notes

9.10 References and Further Readings

- Hill, C. W. L., Schilling, M. A., & Jones, G. R. (2019). Strategic management: Theory and cases: An integrated approach (13th ed.). Cengage Learning.
- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases (12th ed.). Pearson.
- Pisano, G. P. (2020). Creative construction: The DNA of sustained innovation.PublicAffairs.

BLOCK – III

Notes

Unit 10 Financial Strategy

Unit Structure

10.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Describe the procurement of funds
- Analyse the utilisation of Funds
- Define financial ratio analysis
- Explain the financial strategy and competitive advantage

10.1 Introduction

Financial policies and strategies of an organisation are concerned with the raising and utilisation of funds. The basic purpose is to ensure adequate and regular supply of capital to the organisation, keeping the present and future requirements of business in mind. Capital, of course, should not only be adequate but should also be judiciously employed. As Hoagland has rightly stated, "Wasteful use of capital is as bad as inadequate capital". Hence, while estimating fixed and working capital requirements, the types of securities to be issued, the sources to be exploited, financial managers should bear in view the proper use of funds.

10.2 Procurement of Funds

Finance is required in order to maintain an adequate cash flow to keep the business operating and also for development. For the latter, the right amount is required at the right time and at the right cost. So the first question here is about deciding the capital structure of a company, which refers to the kind and proportion of different securities for raising long-term finance. It involves decisions regarding the form of capitalisation (the sum total of all long-term securities issued by a company – equity as well as debt – and the surplus not meant for distribution). It deals with some ticklish questions such as what is the total capital required? What should be the mix of equity, i.e., owner's capital and debt in the total capital? Generally speaking, there should be a healthy mix of equity and debt in a company's capital structure in order to maximise returns to its owners. At the same time, it should neither be over-capitalised nor under-capitalised.

Notes

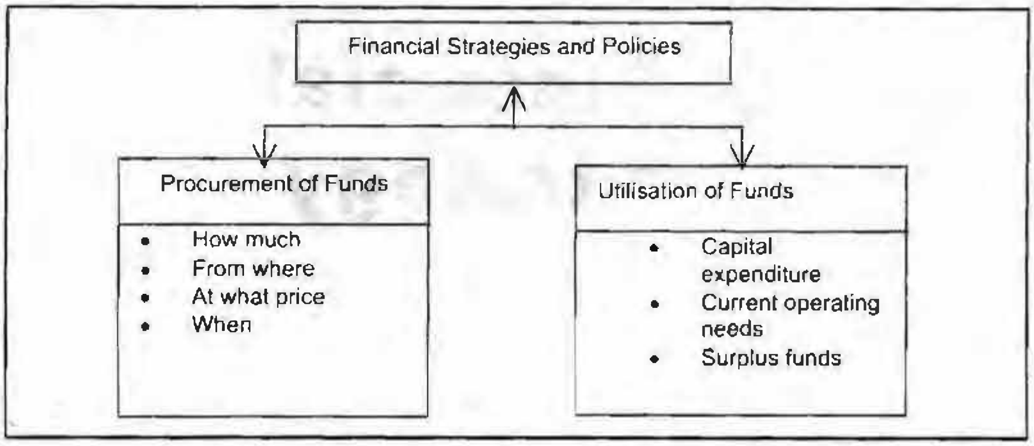


Figure 10.1: Funds Management

10.3 Utilisation of Funds

The amounts raised through various sources, at the right cost, at the right time, should be put to good use. A proper balance should be maintained while investing in fixed assets and current assets. Fixed assets involve investment of funds (in land and buildings, plant and machinery, furniture and fittings, office equipment etc.) over a fairly long period of time.

Working capital may be expressed in two ways. Gross working capital refers to working capital as the total of current assets whereas the net working capital refers to working capital as excess of current assets over current liabilities. The networking capital position of a company is an important issue in that it will decide the firm's profitability and liquidity. Liquidity here means the ability to settle bills on time which is possible only when you have sufficient cash. The current assets should be deployed properly to improve overall profitability which is possible only when you do not keep your current assets like cash idle. While striking a fine balance between these apparently conflicting objectives, the finance manager has to take a number of factors into account such as the business (steel firms need more working capital, seasonal businesses and firms requiring large doses of imported raw materials also need more working capital), the length of production cycle, proper physical layout, terms and conditions set by suppliers of material and buyers of products etc. Every company should, in the final analysis, try to reduce the operating cycle to the minimum in order to manage funds efficiently and effectively. The operating cycle refers to the time taken for the conversion of cash into raw material, raw material into work-in-process, work-in-process in to finished goods, finished goods into receivables and receivables into cash.

Table 10.1: Comparison between Own and Lease Options

Own Assets	Point of Distinction	Leased Assets
Heavy amounts needed	Initial outlay	Not required
Funds locked up: limited flexibility	Opportunity cost	Funds can be put to other uses
Not significant	Recurring expenditure	Very high due to annual rentals
Owners must absorb the repair costs	Repairs	Generally, not the responsibility of the lease-holder
Owners must face the music if rate of change in technology is very high	Obsolescence risk	Risk is minimum as assets are leased for short periods
Interest on loans, depreciation repairs, maintenance etc available	Tax Benefits	Annual lease rent allowed.

10.4 Financial Ratio Analysis

Notes

Another useful way of analysing a firm from a financial standpoint is to carry out a financial ratio analysis. Ratio analysis involves a study of ratios between various items or groups of items in financial statements. Ratios can be broadly classified into the following categories:

- *Liquidity Ratios:* Liquidity ratios indicate the ability of a firm to meet its eminent and short-term obligations. Generally speaking, the current ratio should be about 2:1 although what is acceptable depends on the industry and the situation.
- *Leverage Ratios:* These are capital structure ratios reflecting the long-term solvency of the firm and are calculated for the benefit of long-term creditors. They indicate the ability of the firm to repay the principal amount when it becomes due and to make regular payments of interest. Indian financial institutions generally permit a debt equity ratio of 2:1. A very high debt-equity ratio is not healthy because it entails correspondingly heavy interest payment and loan repayment obligations.
- *Activity Ratio:* Activity ratio finds out how well the organisation handles its assets. For strategic management purposes, two of the most important activity ratios measure inventory turnover and total asset utilisation.
- *Profitability Ratios:* There are two important profitability ratios, namely profit margin (gross or net) on sales and return on investment. The gross profit margin is calculated by dividing net profit by sales. A high gross profit margin and net profit margin is a measure of increased profitability. Return on investment is calculated by dividing earnings after taxes by total assets (also called return on assets ratio). This ratio gives an indication of how productivity the organisation has acquired, used and managed assets.

The following is the summary of the most important financial ratios.

Box 10.1: Important Financial Ratios

Liquidity Ratios:

1 Current Ratio $= \dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

2. Quick Ratio $= \dfrac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$

Leverage Ratios:

1. Total Debt Ratio $= \dfrac{\text{Total Debt}}{\text{Capital Employed}}$

2. Debt-equity Ratio $= \dfrac{\text{Net Worth}}{\text{Total Debt}}$

3. Capital-equity Ratio $= \dfrac{\text{Capital Employed or Net Assets}}{\text{Net Worth}}$

4. Interest Coverage $= \dfrac{\text{EBIT} + \text{Depreciation}}{\text{Interest}}$

Activity Ratios:

1. Inventory Turnover $= \dfrac{\text{Cost of Goods Sold or Sales}}{\text{Inventory}}$

2. No. of Days, Inventory $= \dfrac{360}{\text{Inventory Turnover}}$

Contd...

3. Debtors Turnover = $\frac{\text{Credit Sales or Sales}}{\text{Debtors}}$

4. Collection Period = $\frac{360}{\text{Debtors Turnover}}$

5. Assets Turnover = $\frac{\text{Sales}}{\text{Net Assets or Capital Employed}}$

6. Working Capital Turnover = $\frac{\text{Sales}}{\text{Net Working Capital}}$

Profitability Ratios:

1. Gross margin = $\frac{\text{Gross Profit}}{\text{Sales}}$

2. Net Margin = $\frac{\text{Profit After Tax}}{\text{Sales}}$

3. PAT to EBIT Ratio = $\frac{\text{PAT}}{\text{EBIT}}$

4. (i) Return on Investment = $\frac{\text{EBIT}}{\text{Net Assets or Capital Employed}}$

5. Return on Equity = $\frac{\text{PAT}}{\text{Net Worth}}$

Where

PAT = Profit After Tax

EBIT = Earnings Before Interest and Tax

10.5 Financial Strategy and Competitive Advantage

Financial strategy aims at providing the firm with the appropriate financial structure and help to meet its overall objectives. It tries to explore various strategic alternatives such as acquisition or investment in new products or new plants and pinpoint the most lucrative ones. Finally, it provides a distinct competitive advantage through cheaper funding and a flexible ability to raise capital (Clarke). As indicated previously, investments should yield more than the cost of capital used to fund them. The profits earned should be greater than the money required to finance a loan or increased equity funding. Choices between equity dilution or loan funding should be made carefully. Loan funding requires regular and fixed interest payments whereas equity offers more flexibility. At the same time, equity is quite expensive in that it is not easy to service a large equity. When earnings are not consistent, loan funding becomes a risky proposition. To strike a balance between the two, companies look for leasing opportunities actively. Under this arrangement, assets are obtained on lease for an agreed annual charge for a specified period and the funds that would have remained locked up are released for more profitable investments elsewhere. The company, additionally, obtains tax concessions.

Strategic Investment Decisions

While allocating funds to major projects (buy equipment, acquire another company, launch new product, etc.), a finance manager should carefully look into other strategic issues – in addition to the ability to raise money and costs involved (Thompson) – namely:

Notes

1. Does the proposed investment make sense strategically, given the present objectives?
2. Will the investment yield an adequate financial return?
3. How long will it take to achieve the best fit between investments and generating returns (estimating cash flows over a period of time)?
4. Is it worthwhile to proceed further? What other strategic alternatives could be profitably explored?
5. Is the proposal strategically attractive? Will any advantage gained be sustainable? Are there any synergies with other parts of the business?
6. Can we incorporate the risk and uncertainty elements into the evaluation process through, say sensitivity analysis? (Sensitivity analysis involves changing certain parameters and finding their implications).
7. While acquiring companies, finance managers should carefully value a company taking earnings potential, market share, brand value, investor perception etc. into account (the hidden costs, implicit financial obligations, overheads and other indirect costs should be evaluated carefully).

Competitive Advantage

Companies obtain competitive advantage in the field of finance through low cost finance (cost of capital lower than one's competitors), cost effective production, high quality through low wastage, proper inventory management and purchase and stores control. The ability to raise funds from appropriate sources at competitive rates would, often, spell the difference between success and failure. While committing funds to the best advantage, the finance manager should critically evaluate investment proposals and lop off things that do not add value. Unrelated diversification moves, acquiring businesses that do not mesh with existing operations or bring in additional benefits, losing debt capital to conquer territories rapidly are some of the risky moves that need close monitoring. The reduce costs, the finance manager should also manage working capital effectively. Working capital, as a rule, is related to the movement of funds in and out of the business. If there is proper inventory management, debtors (days of credit extended) and creditors (days of credit taken), then overdrafts can be cut down or cash flows enhanced. As a result, there is either a saving of interest payments which literally leads to reduced costs or to improved returns on investments.

Student Activity

1. Is the following statement true or false – "Retained Earnings on the balance sheet are not monies available to finance strategy implementation"? Explain.
2. "Financial policies and strategies deal with creation of wealth to shareholders" – Is this true? If yes, how?
3. What factors generally influence the procurement and utilisation of funds in the case of a medium-sized firm operating in an environment marked by rapid change?
4. Is it possible to build competitive advantages through appropriate financial strategies? If yes, explain through an example supporting your arguments.

Notes

10.6 Summary

Every finance manager must resolve there important issues – cash, inventory and receivables – in order to have an effective level of working capital. Striking a fine balance between what is required to meet payment schedules and how much is needed to exploit opportunities or to meet contingencies is a ticklish problem everywhere. Cash budgets are devised to solve this problem and are prepared taking into effect various factors that have a bearing on cash flows. Any funds in excess of budgetary needs are deployed in the market, especially in short-term securities such as treasury bills, certificates of deposit, commercial paper, inter-corporate deposits, etc. In order to achieve optimal use of operating funds, the finance manager should also keep an eye on inventory movement.

10.7 Keywords

Capital: Total paid up value of shares issued by a company.

Capitalisation: If refers to the shares issued, debentures outstanding and the surplus accumulated.

Capital Structure: It refers to the composition of long-term financing. Capitalisation is a quantitative concept that shows the total amount of long-term finance whereas capital structure shows the kind of securities issued to raise the total amount (qualitative aspect).

Over-capitalisation: A company may be under-capitalised when the rate of profit it is making on the total capital is exceptionally high in relation to the return enjoyed by similarly situated companies in the same industry or when it has too little capital with which to conduct its business.

10.8 Review Questions

1. Discuss the important issues while procuring funds for a company from various sources.
2. What factors should be kept in view by management while determining the dividend policy of a company?
3. Write short notes on:
   (a) Liquidity Ratios
   (b) Leverage Ratios
   (c) Activity Ratios
   (d) Profitability Ratios
4. What are the important factors that must be kept in mind while utilising funds in a firm?
5. Briefly outline the factors which need to be taken into consideration for capital structure planning.
6. Explain how financial strategies could bring in distinct competitive advantages to a firm.

10.9 References and Further Readings

Barney, J. B., & liesterly, W. S. (2019). Strategic management and competitive advantage. Concepts and cases (6th ed.). Pearson.

- Wheelen, T. L., liunger, J. D., lioffman, A. N., & Bamford, C. E. (2018). Strategic management and business policy. Globalization, innovation, and sustainability (15th ed.). Pearson.

Notes

Unit 11 Marketing Strategy

Unit Structure

11.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define market segmentation and product positioning
- Identify the product strategies
- Explain the product life cycle concept
- Define pricing strategies
- Describe the distribution and promotion strategies

11.1 Introduction

Marketing is the business function that identifies customers needs and wants, determines the target markets which the organisation can serve best, and designs appropriate products, services and programmes to serve these markets. Marketing requires everyone in the organisation to 'think customer' and to do all they can to help create and deliver superior customer value and satisfaction. Target consumers are at the centre of all marketing efforts. The organisation identifies the total market, divides it into smaller segments, picks up the most promising ones and focuses on serving and satisfying these segments. A suitable marketing mix is designed to differentiate its marketing offer and position this offer in select target segments.

11.2 Market Segmentation

Marketers have to divide the market into distinct groups of buyers on the basis of needs, characteristics or behaviour, who might require separate product offerings. This is popularly known as market segmentation. The logic of market segmentation is quite simple. It is based on the idea that a single product item does not usually appeal to all consumers. Market segmentation helps a firm to distinguish one customer group from another within a given market and focus attention on the segment which could be exploited profitably. In the passenger car market, for example, customers who choose the biggest, most comfortable car regardless of price make up on market segment (luxury car segment). Another segment would be customers who are concerned about price

Notes

and operating economy (popular, small car segment). Yet another segment could be concerned about reasonable comforts at an affordable price (mid-size segment). In the present day competitive scenario, there is no use adopting one marketing mix strategy for all the segments (remember what happened to Ambassador and Premier Padmini in India?).

Why Market Segmentation?

Market segmentations offers innumerable benefits to a firm:

1. It is able to find out and compare the market potential of its products in various market segments.
2. The firm can carry out a SWOT analysis, find its own strengths in comparison to others in each segment.
3. By focussing sharply on each of the different customer groups within a market, market segmentation would make the marketing effort more economical.
4. The firm can explore and create new markets for its products.
5. Segmentation forces rivals to face each other head-on: offer their best products to customer at competitive prices and innovate continually to stay in the business.

How to Segment a Market?

Segmentation can be done using several bases. In consumer marketing, there are four major segmentation variables: geographic, demographic, psychographic and behavioural. In geographic segmentation, the market is divided into different geographical units such as nations, states, regions, cities, etc. Fast food restaurants such as McDonald's and Burger King use information on population size and population density to help them select restaurant locations. In demographic segmentation, the market is classified into groups based on age, sex, family size, income, education, occupation, religion, race and nationality. Infact, many products are designed for groups based on the basis of sex (clothes, cosmetics); age (toys) or income (automobiles). In psychographic segmentation, the market is divided into different groups based on social class, life style or personality characteristics. In benefit segmentation, consumers are grouped into markets on the basis of different benefits sought from the product. For example, the toothpaste market can be divided into four groups, based on benefit segmentation. The sensory segment would require flavour, product appearance (children demanding spearmint toothpaste). The sociable segment would need bright, sparking teeth (outgoing, active youth market), the worrier segment would demand decay prevention (large families using toothpaste heavily); and the independent segment would require low prices and usually prefer sale brands (R.I Haley).

Segmentation Strategies

Segmentation strategies are of three types undifferentiated, differentiated and concentrated. An undifferentiated marketing strategy (mass marketing) ignores market-segment differences and goes after the whole market with one offer. The focus here is on what is common in the needs of consumers rather than what is different. An example of undifferentiated marketing is the Coca-Cola company's early marketing of only one drink in one bottle size in one taste to suit everyone. This strategy is appropriate if consumers are insensitive to product variations, if the competition is light, or if the product itself cannot be early varied. It has limited use in the present day competitive world where even water is marketed in brands to different segments.

Targeting Market Segments

Market targeting is the act of selecting one of more market segments to enter. While doing so, the firm should look into three things: segment size and growth, segment

Notes

structural attractiveness and firm's objectives and resources. (a) Segment size and its growth potential may not always be the criterion, especially in the case of smaller firms not having requisite funds. Again, such fastest-growing segments may be highly competitive. Hence, such firms may go after smaller segments and serve the same with a unique marketing mix. However, if the firm has a competitive advantage that cannot be easily copied, it will always try to exploit the larger market segments successfully. (b) The firm also needs to examine the structural factors that affect long-term profit potential of the segments. This, according to Porter, depends on: whether there are strong and aggressive competitors; whether there are entry barriers to new players; availability of substitute products, presence of powerful buyers who will try to force prices down and the existence of powerful suppliers who can join hands to reduce price/quality/demand collectively. (c) Again, the selection of target markets has a lot to do with the firm's objectives and capabilities. Generally speaking, a firm should enter segments only in which it can offer superior value and gain competitive advantage over competitors.

11.3 Product Positioning

Once segments have been selected and targeted, the firm must position its products and services, in the minds of its customers. Positioning is the act of designing the firm's offer and image so that the target market understands and appreciates what the firm stands for in relation to its competitors. Here the firm must carefully select the ways in which it will distinguish itself from competitors. A difference is worth establishing if it meets the following criteria (Keller).

- *Important:* The difference delivers a highly valued benefit to a sufficient number of buyers.
- *Distinctive:* The difference either isn't offered by others or is offered in a more distinctive way by the company.
- *Superior:* The difference is superior to other ways to obtain the same benefit.
- *Communicable:* The difference is communicable and visible to buyers.
- *Preemptive:* The difference cannot be easily copied by competitors.
- *Affordable:* The buyer can afford to pay for the difference.
- *Profitable:* The company will find it profitable to introduce the difference.

11.4 Product Strategies

A product is anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need. A firm has to look into several important issues while deciding an appropriate product policy such as what products to make, where to offer these products, to which segment in the market, what type of brand policy, etc. Let's examine these in greater detial.

- *Product line decisions:* Most firms produce a product line rather than a single product. A product line is a group of products that are related in function, customer-purchase needs, or distribution channels. For example, Nike produces several lines of athletic shoes, Videsh Sanchar Nigam Ltd. offers several lines of long distance telephone services.
- *Product mix decisions:* The product mix consists of all the different product lines that a firm offers. Decisions here usually deal with four aspects: width, length, depth and consistency. The width of a product mix is based on the number of different product lines which a firm offers. Product mix length refers to the total number of items the firm carries within its product lines (like ten laundry detergents, eight shampoos, etc.).

Notes

- *New product development decisions:* Rapid changes in consumer tasks, technology and competition compel firms to develop a steady stream of new products and services. New products for our discussion here will include original products, improved products, modified products and new brands that the firm develops through its own R&D efforts.

11.5 Product Life Cycle Concept

The PLC is a concept that tries to describe a product's sales, profits, customers, competitors and marketing emphasis from its beginning until it is removed from the market. The PLC concept is based on four premises:

- Products have a limited life;
- Product sales has to go through distinct stages, each with different marketing implications;
- Profits from a product vary at different stages in the life cycle;
- Products require different strategies at different life cycle stages.

It will be seen from Figure 11.1 that the life cycle of a typical product exhibits an S-shaped sales curve marked by four distinct stages, viz., introduction, growth, maturity and decline. During product development, the company incurs increasing costs and losses are also incurred. When the product is launched, its sales pass through an introduction period, sales increase during the period of growth and maturity and eventually decline. Profits are negative in the beginning, then increase and reach a peak in the growth and maturity stages and then decline.

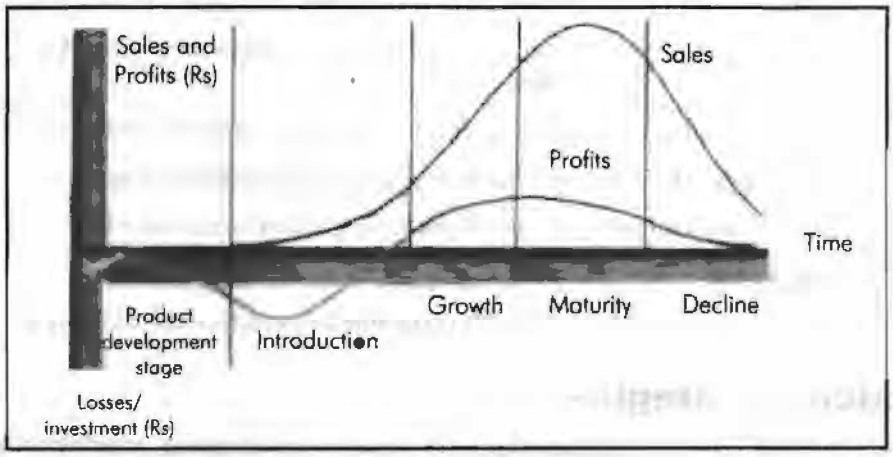


Figure 11.1: Product Life Cycle

If the company does not do research work and develops a new product or new uses of an existing product, then the sales curve will keep on declining till the product dies a natural death. If the sales decline has to be halted, modifications have to be introduced in the product just at the time sales begin to decline. Thus we can say that in many cases, the urge for a new model comes not from the consumer but from the manufacturer, who has to think of surviving n this competitive world. He does this after judging the potential needs of the consumer through market research.

As pointed out previously, not all the products necessarily pass through the five stages of the product life cycle nor will the stages be of equal duration. Some products will pass through a rapid growth period soon after introduction; others skip the growth stage and enter the maturity stage after introduction. Some products move from maturity to a second stage of rapid growth if during the maturity stage a new or improved product is introduced just at the time the sales begin to decline.

Notes

Introduction Stage

It is a period of slow growth. As can be seen from the profit curve, profits are almost non-existent due to heavy promotional and research expenditure. The slow growth and non-existence or inadequacy of profits are due to the following reasons:

(a) Technical snags in the new product and its non-acceptance by the public.

(b) Its production capacity may not still be geared to the new product or fit in the existing product line.

(c) Distribution channels may be inadequate.

(d) Small number of buyers if the product is expensive.

(e) Heavy distribution and promotional expenses in the introductory stage.

(f) High cost of production due to small scale production.

In the introduction stage, competitors are few and the promoters usually direct their energies to the higher income groups and adopt a pricing policy of skimming the profits. The marketing strategy involved is extensive advertising, aggressive sales promotion and introducing inducements.

Growth Stage

It is a period of consumer acceptance and profit improvement; sales and profits rise due to the following reasons:

(a) Technological snags have been ironed out and quality is better.

(b) New segments of the market are pierced.

(c) New distribution channels are opened.

(d) Profits rise as promotion costs are spread over a larger volume of production.

In the growth stage, competitors enter attracted by profits. Prices remain the same or fall slightly so as to attract the next layer of the price-conscious buyers. Companies maintain their promotional expenditure at the same level or a slightly less level to fight competition. However, since sales rise, the promotion – sales ratio declines. The promotional expenditures remain high although they tend to fall as a ratio to sales volume. The falling ratio of promotional expenditure to sales is an important contribution to high profits at this stage. The marketing strategy now shifts to price appeals and product improvements.

Maturity Stage

It is a period of slowdown in the rate of growth as sales reach the maximum and then start declining. Profits also reach the peak and start declining as competitors enter the field and many promotional expenses have to be undertaken. The slow rate of sales growth leads to excess capacity and strong price competition leading to mark-down pricing. Since the saturation point is reached, the company may merely attempt to recover costs. It is during this stage that many crucial decisions have to be made and market strategies to be properly spelt out. Firstly, the expenses of research and development have to be increased to find new uses of old products or an improved quality of the product and this will further reduce profits. Secondly, the new or improved product has to be introduced in the market just at the time the sales begin to decline; as for example, new uses have been found for paper such as paper bags, paper cups, paper napkins, etc. Similarly, research on cloth has produced cloth that does not shrink, that does not require ironing, and so on.

Notes

Decline Stage

If in the period of maturity, an aggressive sales promotion campaign is not planned, or a new or improved product is not introduced just at the time sales begin to decline, the sales will fall further and eventually the product will have to be dropped. If a new or improved product is introduced, the sales-curve will start rising. Aggressive sales campaigns at this stage may help in pushing sales up for a while.

During this stage, weaker firms drop out and only stronger firms remain. Promotional budget is reduced. Prices are also reduced. Profitability falls because the product may become obsolete due to technological advances, or the rivals may push forward with striking improvements in their products or substitutes may emerge. There are also hidden costs such as spoiling the image of the company and tying up scarce resources and capital.

Marketing strategies differ for products as they move through different life cycle stages. In the introduction stage, the firm emphasises generating customer awareness and stimulating trial of the product. During the growth stage, it focuses on building consumer brand preference to secure a strong market position. The maturity stage calls for a variety of strategies to maintain market share and extend the life cycle. During the decline stage, the firm must consider options to maintain, harvest or drop the products.

11.6 Pricing Strategies

The importance of price in marketing strategy varies according to a number of factors: the stage of the product life cycle, intensity of industry competition, the company's market position, company resources, type of competition (oligopolistic or monopolistic), state of economic cycle (boom or bust), degree of price elasticity, etc. Any business should evaluate its pricing options when planning its marketing policies. Five categories of pricing strategies may be considered by marketing planners in this regard.

Market Positioning Strategies

An important marketing strategy is to determine where the business should be positioned in its product markets. Price is one of the commonly employed means to segment a market. High-price segment contains few competitors and wide profit margins. Buyers seeking top quality or prestige products are less price sensitive. Medium-price segment is subject to intense competition and therefore, offers lower profit margins. Low-price segment offers an opportunity for producers and companies with weak brand names to get into the market. However, it suffers from intensive price competition and low margins.

Cost-based Strategies

There are three well-known approaches to price setting: cost-plus, target-return, and marginal cost.

- *Cost-plus pricing:* This approach involves determining the product's full cost and then adding a percentage for the profit margin. This approach may work well if the firm has a strong grip over the market.
- *Target-return pricing:* This approach is based on the belief that the single best measure of business performance is the profit earned on capital invested. This is designed to set prices that will provide a predetermined profit return on capital employed to produce and market each product.
- *Marginal cost pricing:* Sometimes called contribution pricing, a marginal cost strategy is one in which orders are taken at prices which cover all variable expenses and some portion of fixed expenses. With excess production capacity, for instance,

a company may be better off taking orders at prices that make some contribution to fixed cost rather than lose orders at prices that cover full costs.

Notes

Trade Positioning Strategies

These strategies offer higher or lower trade discounts in order to position the firm in the market in an advantageous way. Higher trade discounts are offered generally:

(i) to help the company with a weak market position sign up wholesalers and retailers to represent the product line;

(ii) to encourage wholesalers to provide extra promotion effort.

Lower trade discounts are offered when the company's position in the market is strong and wholesalers and retailers want to carry the product voluntarily.

Price Administration Strategies

There are three options to administer price strategies: price maintenance, flexible pricing and negotiated pricing. Price maintenance refers to the efforts of a firm to hold to its established price.

New Product Strategies

The important question in the pricing of new products is whether to price above, below, or at market rate. The answer will depend on the effectiveness of your new product's differentiation, its cost relative to competitors, and the marketing resources to be put behind the market introduction. Test marketing at different prices can be helpful in spotting the optimum price. There are two well-known price strategies adopted for new products. Under the skimming pricing strategy, the new product is introduced at a high price, with market promotion aimed at early adopters and those with low sensitivity to price. The idea is to 'skim the cream' before lowering the price at later intervals to capture the increasingly price-sensitive segments. Penetration pricing calls for introducing the new product at a low price to develop the market quickly. This strategy is more suitable when: the product is price sensitive in the early stages, there are opportunities to reduce costs through economies of scale, there is likely to be early strong competition and there is no elite segment willing to pay a higher price to obtain the newest and best.

11.7 Distribution and Promotion Strategies

Distribution strategies and policies are concerned with specific objectives in terms of market coverage, services to customers, product promotion, support and optimisation of cost/performance ratios.

1. *Market coverage strategies:* Market coverage for consumer goods can be classified as intensive, selective or exclusive, according to the relative numbers of retail outlets used for each geographic market. Intensive coverage calls for distribution through many retail outlets; selective coverage, through a few retail outlets; and exclusive coverage, through only one retail outlet per geographic area. Industrial (multi-purpose) products like screws, nuts, bolts, office supplies and consumer goods like soaps, toothpaste, etc. are offered through mass merchandising stores. Shopping goods like television sets, bicycles, typewriters, stereo sets, etc. are offered through selected retail outlets. Similarly, industrial goods like plumbing equipment, electrical equipment, lumber etc., are distributed through select retail outlets. Specialty goods like Scotch whiskey, special drugs, high quality men's suits, jewellery etc. are offered through exclusive retail outlets in metropolitan areas. Exclusive industrial goods dealership is found in heavy equipment industries such as farm, road and drilling equipment.

Notes

Table 11.1: Factors affecting Company Market Position in relation to Competition

Product	Price	Distribution	Promotion	Market perceptions
– uniqueness – quality and performance fit with market requirements – customer service – effectiveness of packaging. – market segments served/not served – cost efficiency	– segments served – price same, above or below competition – adequacy of trade discounts and allowances	– breadth and quality of distribution – product availability at point of sale when ordered – sales support by channel intermediaries – attitude of channel members toward company	– reach and frequency of advertising – effectiveness of advertising – effectiveness of sales promotion – breadth and depth of sales force coverage	– brand awareness – perceived degree of product differentiation – attitudes toward company, brands products, services

2. *Channel strategies:* There are two basic strategic decisions that manufacturers must make concerning channels:

   (i) whether to employ direct or indirect channels and

   (ii) if the decision is to employ indirect, whether to use single or multiple product channels.

   Indirect channels are highly suitable for consumer goods because they help in meeting the regular, frequent shopping needs of consumers. In general, the direct channel is appropriate for industrial goods:

   (i) when products are of high value,

   (ii) when there are relatively few customers,

   (iii) when transportation costs are low relative to product value or

   (iv) when orders are infrequent.

   Other factors that may favour the direct channel are proximity to customer locations and the degree of after-sale service needed by the products.

3. *Strategies for cost/performance optimisation:* While selecting a practical strategy, the manufacturer should be able to achieve the best trade-off between costs on the one hand and performance on the other. He should also see whether the marketing requirements can be met in terms of levels of production, at the required quality and cost so as to market the product successfully and make it sufficiently profitable to be financially acceptable? The manufacturer should also evaluate the promotional efforts in terms of expenditures and quality, relative to his major competitors. He should also compare the expenditures for advertising, personal selling and sales promotion with competitors' expenditures and note any change in trends of his own or competitors' expenditures. He should also evaluate the effectiveness of his advertising in terms of reach frequency, and performance compared to objectives.

Student Activity

1. Explain how companies can position their products for maximum competitive advantage in the market place.
2. Why are many people willing to pay more for branded products than for unbranded products? What does this tell you about the value of branding?
3. Explain how marketing strategies change during the product's life cycle.

11.8 Summary

Marketing strategy, over the years, has passed through three stages. Mass marketing is a way to mass produce and mass distribute one product and try to attract all kinds of buyers. For example, Henry Ford offered the model T Ford to all buyers. They could have the car 'in any colour as long as it is black'. Segment marketing recognises that buyers differ in their needs, perceptions and buying behaviours. So the firm here tries to isolate broad segments that make up a market and adapts its offers to more closely meet the needs of one or more segments. Firms also pursue niche marketing to cater to the specific needs of a sub-group within each segment. A niche is a more narrowly defined group having a distinctive set of traits - seeking certain special benefits and willing to pay a premium price. Target marketing is the decision to distinguish the different groups that comprise a market and to develop corresponding products and marketing mixes for each target market.

11.9 Keywords

Marketing: A process by which individuals and groups obtain what they need and want by creating and exchanging products and value with others.

Marketing Concept: Achieving organisation goals depends on determining the needs and wants of target markets and delivering the desired satisfactions more effectively and efficiently than competitors do.

Marketing Process: It matches consumer needs with the company capabilities and objectives.

Marketing Mix: The overall marketing offer (consisting of product, price, promotion and place) to appeal to the target market.

11.10 Review Questions

1. Define market segmentation. State the importance of segmenting a market. What are the important segmentation strategies pursued by a multi-product firm?
2. What are the essential requirements for successful market segmentation?
3. Write short notes on
   (a) Market targeting
   (b) Customised marketing
   (c) Product positioning
   (d) Niche marketing
4. What is a product life cycle? What is its importance in product policy decisions?
5. In a competitive market what are the possible ways in which a company producing ready made garments could make its offerings more distinctive?
6. Write short notes on:
   (a) Product line decisions
   (b) Products mix decisions
   (c) Branding and packaging decisions
7. How frequently should a motor cycle manufacturer change the design of its products? What factors should be taken into account while deciding such design changes?

Notes

11.11 References and Further Readings

- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases(12th ed.). Pearson.
- Dess, G. G., Lumpkin, G. T., Eisner, A. B., & McNamara, G. (2022). Strategic management: Text and cases (9th ed.). McGraw-Hill Education.
- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage: Concepts and cases (22nd ed.). McGraw-Hill Education.
- Wheelen, T. L., Hunger, J. D., Hoffman, A. N., & Bamford, C. E. (2018). Concepts in strategic management and business policy: Globalization, innovation and sustainability (15th ed.). Pearson.

Notes

Unit 12 Human Resource Strategy

Unit Structure

12.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define human resource strategy and personnel policies
- Explain the role of HRM
- Describe the challanges in performance management

12.1 Introduction

Organisations have come to realise, over the years, that improving technology and cutting costs improve performance only upto a point. To move beyond that point, the organisation's people are its most important resource. In the end, everything an organisation does depends on people. Low-cost, high-quality cars like Toyota and Saturns are not just a product of sophisticated automated machines. Instead they are a result of committed employees all working hard to produce the best cars that they can at the lowest possible cost (Dessler).

12.2 Human Resource Strategy

Human resources, then, are critically important strategic resources. Successful organisations will be able to attract, motivate, develop, reward and keep competent employees thorough appropriate human resource practices. They will be able to create and implement strategic changes in an atmosphere of close cooperation and participation while trying to manage people, of course, there is no one best way of getting results. The human resource practices must be in tune with the expectations of employees and in line with industry norms.

Notes

Role of HRM

Human resource management is the art of procuring, developing and maintaining competent workforce to achieve the goals of an organisation in an effective and efficient manner. The biggest challenge for the HR managers, nowadays, is to shift their attention from current operations to developing strategies for the future. HRM is no longer a standalone staff function. It has to involve everyone to develop partnerships and programmes that permit the firm to succeed in a highly competitive environment. HRM would offer competitive advantages if (Towers Perrain):

- HR policies are jointly developed and implemented by HR and operating managers.
- HRM puts focus on quality, customer service, employee involvement, teamwork and productivity.
- HRM strategies are in tune with changing competitive requirements (such as globalisation, downsizing, etc.).

Competitive Advantage through People

Competitive advantage refers to the ability of an organisation to formulate strategies to exploit profitable opportunities, thereby maximising its return on investment. Competitive advantage occurs if customers perceive that they receive value from their transaction with an organisation. This requires single minded focus on customer needs and expectations. To achieve this, the organisation needs to tune its policies in line with changing customer requirements. The second principle of competitive advantage derives from offering a product or service that your competitor cannot easily imitate or copy. An organisation should always try to be unique in its industry along dimensions that are widely valued by customers. In order to enjoy the competitive advantage, the firm should be a cost leader, delivering value for money.

12.3 Personnel Policies

A policy is a plan of action. Brewster and Richbell defined personnel policies as, "a set of proposals and actions that act as a reference point for managers in their dealings with employees. Personnel policies constitute guides to action. They furnish the general standards or bases on which decisions are reached. Their genesis lies in an organisation's values, philosophies, concepts and principles." Personnel policies guide the course of action intended to accomplish personnel objectives. For example, one of the personnel policies of Indian Railways is to provide equal employment opportunities to minorities.

Broadly speaking, policies are broad statements which express the organisation's principles and philosophies towards its human resource group, intentionally broad, so that they may be applied to various situations. Policies do not include detailed statements describing specifically how the policy is to be implemented. Policies are implemented by procedures. While developing sound personnel policies, management should pay attention to the following things:

- ***Related to objectives:*** Policies must be capable of relating objectives to functions, physical factors and company personnel.
- ***Easy to understand:*** Policies should be stated in definite, positive, clear and understandable language.
- ***Precise:*** Policies should be sufficiently comprehensive and prescribe limits and yardsticks for future action.
- ***Stable as well as flexible:*** Personnel policies should be stable enough to assure people that there will not be drastic overnight changes. They should be flexible enough to keep the organisation in tune with the times.

Notes

- *Based on facts:* They should be built on the basis of facts and sound judgment and not on personal feelings or opportunistic decisions.
- *Appropriate number:* There should be as many personnel policies an necessary to cover conditions that can be anticipated, but not so many policies as to become confusing or meaningless.
- *Just, fair and equitable:* Personnel policies should be just, fair and equitable to internal as well as external groups. For example, a policy of recruitment from within may limit opportunities to bright candidates from outside; and a policy of 'recruitment from outside only' would limit promotional avenues to promising internal candidates. To ensure justice, it is necessary to pursue both the policies scrupulously and apply them carefully.
- *Reasonable:* Personnel policies must be reasonable and capable of being accomplished. To gain acceptance and commitment from employees, the policy should be 'conditioned by the suggestions and reactions of those who will be affected by the policy'.
- *Review:* Periodic review of personnel policies is essential to keep in tune with changing times and to avoid organisational complacency or managerial stagnation. For instance, if the current thinking is in favour of workers' participation in management, the personnel policy should be suitably adjusted to accommodate the latest fad, accepted by many in the organisation.

Personnel policies, to be sound, should also have broad coverage in addition to satisfying the above conditions.

12.4 Human Resource Planning

Finding the right man for the right job and developing him into an effective team member is an important function of every manager. Human resources are alone capable of enlargement, i.e., capable of producing an output that is greater than the sum of inputs. In order to harness the human energies in the service of organisational goals, every manager is expected to pay proper attention to recruitment, selection and training activities in an organisation. Proper promotional avenues must be also created so as to motivate people to peak performance. All these things, however, do not come by easily. It requires thorough planning and a certain amount of zeal and commitment to convert to the rhetoric into concrete action (Walker).

Human resource planning is essentially the process of getting the right number of qualified people into the right job at the right time. It is a system of matching the supply of people (existing employees and those to be hired or searched for) with openings the organisation expects over a given time frame.

12.5 Recruitment

The human resources are the most important assets of an organisation. The success or failure of an organisation is largely dependant on the caliber of the people working therein. Without positive and creative contributions from people, organisations cannot progress and prosper. In order to achieve the goals or the activities of an organisation, therefore, we need to recruit people with requisite skills, qualifications and experience. While doing so, we have to keep the present as well as the future requirements of the organisation in mind. Recruitment is a 'linking function' – joining together those with jobs to fill and those seeking jobs. It is a 'joining process' in that it tries to bring together job seekers and the employer with a view to encourage the former to apply for a job with the latter. The basic purpose of recruiting is to develop a group of potentially qualified people. To this end, the organisation must communicate the position in such a way that job seekers respond. To be cost effective, the recruitment process should attract qualified applicants and provide enough information for unqualified persons to self-select themselves out.

Types of Recruitment

The recruitment may be broadly divided into two categories: internal recruitment and external recruitment.

Organisations like General Electric, United Parcel Service, give lot of importance to developing and promoting managers within the firm. Grooming talent from within is also a much-publicized path chosen by Larsen & Toubro, ITC, HLL etc., in India. Both have their own merits and demerits. Let's examine these.

Internal Recruitment

Persons who are already working in an organisation constitute the 'internal sources'. Retrenched employees, retired employees, dependents of deceased employees may also constitute the internal sources. Whenever any vacancy arises, someone from within the organisation is upgraded, transferred, promoted or even demoted.

Internal Recruitment Methods

Promotions and Transfers: Many organisations prefer to fill vacancies through promotions or transfers from within wherever possible. Promotion involves movement of an employee from a lower level position to a higher level position accompanied by (usually) changes in duties, responsibilities, status and value. The Tatas, the Birlas and most multinationals (e.g., HLL's Lister programme tracking star performers at an early stage and offering stimulating opportunities to grow vertically) have fast-track promotion systems in place. The credo now is reward performance, but promote competency. In the recent past, the AV Birla group has placed over 200 people through the fast-tracker system (promoting star performers quickly). A transfer, on the other hand, involves lateral movement within the same grade, from one job to another. It may lead to changes in duties and responsibilities, working conditions, etc., but not necessarily salary. Internal promotions and transfers certainly allow people greater scope to experiment with their careers, kindling ambitions and motivating them to take a shot at something they might otherwise never have considered. The system, of course, works best for young executives who are willing to take risks. (Ganguly, Vaidyanathan, Daum)

Job Posting and Job Bidding: Job posting is another way of hiring people from within. In this method, the organisation publicizes job openings on bulletin boards, electronic media and similar outlets. Most software firms typically rely on intranet or the internet for informing employees that job openings exist. Job bidding is a procedure that allows employees who believe that they possess the required qualifications to apply for a posted job. Hindustan Lever introduced its version of open job postings in early 2002 and quite a sizeable number of positions have since been filled through the process. HLL even allows its employees to undertake career shifts, for example from technical positions to non-technical jobs such as marketing, market research etc., through the open job posting system. Likewise, when Kotak Securities was hit hard by the bear market during 2008, the excess staff were shifted to Kotak Mahindra Bank which had openings in branch banking and credit card business. The AV Birla group allows its employees an opportunity to apply not just for jobs within their own companies, but for jobs in any company in the Birla group both in India and abroad. (Ganguly, Business Today and Business World, Best Employer survey and Best Places to Work Survey 2008, 2009)

One of the important advantages of this method is that it offers a chance to highly qualified applicants working within the company to look for growth opportunities within the company without looking for greener pastures outside. Complaints from employees that they were not aware of such openings internally would get buried automatically. The procedure reflects an openness that most employees would welcome (Mondy). Of course, the system would fail to deliver results if the most qualified applicant, especially in the eyes of large majority of peers working therein, is not chosen. Unsuccessful applicants must need to be informed about why they could not make it.

If the trust and confidence between eligible candidates and the management breaks down, employees might revolt violently and morale-related problems may vitiate campus life in a major way.

Employee Referrals: Employee referral (also known as word of mouth advertising) means using personal contacts to locate job opportunities. It is a recommendation from a current employee regarding a job applicant. The logic behind employee referral is that "it takes one to know one". Employees working in the organisation, in this case, are encouraged to recommend the names of their friends working in other organisations for a possible vacancy in the near future. In fact, this has become a popular way of recruiting people in the highly competitive Information Technology industry nowadays. Companies offer rich rewards also to employees whose recommendations are accepted – after the routine screening and examining process is over – and job offers extended to the suggested candidates. Citibank, for example, offers ₹ 50,000 to its employees for every vacancy filled up by the bank on the basis of their referral. Adobe India runs a referral scheme where all employees who have successfully referred a candidate are eligible for a lucky draw where they can win a luxury car.

Birla 3M also has an incentive-based employee referral programme in place. Infotech companies such as Polaris Software Labs, Cognizant Technology Solutions, Cisco Systems, etc., have even discovered that the stickiness of employees joining through referral scheme is quite high. Companies like Intel, IBM, Cisco, Flextronics encourage employees to refer their friends and acquaintances regularly and win referral bonus, on the spot cash awards, get entitled to a lucky draw (in addition to the above).

Modern companies also use what is popularly known as Employee Enlistment. It is a unique form of employee referral where every employee becomes a company recruiter. This is not merely asking existing employees to refer their friends to the company. The firm supplies employees with business cards that do not reveal names or positions. They simply contain a message "We are looking for ————. For additional information log on to our Web site" employees are encouraged to distribute these cards wherever they go, such as parties, picnics, family gatherings, sports events, community gatherings, etc. The underlying philosophy is to let everyone know that the company wants qualified people to apply immediately. (See Mondy)

External Recruitment

External recruitment sources lie outside an organisation. Here the organisation can have the services of: (a) Employees working in other organisations; (b) Job aspirants registered with employment exchanges; (c) Students from reputed educational institutions; (d) Candidates referred by unions, friends, relatives and existing employees; (e) Candidates forwarded by search firms and contractors; (f) Candidates responding to the advertisements, issued by the organisation; and (g) Unsolicited applications/ walk-ins.

External Recruitment Methods

Campus Recruitment: It is a method of recruiting by visiting and participating in college campuses and their placement centres. Here the recruiters visit reputed educational institutions such as IITs, IIMs, colleges and universities with a view to pick up job aspirants having requisite technical or professional skills. Job seekers are provided information about the jobs, and the recruiters, in turn, get a snapshot of job seekers through constant interchange of information with respective institutions. A preliminary screening is done within the campus and the shortlisted students are then subjected to the remainder of the selection process. In view of the growing demand for young managers, most reputed organisations (such as Hindustan Lever Ltd., Proctor & Gamble, Citibank, State Bank of India, Tata and Birla group companies) visit IIMs and IITs regularly and even sponsor certain popular campus activities with a view to earn goodwill in the job market. ICICI Bank has gone a step ahead in striking rapport with leading academic institutions by explaining its requirements and requesting the academic leaders to create a curriculum that is relevant to market requirements. WIPRO, Infosys, Tata Motors, Intel, Convergys, etc. have an excellent relationship with leading technological institutes and universities to recruit freshers possessing employable skills and knowledge through an online testing programme. Companies like HLL, Pantaloon Retail, Reliance Industries, RPG Enterprises have joined hands with leading management institutes in creating specialised courses required by the retailing and logistics businesses. Leading audit, taxation, consultancy and BPO firms have started looking for talent in reputed undergraduate colleges all over India, especially in cities like Delhi, Mumbai, Bangalore, Chennai and Pune. To hire the best, companies are using a variety of tools— such as group discussions, case presentations, aptitude tests, interviews, personality profiling—in recent times.

Advertisements: These include advertisements in newspapers; trade, professional and technical journals; radio and television; etc. In recent times, this medium has become just as colourful, lively and imaginative as consumer advertising. The ads generally give a brief outline of the job responsibilities, compensation package, prospects in the organisation, etc. This method is appropriate when (a) the organisation intends to reach a large target group and (b) the organisation wants a fairly good number of talented people – who are geographically spread out. To apply for the advertised vacancies, let's briefly examine the wide variety of alternatives available to a company – as far as ads are concerned:

What do Indian Companies Expect from Job-seekers?

The expectations of recruiters are inextricably intertwined with the corporate culture in which they operate. They're in line with the overall philosophy of the company in question. Let's summarise these in a capsule form thus:

Box 12.1: Recruitment of Trainees: Expectations of Indian Companies

Pepsi: Pepsi is a flat organisation. There are a maximum of four reporting levels. Executives here emphasise achievement, motivation, the ability to deliver, come what may. As the Personnel Manager of Pepsi Foods remarked "we hire people who are capable of growing the business rather than just growing with the business". Recuritees must be capable of thinking outside the box, cutting the cake of conventional barriers whenever and wherever necessary. They must have a winner's mindset and a passion for creating a dynamic change. They must have the ability to deal with ambiguity and informality.

Reebok: As Reebok's customers are young, the company places emphasis on youth. The average age at Reebok is 26 years. Employees are expected to have a passion for the fitness business and reflected the company's aspirations. Recruites should be willing to do all kinds of job operations. The willingness to get one's hands dirty is important. They must also have an ability to cope with informality, a flat organisation and be able to take decisions independently and perform consistently with their clearly defined goals.

Indian Hotels: The Taj group expects the job aspirants to stay with the organisation patiently and rise with the company. Employees must be willing to say 'yes sir' to any body. Other criteria include: communication skills, the ability to work long and stressful hours, mobility, attention to personal appearance and assertiveness without aggression.

12.6 Selection

To select means to choose. Selection is the process of picking individuals who have relevant qualifications to fill jobs is an organisation. The basic purpose is to choose the individual who can most successfully perform the job from the pool of qualified candidates.

The purpose of selection is to pick up the most suitable candidate who would meet the requirements of the job and suit the organisation best. The company obtains and assesses information about the applicant in terms of age, qualifications, skills, experience, etc. The needs of the job are, then matched with the profile of candidates. The most suitable

Notes

person is then picked up after eliminating the unsuitable applications through successive stages of selection process. How well an employee is matched to job is very important because it directly affects the amount and quality of employee's work. Any mismatch in this regard can cost an organisation a great deal of money, time and trouble, especially, in terms of training and operating costs. In course of time, the employee may find the job distasteful and leave in frustration. He may even circulate 'hot news' and juicy bits of negative information about the company, causing incalculable harms in the long run. Effective selection, therefore, demands constant monitoring of the 'fit' between person and the job.

Process of Selection

Selection is usually a series of hurdles or steps. Each one must be successfully cleared before the applicant proceeds to the next. Table below nutlines the important steps in the selection process of a typical organisation. The time and emphasis placed on each step will of course vary from one organisation to another and, indeed, from job to job within the same organisation. The sequencing of steps may also vary from job to job and organisation to organisation. For example, some organisations may give importance to testing, while others may emphasise interviews and reference checks. Similarly, a single brief selection interview might be enough for applicants for lower level positions, while applicants for managerial jobs might be interviewed by a number of people.

Table 12.1: Steps in Selection Process

Step 1	Reception
Step 2	Screening Interview
Step 3	Application blank
Step 4	Selection Tests
Step 5	Selection interview
Step 6	Medical examination
Step 7	Reference check
Step 8	Hiring decision

Reception

A company is known by the people it employs. In order to attract people with talent, skills and experience, a company has to create a favourable impression on the applicants right from the stage of reception. Whoever meets the applicant initially should be tactful and able to extend help in a friendly and courteous way. Employment possibilities must be presented honestly and clearly. If no jobs are available at that point of time, the applicant may be asked to contact the HR department after a suitable period of time has elapsed.

Screening Interview

A preliminary interview is generally planned by large organisations to cut the costs of selection by allowing only eligible candidates to go through the further stages in selection. A junior executive from the HR Department may elicit responses from applicants on important items determining the suitability of an applicant for a job such as age, education, experience, pay expectations, aptitude, location choice, etc. This 'courtesy interview', as it is often called, helps the department screen out obvious misfits. If the department finds the candidate suitable, a prescribed application form is given to the applicants to fill and submit.

Application Blank

Application blank or form is one of the most common methods used to collect information on various aspects of the applicants' academic, social, demographic, work-related background and references. It is a brief history sheet of an employee's background, usually containing the following things:

- Personal data (address, sex, identification marks)
- Marital data (single or married, children, dependents)
- Physical data (height, weight, health condition
- Educational data (levels of formal education, marks, distinctions)
- Employment data (past experience, promotions, nature of duties, reasons for leaving previous jobs, salary drawn, etc.)
- Extracurricular activities data (sports/games, NSS, NCC, prizes won, leisure-time activities)
- References (names of two or more people who certify the suitability of an applicant to the advertised position)

Even when applicants come armed with elaborate resumes, it is important to ask the applicants to translate specific resume material into a standardised application form. Job seekers tend to exaggerate, or overstate their qualifications on a resume. (Brown) So it's always better to ask the applicant to sign a statement that the information contained on the resume or application blank is true and that he or she accepts the employer's right to terminate the candidate's employment if any of the information is found to be false at a later date. (Lammers)

Selection Testing

Another important decision in the selection process involves applicant testing and the kinds of tests to use. A test is a standardised, objective measure of a person's behaviour, performance or attitude. It is standardised because the way the test is carried out, the environment in which the test is administered and the way the individual scores are calculated – are uniformly applied. It is objective in that it tries to measure individual differences in a scientific way, giving very little room for individual bias and interpretation.

Over the years, employment tests have not only gained importance but also a certain amount of inevitability in employment decisions. Since they try to objectively determine how well an applicant meets job requirements, most companies do not hesitate to invest their time and money in selection testing in a big way. Some of the commonly used employment tests may be stated thus: (Urbina; Marnet)

1. *Intelligence tests:* These are mental ability tests. They measure the incumbent's learning ability and also the ability to understand instructions and make judgements. The basic objective of intelligence tests is to pick up employees who are alert and quick at learning things so that they can be offered adequate training to improve their skills for the benefit of the organisation. Intelligence tests do not measure any single trait, but rather several abilities such as memory, vocabulary, verbal fluency, numerical ability, perception, spatial visualisation, etc., Stanford-Binet test, Binet-Simon test, The Wechsler Adult Intelligence Scale are examples of standard intelligence tests. Some of these tests are increasingly used in competitive examinations while recruiting graduates and post-graduates at entry level management positions in Banking, Insurance and other Financial Services sectors.

2. *Aptitude tests:* Aptitude tests measure an individual's potential to learn certain skills – clerical, mechanical, mathematical, etc. These tests indicate whether or not an individual has the ability to learn a given job quickly and efficiently. In order to recruit efficient office staff, aptitude tests are necessary. Clerical tests, for example, may measure the incumbent's ability to take notes, perceive things correctly and quickly locate things, ensure proper movement of files, etc. Aptitude tests,

unfortunately, do not measure on-the-job motivation. That is why the aptitude test is administered in combination with other tests, like intelligence and personality tests.

Notes

3. *Personality tests:* Of all the tests required for selection, personality tests have generated lot of heat and controversy. The definition of personality, methods of measuring personality factors and the relationship between personality factors and actual job criteria have been the subject of much discussion. Researchers have also questioned whether applicants answer all the items truthfully or whether they try to respond in a socially desirable manner. Regardless of these objections, many people still consider personality as an important component of job success.

   Personality tests are used to measure basic aspects of an applicant's personality such as motivation, emotional balance, self-confidence, interpersonal behaviour, introversion, etc. The most frequently used tests are the Minnesota Multiphasic Personality Inventory (MMPL), the California Psychological Inventory, the Manifest Anxiety Scale, Edwards Personal Performance Schedule, etc.

Selection Interview

Interview is the oral examination of candidates for employment. This is the most essential step in the selection process. In this step, the interviewer tries to obtain and synthesise information about the abilities of the interviewee and the requirements of the job. Interview gives the recruiter an opportunity to: (Dessler)

- size up the interviewee's agreeableness;
- ask questions that are not covered in tests;
- obtain as much pertinent information as possible;
- assess subjective aspects of the candidate – facial expressions, appearance, nervousness and so forth;
- make judgements on interviewee's enthusiasm and intelligence;
- give facts to the candidate regarding the company, its policies, programmes, etc., and promote goodwill towards the company.

Medical Examination

Certain jobs require physical qualities like clear vision, acute hearing, unusually high stamina, tolerance of arduous working conditions, clear tone of voice, etc. Medical examination reveals whether or not a candidate possesses these qualities. Medical Examination can give the following information:

1. Whether the applicant is medically suitable for the specific job or not?
2. Whether the applicant has health problems or psychological attitudes likely to interfere with work efficiency or future attendance?
3. Whether the applicant suffers from bad health which should be corrected before he can work satisfactorily (such as the need for spectacles)?
4. Whether the applicant's physical measurements are in accordance with job requirements or not?

Reference Checks

Once the interview and medical examination of the candidate is over, the personnel department will engage in checking references. Candidates are required to give the names of two or three references in their application forms. These references may be from individuals who are familiar with the candidate's academic achievements, or from applicant's previous employer, who is well-versed with the applicant's job performance, and sometimes from co-workers. In case the reference check is from the previous employer, information in the following areas may be obtained. They are: job title, job description, period of employment, pay and allowances, gross emoluments, benefits provided, rate of absence, willingness of the previous employer to employ the candidate again, etc. Further, information regarding candidate's regularity at work, character, progress, etc., can be obtained. Often a telephone call is much quicker. The method of mail query, provides detailed information about the candidate's performance, character and behaviour. However, a personal visit is superior to the mail and telephone methods and is used where it is highly essential to get detailed, firsthand information which can also be secured by observation. Reference checks are taken as a matter of routine and treated casually or omitted entirely in many organisations. But a good reference check, when used sincerely, will fetch useful and reliable information to the organisation.

Hiring Decision

The Line Manager concerned has to make the final decision now - whether to select or reject a candidate after soliciting the required information through different techniques discussed earlier. The line manager has to take adequate care in taking the final decision because of economic, behavioural and social implications of the selection decisions. A careless decision of rejecting a candidate would impair the morale of the people and cause them to suspect the selection procedure and the very basis of selection in a particular organisation. A true understanding between line managers and HR managers should be established so as to facilitate good selection decisions. After taking the final decision, the organisation has to intimate this decision to the successful as well as unsuccessful candidates. The organisation sends the appointment order to the successful candidates either immediately or after some time, depending upon its time schedule.

Selection Practices in India

The following Box 12.2 throws light on how the global giants use selection testing as a basis for picking up right candidates to fill the vacancies arising internally:

Box 12.2: Selection Practices of Global Giants

1. **Siemens India:** It uses extensive psychometric instruments to evaluate short-listed candidates. The company uses occupational personality questionnaire to understand the candidate's personal attributes and occupational testing to measure competencies.
2. **LG Electronics India:** LG Electronics uses 3 psychometric tests to measure a person's ability as a team player, to check personality types and to find a person's responsiveness and assertiveness.
3. **Arthur Anderson:** While evaluating candidates, the company conducts critical behavioural interviews which evaluates the suitability of the candidate for the position, largely based on his past experience and credentials.
4. **Pepsico India:** The company uses India as a global recruitment resource. To select professionals for global careers with it, the company uses a competency-based interviewing problem solving, managing the environment. These apart, Pepsi insists that to succeed in a global positing, these individuals possess strong functional knowledge and come from a cosmopolitan background.

12.7 Placement

After selecting a candidate, he should be placed on a suitable job. Placement is the actual posting of an employee to a specific job. It involves assigning a specific rank and responsibility to an employee. The placement decisions are taken by the line manager after matching the requirements of a job with the qualification of a candidate. Most organisations put new recruits on probation for a given period of time, after which their services are confirmed. During this period, the performance of the probationer is closely monitored. If the new recruit fails to adjust himself to the job and turns out poor performance, the organisation may consider his name for placement elsewhere. Such second placement is called 'differential placement'. Usually the employees' supervisor, in consultation with the higher levels of line management, takes decisions regarding the future placement of each employee.

Notes

12.8 Induction/Orientation

Orientation or induction is the task of introducing the new employees to the organisation and its policies, procedures and rules. A typical formal orientation programme may last a day or less in most organisations. During this time, the new employee is provided with information about the company, its history, its current position, the benefits for which he is eligible, leave rules, rest periods, etc. Also covered are the more routine things a newcomer must learn, such as the location of the rest rooms, break rooms, parking spaces, cafeteria, etc. In some organisations, all this is done informally by attaching new employees to their seniors, who provide guidance on the above matters. Lectures, handbooks, films, groups, seminars are also provided to new employees so that they can settle down quickly and resume the work.

12.9 Training and Development

Training is the act of increasing knowledge and skills of an employee for doing a particular job. The major outcome of training is learning. A trainee learns new habits, refined skills and useful knowledge during the training that helps him improve performance. Training enables an employee to do his present job more efficiently and prepare himself for a higher level job. Training, thus, may be defined as a planned programme designed to improve performance and bring about measurable changes in knowledge, skills, attitude and social behaviour of employees.

A wide variety of training programmes are used in different organisations, depending upon requirements and size of their manpower. Some of the commonly used programmes may be listed thus:

1. *Orientation training:* Orientation or induction training tries to put the new recruits at ease. Each new employee is usually taken on a formal tour of the facilities, introduced to key personnel and informed about company policies, procedures and benefits. To be effective, orientation training should be well planned and conducted within the first week of employment. Such a pre-job training helps the recruit to familarise himself with the job and its settings.
2. *Job instruction training:* Job instruction training (JIT) was popular during World War II. JIT was offered to white-and-blue-collar employees and technicians, with a view to improve their job-specific skills. The approach, basically, consisted of four steps:
   (a) Orient trainees to the job situation by providing them with an overview of the job.
   (b) Demonstrate the entire job, using the services of experienced trainers.
   (c) Ask trainees to do the job as often as necessary until satisfactory performance is obtained.
   (d) Evaluate employee performance periodically and offer supplementary training, if necessary.
3. *Refresher training:* Rapid changes in technology may force companies to go in for this kind of training. By organising short-term courses which incorporate the latest developments in a particular field, the company may keep its employees up-to-date and ready to take on emerging challenges. It is conducted at regular intervals by taking the help of outside consultants who specialise in a particular descriptive.

4. ***Apprenticeship training:*** Commonly found in industries such as carpentry and plumbing, apprentices are trainees here who spend a prescribed period of time working with an experienced, master worker.

5. ***Vestibule training:*** It is training offered on actual equipment used on the job but conducted away from the actual work setting in a simulated work situation.

Executive Development Programmes

Executive Development Programmes help in acquiring and developing different types of managerial skills and knowledge. Different types of techniques are used to acquire and develop various types of managerial skill and knowledge. They are explained below:

1. ***Decision-making Skills:*** The main job of a manager is to make both strategic and routine decisions. His ability to make decisions effectively can be enhanced by developing decision-making skills through various techniques, as explained below:

   (a) *In-basket:* In this method, the participant is given a number of business papers such as memoranda, reports and telephone message that would typically come across a manager's desk. The papers, presented in no particular sequence, call for actions ranging from urgent to routine handling. The participant is required to act on the information contained in these papers. Assigning a priority to each particular matter is initially required.

   (b) *Case Study:* This is a training method that employs simulated business problems for trainees to solve. The individual is expected to study the information given in the case and make decisions based on the situation. If the student is provided a case involving an actual company, he is expected to research the firm to gain a better appreciation of its financial condition and corporate culture. Typically, the case method is used in the classroom with an instructor who serves as a facilitator.

   (c) *Business Game:* Simulations that represent actual business situations are known as business games. These simulations attempt to duplicate selected factors in a specific situation, which are then manipulated by the participants. Business games involve two or more hypothetical organisations competing in a given product market. The participants are assigned such roles as Managing Director, General Manager, Marketing Manager, etc. They make decisions affecting price levels, production volume and inventory levels. The results of their decisions are manipulated by a computer programme, with the results simulating those of an actual business situation. Participants are able to see how their decision affects the other groups and vice versa.

2. ***Inter-personal skills:*** A manager can achieve results only when he is able to put individuals on the right track. He must interact people actively and make them work unitedly. Managerial skills in the area of inter-personal relations can be enhanced through various techniques, viz, Role Play and Sensitivity Training.

   (a) *Role Play:* This is a technique in which some problem—real or imaginary-involving human interaction is presented and then spontaneously acted out. Participants may assume the role of specific organisational member in a given situation and then act out their roles. For example, a trainee might be asked to play the role of the employee. The individual playing the supervisory role would then proceed to take whatever action is deemed appropriate. This action then provides the basis for discussion and comments by the group.

   (b) *Sensitivity training:* This is a method of changing behaviour through unstructured group interaction. Sensitivity training is sought to help individuals towards better relations with others. The primary focus is on reducing interpersonal friction.

Job Knowledge

In addition to decision-making skills and inter-personal skills, managers should also possess job knowledge to perform their jobs effectively. Trainers acquire job knowledge through on-the-job experience, coaching and understudy.

Notes

1. *On-the-job experience:* On-the-job techniques are most widely used. No other technique may interest the trainee so much as the location of the learner is not an artificial one in the classroom techniques. The success of these techniques depends on the immediate supervisor and his teaching abilities. On-the-job techniques are especially useful for certain groups like scientific and technical personnel.

2. *Coaching:* In coaching, the trainee is placed under a particular supervisor who acts as an instructor and teaches job knowledge and skills to the trainee. He tells him what he wants him to do, how it can be done and follows up while it is being done and corrects errors.

3. *Understudy:* An understudy is a person who is in training to assume at a future time, the full responsibility of the position currently held by his superior. This method supplies the organisation a person with as much competence as the superior to fill his post which may fall vacant because of promotion, retirement of transfer.

Organisational Knowledge

Managers in addition to the job knowledge, should also possess the knowledge of various jobs, products, markets, finances, creditors of the organisation. The techniques of imparting organisational knowledge are job rotation and multiple management.

1. *Job rotation:* The transferring of executives from job to job and from department to department in a systematic manner is called job rotation. The idea behind this is to give him the required diversified skills and an overall broader outlook, which are very important at the upper management levels. The management should provide a variety of job experiences for those judged to have the potential for higher ranks before they are promoted.

2. *Multiple management:* Multiple management is a system in which permanent advisory committees of managers study problems of the company and make recommendations to higher management. It is also called a junior-board of executives. These committees discuss the actual problems and different alternative solutions after which the decisions are taken.

General Knowledge

The managers in addition to job knowledge and organisational knowledge should possess general knowledge, as the external environment interacts with and influences the business. The general knowledge, includes the knowledge about the economic conditions of the country, prices, GNP per capita income, various other industries, other sectors of the economy, political conditions, social factors, etc. General knowledge can be acquired through special courses, special meetings and specific readings.

1. *Special courses:* Special courses like the workshops or executive development programmes organised by the institutes, universities and colleges help the trainees to acquire general knowledge.

2. *Special meetings:* Special meetings organised in consumers' forums, voluntary organisations help the trainees develop their general knowledge.

3. *Specific readings:* Specific articles published by various journals, specific portions of the books are provided to the trainees to improve their general knowledge.

Specific Individual Needs

Some trainees may be weak in some areas. Such trainees are provided with special facilities for development. These facilities include special projects and committee assignments.

1. *Special projects:* In this method, a trainee is put on a project closely related to the objectives of his department. For example, a new recruit in a property evaluation firm may be asked to do a small project reviewing the prospects of selling commercial space in satellite townships (like Gurgaon, Rohtak and Ghaziabad) near Delhi. The project will give first hand experience of the problems and prospects in space selling to the new recruit.

2. *Committee assignment:* In this method, an adhoc committee is appointed to discuss, evaluate and offer suggestions relating to an important aspect of business. For example, a group of experts may be asked to look into the feasibility of developing a software technology park in an upcoming area by the Delhi Development Authority.

Other Off-the-Job Methods

1. *Conferences:* The conference method is another commonly used method of executive development. Topics such as human relations, safety education, customer relations, sales training, are often discussed, debated, spoken about at conferences specially organised and designed for the purpose. A conference is a meeting of people to discuss a subject of common interest. The conference is structured around a small group meeting wherein a leader helps the group identify and define a problem, guides the discussion along desired lines and summarises the views that represent the consensus of the group in dealing with the problem.

2. *Lectures:* Lectures are formal presentations on a topic by an experienced and knowledgeable person. The presentation is generally supported by discussions, case studies, audio-visual aids and film shows.

3. *Group discussion:* In this method, papers are presented by two or three trainees on a selected topic, followed by stimulating discussions. The topics for discussion are selected in advance and the papers concerning the same, written by various participants, are printed and circulated before hand. It is a variant of the lecture method and is generally preferred where the intention is to give wide circulation and participation to a number of experts sharing their experiences with a fairly large group of individuals.

4. *Programmed instruction (PI):* It is based on certain behavioural laws, particularly dealing with reinforcement. Reinforcement means rewarding a correct response and punishing a wrong one. A major feature of PI is that it offers immediate feedback on whether the trainee has answered questions correctly or not.

12.10 Performance Appraisal

After an employee has been selected for a job, has been trained to do it and has worked on it for a period of time, his performance should be evaluated. Performance evaluation or appraisal is the process of deciding how employees do their jobs. It is a method of evaluating the behaviour of employees in the workspot, normally including both the quantitative and qualitative aspects of job performance. It is a systematic and objective way of evaluating both work-related behaviour and potential of employees. It is a process that involves determining and communicating to an employee how he or she is performing the job and ideally, establishing a plan of improvement. The appraisal process actually consists of six steps: (1) establish performance standards with employees; (2) set measurable goals (manager and employee); (3) measure actual performance; (4) compare actual performance with standards; (5) discuss the appraisal with the employee; and (6) if necessary, initiate corrective action.

Notes

There are three different approaches for carrying out appraisals. Employees can be appraised against (i) absolute standards (where employee's performance is measured against some established standards; the subjects here are not compared with any other person) (ii) relative standards (where the subjects are compared against other individuals) and (iii) objectives (here employees are evaluated by how will they accomplish a specific set of objectives that have been determined to be critical in the successful completion of their job). No one approach is always best; each has its strengths and weaknesses. Of course, a successful performance appraisal system requires more than good technique. It depends on a consistent approach for comparability of results, clear standards and measures, and bias-free ratings. Against this backdrop, let's see how some of the trading companies in India carry out the appraisal process.

(1) *Hughes Escort:* Hughes Escorts, the subsidiary of the US-headquartered telecom company, Hughes, uses a competency-based performance-enhancement model. Each position in the organisation is defined in terms of 23 key competencies, categorised into four groups: attitude-based, knowledge-driven, skill-centred, and value based. The company uses these competencies to measure shortfalls and provide relevant training inputs. This is done to both maximise productivity and make employees aware of their professional standing.

Source: Business Today, June 22 - July 26, 2000

(2) *National Panasonic:* This Japanese white-goods major has developed a performance-assessment system driven by key result areas (KRAs). KRAs describe performance goals—business, functional, and behavioural ones—with defined time-frames and are decided jointly by the employee and the manager at the beginning of the year. It is a structured exercise using a written format. These KRAs are then used to map the employee's progress and, based on the results, the company decides to plug performance gaps with the help of relevant training inputs. National Panasonic puts a great deal of emphasis on this process for re-skilling its employees as it believes in growing its own timber rather than opting for expensive mid-career hires.

Source: Business Today, June 22 - July 26, 2000

Challenges in Performance Management

In present day organisations, the twin principles of motivating employees are common at all levels: acknowledge unique contributions and alleviate personnel performs that impede professional performance. To get the best out of people, the CEOs should:

- Create a culture of excellence that motivates employees at all levels.
- Match organisational objectives with individual aspirations.
- Equip people with requisite skills to discharge their duties well.
- Clear growth paths for talented employees.
- Provide new challenges to rejuvenate plateauing careers.
- Empower employees to take decisions without fear of failing.
- Encourage teamwork and team spirit and open communication.

Student Activity

1. Why can some organisations that fail to invest heavily in human assets still be financially successful? Why can some organisations that do invest heavily in human assets still be financially unsuccessful?
2. Identify the HR challenges associated with each of the three major business unit strategies (i.e. cost leadership, differentiation and focus).

12.11 Summary

The basic purpose of having a manpower plan is to have an accurate estimate of the number of employees required, with matching skills requirements to meet organisational objectives. It provides information about the manner in which existing personnel are employed, the kind of skills required for different categories of jobs and manpower needs over a period of time in relation to organisational objectives. It would also given an indication of the lead time that is available to select and train the required number of additional manpower.

12.12 Keywords

HRM: A process of bringing people and organisations together so that the goals of each one is met effectively and efficiently.

Productivity: The ratio of an organisation's outputs to its inputs.

Empowerment: Allowing employees more control over what they do on the job.

Human Resource Planning: The process of getting the right number of qualified people into the right job at the right time.

12.13 Review Questions

1. Explain the various personnel policy issues that should be of great concern to management in strategy implementation.
2. Outline the important considerations that govern the recruitment and selection policy of a growth oriented modern organisation.
3. What is the importance of training and development of personnel in strategy implementation?
4. What are the basic issues that must be looked into while designing a compensation policy?

12.14 References and Further Readings

- Grant, R. M. (2021). Contemporary strategy analysis: Text and cases (11th ed.). Wiley.
- Hitt, M. A., Ireland, R. D., &Hoskisson, R. E. (2020). Strategic management: Competitiveness and globalization (13th ed.). Cengage Learning.
- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases (12th ed.). Pearson.

Unit 13 Career Planning and Development

Unit Structure

13.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define career planning and development
- Develop a HR strategy in a dynamic environment

13.1 Introduction

Career planning is the process by which one selects career goals and the path to these goals. The major focus of career planning is on assisting the employees achieve a better match between personal goals and the opportunities that are realistically available in the organisation. Career programmes should not concentrate only on career growth opportunities. Practically speaking, there may not be enough high level positions to make upward mobility and reality for a large number of employees.

13.2 Ernst & Young (India)

The global consulting firm uses the same career development methodology in India that it uses elsewhere. Primarily, it seeks to align individual aspirations with organisational, business and functional goals, using the formal assessment system to check for skill gaps and career potential. While designing training tools, things that are given serious attention are past performance, future potential, the individual skill-sets and competencies of each manager, and the need of the company. However, the firm often takes the assistance of professional trainers brought in from E&Y offices worldwide, or relevant institutions to design specific training programmes for different categories and levels of managers.

Source: Business Today, July 22-August 6, 2000

13.3 Hyundai Motor (India)

Most executives working for this South Korean car-maker, which started operations in India relatively recently, are middle-level recruits from different industries who have

Notes

been chosen on the basis of their track record—a factor whose influence pervades the company's career development system. The company aims to convert these managers into 'achievers' for Hyundai, with attributes like mental toughness, professional competence, and an ambition to advance. The HR department devises interventions keeping these goals in mind. The HR functionaries are expected to look at the development process holistically. The company also conducts a three-day process lab where the system is discussed using case studies and interactive.

Source: Business Today, July 22-August 6, 2000

13.4 Seagram (India)

The Canadian liquor major has a career development system that hinges on speedy induction. Among the inputs given during the induction programme, fitting in with the organisational culture is critical. The aim is to enable the new entrant to hit the ground running in terms of performance. The programmes also includes sessions on the history of the organisation, product portfolio, and operations. The programme includes visits to markets and bottling units and sessions with each functional head.

Source: Business Today, July 22-August 6, 2000

13.5 Compensation Planning

Human resource strategy should also ensure that compensation is payable only if corporate goals are met. Compensation here includes bonuses, commissions, profit sharing plans, incentives, etc. in addition to normal salary payable to an employee. The ultimate goal should be to reward desired behaviours and encourage people to do well in their jobs.

Companies like Mastek, Godrej and Boyce have tried to link their rewards to team based performance in recent times quite successfully.

Team based Rewards : Best Practices

- Set quantifiable targets when evaluating team performance for rewards.
- Ensure that top performers in each team earn the highest level of rewards.
- Link team performance closely to the company's profits and overall financial health.
- Avoid subjectivity when assessing both the team and its member's performance .
- Offer uniform non-team based incentives to employees within each grade.

Other companies like Pfizer, Siemens have been linking rewards to shop floor workers based on the workers ability to meet productivity as well as performance targets. In any case, the emerging picture is quite clear especially in the post-liberalisation era in India. The start-ups that need entrepreneurial action from its employees will have to offer large doses of cash, goal-linked incentive pay and possibly stock options to link compensation to profits.

13.6 HR Strategy in a Dynamic Environment

A number of environmental factors influence the strategies pursued by a HR manager. He cannot perform his job in a vacuum. These factors influence the organisation through human resources. The term 'environment' here refers to the "totality of all factors which influence both the organisation and personnel sub-system".

Table 13.1: External and Internal Factors Influencing the Personnel Function

External factors	Internal factors
• Technological factors	• Mission
• Economic challenges	• Policies
• Political factors	• Organisational culture
• Social factors	• Organisation structure
• Local and Governmental issues	• HR systems
• Unions	
• Employers' demands	
• Workforce diversity	

The external environment consists of those factors (Table 13.1) which affect an organisation's human resources from outside the organisation. Each of these external factors separately or in combination can influence the HR function of any organisation. The job of a HR manager is to balance the demands and expectations of the external groups with the internal requirements and achieve the assigned goals in an efficient and effective manner. Likewise, the internal environment also affects the job of a HR manager. The functional areas, structural changes, specific cultural issues peculiar to a unit, HR systems, corporate policies and a lot of other factors influence the way the HR function is carried out. The HR manager has to work closely with these constituent parts, understand the internal dynamics properly and devise ways and means to survive and progress.

Student Activity

Discuss the career development strategy adopted by Excel Book Pvt. Ltd.

13.7 Summary

Career development consists of the personal actions one undertakes to achieve a career plan (Davis, p.325). The terms 'career development' and 'employee development' need to be differentiated at this stage. Career development looks at the long-term career effectiveness of employees where as employee development focuses on effectiveness of an employee in the immediate future. The actions for career development may be initiated by the individual himself or by the organisation. At the organisation level, let us examine the career development strategies adopted by three leading companies in India.

13.8 Keywords

Career Planning: The process by which one selects career goals and the path to these goals.

Career Development: The personal actions one undertakes to achieve a career plan.

Compensation: It is what employees receive in exchange for their contribution to the organisation.

13.9 Review Questions

1. Explain the process of career planning and development.
2. What are the key factors affecting the personnel functions?

13.10 References and Further Readings

- Dess, G. G., Lumpkin, G. T., Eisner, A. B., & McNamara, G. (2022). Strategic management: Text and cases (9th ed.). McGraw-Hill Education.
- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage: Concepts and cases (22nd ed.). McGraw-Hill Education.

Notes

Unit 14 Levels of Strategy

Unit Structure

14.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Explain the levels of strategies
- Describe the characteristics of different levels of strategies
- Define objectives and strategies
- Explain the annual business planning
- Define functional strategies

14.1 Introduction

Strategy is relevant at all levels in the organisation. Even at a personal level, individuals may have a strategy with respect to their careers. Managers as individuals may have their own agenda and a strategy to accomplish the same. It must be remembered that strategies are formulated through the process of interaction among individuals and these are also implemented with the combined effort of people at various levels.

14.2 Levels of Strategies

Strategies can be visualised to operate at three different levels as shown in the Figure 14.1, strategies levels are as follows:

- Corporate level
- Divisional or business level
- Operational or functional level

Notes

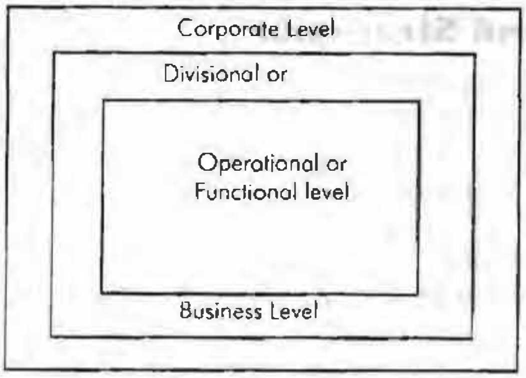


Figure 14.1: Levels of Strategies

Corporate Level

Strategies at corporate level focus on the scope of business activities – what product portfolios to build, to expand and to consolidate simultaneously with the businesses a firm is about to abandon or divest.

Their time frame is usually the longest – five years or more.

Divisional or Business Level

These strategies are directly concerned with the future plans of the profit centres which are divisionalised in large enterprises. These are the sub-strategies as they devolve from the grand strategies and have market orientation because these deal with the current and future product lines and current and future markets including overseas businesses.

Operational or Functional Level

These strategies target the departmental or functional aspects of operations and look at the functional strategies of marketing, finance, human resources, manufacturing, information systems, etc. and devise ways and means of increasing their contribution to the other levels of strategies. When functional strategies are designed to enmesh with the strategies at other levels, they reinforce their acceptance and implementation.

14.3 Characteristics of Different Levels of Strategies

Since the strategies at different level are intended to subserve different objectives, they are bound to differ in respect of various features. A comparative analysis is given on the next page.

S.No.	Characteristics Level	Corporate Level	Business Level	Operational Level
1.	Time frame	Long range	Medium range	Short range
2.	Cost	Major	Medium	Low
3.	Type	Conceptual	Mixed	Operational
4.	Selection parameter	Value judgement	Semi-quantified	Quantified
5.	Frequency	Sporadic	Sporadic or periodic	Periodic
6.	Adaptability	Low	Medium	High
7.	Relation to present activities	Innovative	Mixed	Supplemental
8.	Risks	High	Moderate	Low
9.	Profit potential	Large	Medium	Small
10.	Flexibility	High	Medium	Low
11.	Cooperation required	Considerable	Moderate	

Notes

14.4 Objectives and Strate gies

Clearer the objectives, better is the strategy formulated. There is a hierarchy of objectives which can be achieved by following different vehicles involving people at various levels as described below.

1. ***Long-term goals and philosophy:*** These can be achieved by carefully crafting the vision and mission statements which must be circularised, communicated and notified widely within the organisation. These are prepared by the corporate executives (top management) by involving divisional managers from the profit centres and must always be ratified by the board of directors.
2. ***Long-term objectives:*** These are accomplished by formulating a grand strategy at the corporate level for which the primary responsibility vests with the corporate and divisional/business managers although it is a good practice to get the same approved by the board of directors without whose support, implementation can flounder.
3. ***Annual objectives:*** These are implemented through shorter term strategies which are primarily prepared by the divisional business managers and operational managers but approved by the corporate management.
4. ***Functional objectives:*** These are mediated through functional strategies which may have a time horizon of upto 12 months. These are prepared by functional managers and approved by the divisional business management. These are attained by completing specific tasks; sometimes short-term tactics may also be convenient tools for achieving them.

14.5 Annual Business Planning

Grand or corporate strategies form the basis for drawing up annual corporate plans; they translate long-term aspirations into annual budgets. These are vital links in launching successful implementation of overall strategies. These annual plans must have the following features if they have to subserve their role effectively.

Quality of Annual Plans

To ensure their effectiveness, annual plans must have:

1. ***Clear linkage with the long-term objectives:*** Annual and long-term objectives are distinguished from each other in respect of the following dimensions:
   (a) *Time frame:* Long-term objectives may extend upto 5 years or more whereas the annual plans are more in line with yearly targets.
   (b) *Focus:* Long-term objectives aim at positioning the firm in competitive environments whereas yearly plans highlight achievements in specific areas.
   (c) *Specificity of targets:* Long-term objectives are stated in broad terms while annual targets are more pointed.
   (d) *Measurability:* Although long-term objectives are also measurable, yearly targets are more specific and readily measurable.
2. ***Integrative and co-ordinative objectives:*** Functional senior managers may lose sight of this aspect owing to possible conflicting interests. Discussions are held at critical points in the development of annual targets for vital performance parameters so that integrative and co-ordinative yearly plans formulated are not inconsistent with the long-term objectives.

Notes

Consistency in Annual Plans

Managers of the same firm may have different methods of developing objectives, based on different decision criterion. Owing to this lack of consistency, monitoring may become problematic as the progress is not comparable. To ensure that the firm moves collectively towards the same long-term goals, we must ensure that the annual plans drawn are:

1. *Measurable:* Measurability is the key feature of an annual target. If one cannot measure it, one cannot manage it either. Increasingly, innovative ways are being designed for measuring aspects which were hitherto considered impossible to measure.
2. *Priorities:* In short-term action plans, timing is rather important. Consequently, prioritising activities assumes greater importance. Ranking of priorities should be agreed at the planning stage itself so that the implementing managers do not make any conflicting assumptions and inhibit the progress of execution.

14.6 Functional Strategies

Functional strategies are the game-plans for the functional areas within the company. Their time frame is short extending up to 12 months. These incorporate more specific details of how these areas will be managed in the near future. These strategies have to be compatible with the long-term objectives and grand strategies.

Functional strategies differ from the grand strategies in respect of the followings:

Time Horizon

Functional strategies are for a period up to one year. This short duration is critically important for two reasons.

- It focuses functional manager's attention to what needs to be done now to make grand strategy work.
- Shorter time frame enables managers to identify current conditions and adjust to them.

Specific Tasks

These strategies spell out specific tasks to be carried out by functional areas in order to implement grand strategies which provide a general directional guideline. This improves operating functional managers' willingness and ability to implement long-term strategies. These are facilitated by

- Adding substance to functional areas of responsibility
- Clarifying functional managers plan to accomplish overall strategy
- Increasing top management's confidence and control over grand strategy
- Facilitating coordination among functional departments by clarifying areas of interdependence

Participation

Different people participate in developing functional, business and grand strategies. It sets out the organisation structure, communication, coordination and control mechanism for the different levels of strategy.

Notes

14.7 Strategy and Individual Manager

The cascading nature of strategies to involve managers at different hierarchical levels of organisation ensures a link between the strategy and individual manager's responsibility. This mechanism facilitates the individual manager to understand the bigger aspect of his or her job. This also improves his/her understanding of the basic premises made while formulating strategy and the harsh realities of market and demands of competition. It influences the attitude and behaviour of individual managers who become more work and achievement oriented.

The basic approach of involving operational managers in the development of strategy envisions greater involvement and commitment of managers who also become familiar with the bigger picture of their job. This provides a link between their performance and the performance of the enterprise and leads to greater satisfaction at all levels.

14.8 A Model for Strategic Management

Although there was a lot of debate in the late 1970s and early 1980s about the usefulness and justification of incorporating the discipline of strategic planning and implementation, most organisations are now unanimous about its contribution to the management of the future of the enterprise. Michael E Porter, the guru of strategy, has made significant contribution to the development of basic methodology and has propounded many philosophic concepts that will be remembered for a long time.

Today, strategic planning and management is already well established and most forward looking management institutes are including following functional subjects in their syllabi.

- Strategic marketing management
- Strategic finance management
- Strategic operations management
- Human resource strategies for flexibility and change
- Strategic information resource management.

At any rate, following views have often been preferred for and against strategy.

For	Against
Facilitates the process of anticipating changes	Changes take place so fast that firms have no time to do routine planning, leave alone long range planning
Provides clearer direction and objectives to pursue and achieve	Direction and objectives should preferably be vague and broad
As firms gain experience, the process is becoming simpler and systematic	Managers have little time for experimenting and most studies tend to be too theoretical
Firms who do strategic planning and management, are doing better	There are many firms doing well without strategic planning and management

We are convinced that the subject of strategy is essential for developing an integrative attitude and a corporate personality. If managers at all levels have the same shared vision about the running of the company, it will make for better communication, coordination and synergy among its management team enabling it to achieve success and sustain it.

Although human thinking is neither linear nor sequential, a comprehensive model for the entire process of strategic planning and management should be as below.

Notes

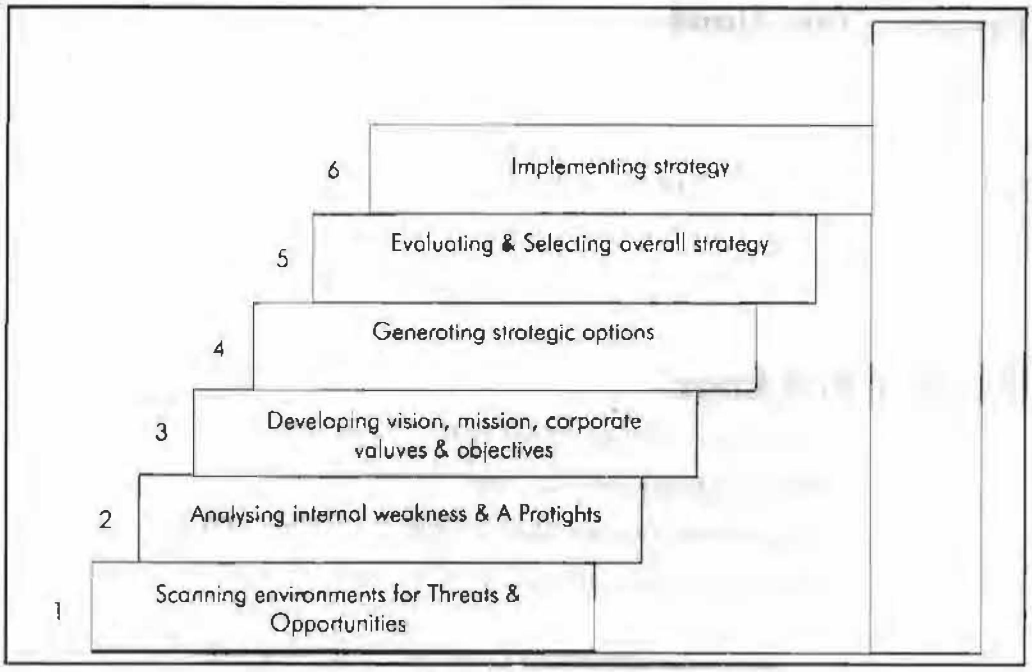


Figure 14.2: Process of Strategic Planning

Student Activity

UCL is a medium sized firm having a single line of business. It manufactures all its requirements in house at their factory in Noida, near Delhi. It has 700 employees on its roll and has achieved a turnover of ₹ 90 crores during the last financial year ended 31st March, 1999. The firm was set up about five years ago and its product, a fast moving snack food item has been well received in the market.

Being a single product firm, it wants to diversify. Making assumptions as required, distinguish between the firm's corporate, business and operational strategies

14.9 Summary

Although most strategies concern with the overall scope of the enterprise, these must be further translated into business and operational levels of strategies. These strategies have different characteristics and they serve to accomplish different objectives. Consequently, levels of people involved are different but the net impact is that every level gets woven into strategy formulation. This process ensures that they become the owners and authors of strategy. This leads to greater involvement, deeper commitment and improved performance of managers at all levels.

14.10 Keywords

Corporate Level Strategies: Strategies at corporate level includes – what product portfolios to build, to expand and to consolidate simultaneously with the businesses, a firm is about to abandon or divest.

Divisional or Business Level: These strategies are directly concerned with the future plans of the profit centres which are divisionalised in large enterprises.

Operational or Functional Level: These strategies target the departmental or functional aspects of operations and look at the functional strategies of marketing, finance, human resources, manufacturing, information systems, etc.

14.11 Review Questions

1. Describe the three levels of strategy. What are their respective roles in managing the future of the enterprise?
2. What are the various objectives a firm wishes to achieve and how does the mechanism of strategic planning and management facilitate it?
3. Describe functional strategies. How do they provide the link with the individual managers?
4. What is the key difference between functional strategies and the grand strategies?

14.12 References and Further Readings

- Porter, M. E. (2019). Competitive strategy: Techniques for analyzing industries and competitors (2nd ed.). Free Press.
- Rothaermel, F. T. (2021). Strategic management (5th ed.). McGraw-Hill Education.
- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases(12th ed.). Pearson.
- Dess, G. G., Lumpkin, G. T., Eisner, A. B., & McNamara, G. (2022). Strategic management: Text and cases (9th ed.). McGraw-Hill Education.

BLOCK – IV

Unit 15 Scanning Environments for Threats and Opportunities

Unit Structure

15.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Analyse environments for threats and opportunities
- Make business environment analysis
- Define the nature of business environments
- Describe the total environments (PEST–LE–DLCSCC)
- Explain total analysis of environmental factors
- Define strategic group mapping

15.1 Introduction

The aim of this step is to change the thinking and orientation from being an inward looking firm to outward looking and focusing on the environments of the business. Enterprises as social beings interact with their surroundings which impact on them just as they impact on their environments. It must be appreciated that most of the external factors are beyond the control of the firm and instead of reacting to the changes taking place therein, it would be good business to anticipate these changes. Just as a successful person is usually well informed, organisations must invest in keeping themselves well informed.

15.2 Analysing Internal Weaknesses and Strengths

It is always useful to know what we are good at and what we are not good at but business demands that we should be good in that area, this is a focused way of identifying problems. This analysis helps us to understand own business, firm and colleagues better and convert them into a stronger outfit. What are our core competencies and what are the areas we are not good at and need to build upon if we are to survive and grow? This analysis should be total and comprehensive covering the following aspects:

- Physical assets
- Technological assets
- Human resources
- Financial resources
- Informational resources

These factors are extended to cover the salient features of the organisational culture and stakeholders' expectations. Every organisation has a dominant culture which is embedded in every decision and action its members take. It would, therefore, be very crucial to understand this paradigm and changes required in it if it were to support and sustain the chosen strategy.

15.3 Developing Vision, Mission, Corporate Values and Objectives

A debate is raging among strategy specialists–Is it most appropriate to start the process of strategy development with the writing of vision and mission? One can perhaps argue in favour of it but the author finds it rather hard to accept jumping to developing the vision and mission statements of the company without having examined the environments and trends therein and without ascertaining own strengths and weaknesses. Similarly, expectations of dominant stakeholders and the cultural style of the organisation have a significant influence on the future shape of the organisation (vision) and the very purpose of the firm (mission).

These exercises involve deep thinking and creativity so that firms can come up with statements which will remain valid for many years in the future and also with which a majority of the employees can relate to. This aspect is becoming extremely crucial in the context of downsizing of the companies which would become more virtual as information and communication technologies get integrated with the bulk of its operations.

15.4 Generating Strategic Options

Strategic planning and management enjoins managers to think strategically; a major difference is that managers should resist the temptation of chasing the first solution or option. As a matter of nature, they must get people together and, after paraphrasing the problem, initiate discussions and seek out various alternative solutions. Having listed them, they should select the option that is considered most suitable, feasible and acceptable. The critical part is the process of joint evaluation and selection and in the process, through the phase of negotiations, of giving up some of their own ideas and taking up some preferred by others.

Once again, this process itself is very rewarding because you learn to work with the team who would prevent any impetuous selection and ad hoc freezing. Managers imbibe the spirit of erasing and effacing themselves and their views in favour of an overall consensus.

15.5 Evaluating and Selecting Overall Strategy

Strategies are intended to ensure a good strategic fit of the firm with its environments. The alternative strategies are appraised with the help of many quantitative, non-quantitative and physical parameters. Relative merits and demerits of every option are examined in depth with respect to the critical success factors relevant to business in the future. These evaluative processes are both analytical and cultural and endeavour to coalesce the intellectual and emotional approaches.

Another important aspect to appreciate is that there are no right or wrong choices. Only the time and future after it has unfolded will make us wise retrospectively about our judgement. The roles of dominant stakeholders' expectations and the cultural context of the organisation are critical in the selection of decision parameters for evaluation itself.

15.6 Implementing Strategy

Until a few years ago, a large number of firms followed top-down approach in strategic planning and management. This meant that the top management felt that it was their exclusive prerogative to devise the strategies and that they were not obliged to consult anyone within the organisation. Later, after obtaining the final approval of the strategy, implementation of strategies was left to the managers. Consequently, most strategies floundered during execution and since most of the persons entrusted with implementation were not involved at the formulation stage, they were not familiar with the compulsions and limitations of the organisation. As a result, there was a widening gap between what was intended to be accomplished and what was actually achieved.

Also, a number of conflicting interpretations were made and there was more bad blood than organisational synergy for achieving the overall strategic goals. Companies failed to position themselves adequately to combat the competition and the returns did not commensurate with the effort and investments made.

Currently, there is a fair degree of unanimity in most organisations that strategic planning and implementation should be managed as a composite activity so as to secure the maximum gains and competitive advantage to the company.

15.7 Business Environment Analysis

The essence of strategy is to match organisational capabilities with the environments. This poses two kinds of problems:

- Owing to a large number of factors operating, it becomes difficult to comprehend their combined effect on a given business; treating them all together or separately, one by one, can be equally dangerous.
- External influences can be very uncertain; understanding uncertainty is always a challenging task. Assessing their history is hazardous and evaluating their influence in the future is going to be more so.

15.8 Nature of Business Environments

External factors can be both dynamic and complex

1. ***Dynamic aspect of external factors:*** This implies that both the rate of change of these factors and the frequency of change in them is high owing to rapid changes sweeping the globe presently. Liberalisation of national economies, their integration with the global marketplace and competition are leading to turbulent changes which are coming in waves frequently rocking the boat of business. In such situations how should managers respond? Should managers be over-obsessed with the past or focus on the future trends intuitively to make some sense out of the happenings around?

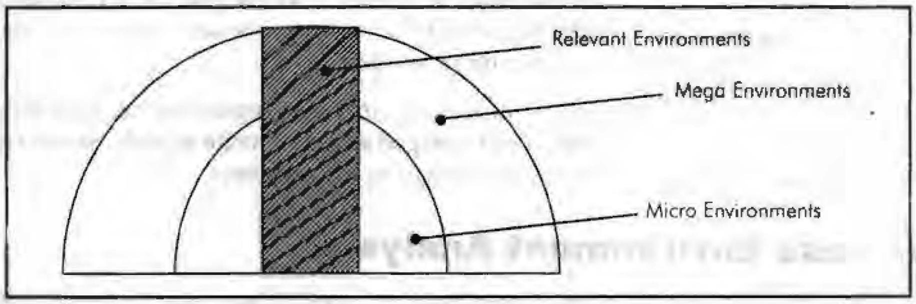
2. ***Complex aspect of external factors:*** Complexity may be arising from the diversity of business in terms of product range or types of markets or both. It may also result from the need to marshal vast amounts of knowledge to be effective in the business. It may emanate because of the impact of knowledge on diverse aspects of business viz., supplies of a very large variety of raw materials, business spanning many countries with different currencies and rapidly changing consumers' tastes and preferences. This makes it very difficult to comprehend and evaluate the influence of these external factors on the business.

The above two dimensions throw up numerous possibilities in business and there can be many options to choose from but mostly based on judgement and personal values. At the same time, companies can ill afford to install a vast base of data and information. The most important thing is that managers should be sensitised to pick up even not so strong signals from their business environments and try to capture these signals as early as possible and appraise their strategic importance.

15.9 Panorama of Environmental Factors

In order to make useful inferences from the business environments, we should view them in three parts as described below:

1. ***Micro environments:*** These are those environmental factors that are more relevant to the line of business the firm is operating in and are often referred to as industry environments. Every industry is more directly effected by certain factors and this list can be fairly unique to an industry.



Micro environments of a computer and software industry are likely to be different than these factors for sugar industry or leather industry.

2. ***Mega environments:*** These are the total environments that have impact on the firm's business. These can be further divided into regional, national or international environments depending upon the type of business that is being analysed.

3. ***Relevant environments:*** Dependent upon the product lines and markets a firm is in, the entire range of micro or mega environments may not be applicable and may not be relevant to a company. Theoretically, no two enterprises will have identical relevant environments which managers must take into account to examine the possible threats and opportunities.

15.10 Total Environments (PEST–LE–DLCSCC)

A comprehensive list of external environments would be as below.

P	-	Political	These are also referred to as Mego environments
E	-	Economic	
S	-	Social	
T	-	Technological	
L	-	Legal	These are sometimes included in Mega and at other times, included in Micro environments
E	-	Ecological	
D	-	Demographic	These are generally part of the Micro environments
L	-	Labour market	
C	-	Capital market	
S	-	Suppliers	
C	-	Customers	
C	-	Competition	

15.11 PEST Analysis

One of the most popular techniques in analysing mega environments is PEST analysis. It considers only four aspects viz.,

P - Political which include legal, government

E - Economic which include capital markets

S - Social which include cultural and demographic

T - Technological which include ecological

While carrying out PEST analysis, we must always try to determine the most important variables now and in the future. Important variables under each of the four aspects are:

Political, Legal and Government	Economic, Labour and Capital Market
1. Laws on monopolies, etc.	1. Planned outlays
2. Taxation low	2. Money supply
3. Import and export barriers	3. Trends in GNP
4. Environmental law	4. Interest rates
5. Employment law	5. Inflation rates
6. Consumer protection laws	6. Disposable income
7. Stability of Government, etc.	7. Levels of unemployment, etc.

Social, Cultural and Demographic	Technological and Ecological
1. Levels of literacy	1. Government s pending on R and D
2. Income distribution	2. Focus of industry on technology
3. Attitude to work, etc.	3. No. of patents per million population
4. Social mobility including rate of urbanisation	4. Rate of obsolescence of physical assets
5. Level of consumerism, etc.	5. New discoveries
6. Social upliftment programmes	6. Pollution control and cleaner techno-logies
7. Levels of religious/cultural activities, etc.	7. Computers, IT and Telecom technology, etc.

The variables under the four headings are only indicative and managers can add or delete as they consider appropriate. One would soon realise that the division between the four aspects is not rigid – a variable may be economic but has been listed under social and vice versa. The real issue is not to debate where it should be listed; instead, we should be able to examine its influence on the business now and in the future.

PESTLE Analysis

In certain situations, one may feel the need to extend the environmental analysis and go in for PESTLE analysis. This means that the approach used is similar to PEST analysis except that two additional aspects will be analysed in depth viz.,

Legal and Regulatory Environment	Ecological and Environmental
1. Excise, sales tax or income tax free trade zones, etc.	1. Enforcement of environmental protection legislation and penalties, etc.
2. Level of deregulation and liberalisation of economy	2. Energy conservation and management in terms of recycling, etc.
3. Alignment of patent laws with WTO guidelines	3. Policy on ozone depletion, generation of green house gases, etc.
4. Level of government subsidies	4. Attitude towards adopting green codes
5. Laws on immigration and emigration	5. Use of birth control measures
6. Laws on equal opportunity	6. Amelioration of rural and urban poverty, etc.
7. Laws preventing mobility of population, etc.	

The above factors should be used as a checklist rather than as the framework for evaluating their influence on the firm's business.

15.12 Total Analysis of Environmental Factors

Although rare, one must be familiar with the remaining aspects of environmental analysis. These aspects often relate to micro environments.

Demographic	Labour Market
1. Rate of increase of population	1. Availability of skilled labour
2. Birth rates	2. General level of education
3. Death rates	3. No. of craft training institutes
4. Rate of urbanisation	4. Ingenuity of technicians
5. Demographic profile in terms of age, education and trends thereof	5. Pride in the craft and attitude to quality
6. Social security programmes for senior citizens	6. Industrial relations climate
7. Life expectancy, etc.	7. Union leadership, etc.

Capital Market	Suppliers
1. Availability of term loans	1. Proximity of suppliers
2. Availability of working capital	2. Number of suppliers
3. Fiscal concessions from State Government	3. Dependence of suppliers on competitors
4. Concessional funds for technology and quality upgradation	4. Availability of water and power
5. Incentives for export	5. Rates for water and power
6. Easy schemes for loans against mortgages	6. Import of technology and experts
7. Leasing and related financing schemes, etc.	7. Availability of cheap fuels, etc

Customers	Competition
1. Established channels for distribution	1. Quantum of demand and trend in growth
2. Geographical spread of disposable income	2. Steady or seasonal demand
3. Recognising unmet demand	3. Deregulation of industry
4. Agencies for market survey etc.	4. Structure of market
5. Attitude towards quality and service	5. Level of competition
6. Customer awareness	6. Level of innovation in marketing
7. Brand loyalty, etc.	7. Relationship marketing, etc.

The above listing of variables is intended to serve as a checklist and may be used more as a guideline; specific variables may be picked up with the help of the team sitting through a brain-storming session.

Impact Analysis

The above analysis can be useful in many ways:

1. *Identifying key influences:* Managers tend to be busy with their day to day problems and pressures of work. They may fail to identify the key influencing factors but, with the help of this analysis, they can focus on them with good results.
2. *Determining drivers for change:* In the emerging scenario of global markets, there are many possibilities. There is now a greater need of undertaking these analysis so as to understand the forces behind the changes that are coming about. For example, if we comprehend the reasons for rapid changes in technology, we can respond better and cope with them.

There are global trends emerging in some industries. For example, the taste and preference of the younger generation in music is almost becoming universal. Consequently, firms in music or entertainment industry should evolve global strategies. Sony saw that in 1960s and moved into the international market. BPL has already moved in and if Videocon has to grow and flourish, writing on the wall is unmistakably clear.

3. ***Quantifying the differential effect of the external factors:*** All factors do not have impact on business to the same extent – their influence can be significantly different. This can be evaluated by using the following simple scale of measurement:

+ +	=	Very strong
+	=	Strong
-	=	Weak
--	=	Very weak

The impact analysis can be done by using the following matrix.

S.No.	Key External Influences	Firm A	Firm B	Firm C
1.	Track record in meeting the challenge of short life cycles of products	+ +	- -	+
2.	Measuring needs and wants of customers	+ +	- -	+ +

The impact matrix can be continued for even very complex and large number of external factors influencing the business.

15.13 Scenario Building

Scenario Building (SB) is a well established technique and can be used effectively in the environmental analysis for strategic planning. It is very useful if the variables are few and the time horizon is long, say about five years. It is a team approach and efforts are directed towards building a few possible scenes for the future shape of the company. These are not wild guesses or hunches of one individual (CEO or any other powerful incumbent); instead, these are consistent views of possible developments around key factors identified with the help of any one of the above analyses.

Scenario Building (SB) is evolved by carrying out the following steps:

1. ***Identifying key factors:*** Number of these factors must be kept low say up to three to five.
2. ***Study past trends:*** We must analyse the history and find out their impact in the past on market conditions and consequently on the firm's strategy in the past. We must learn the root cause of these factors themselves so as to understand their gyration and amplitude better.
3. ***Construct scenarios:*** With the active help of the team, we try to construct two to four alternative scenarios that may be possible, consistent and logical through debates and discussions. If the number of variables is large, we think in terms of the optimistic, most likely and pessimistic values of dominant factors only. This will help cut out improbable scenarios. In no case should we try to allocate probability of happening to these factors as they may give a misleading view on the accuracy whereas probability has been at best a guess-estimate.

The exercise of SB is useful because it imparts better understanding of the external variables influencing the business. Besides, it facilitates challenging taken for granted assumptions about their influence.

Notes

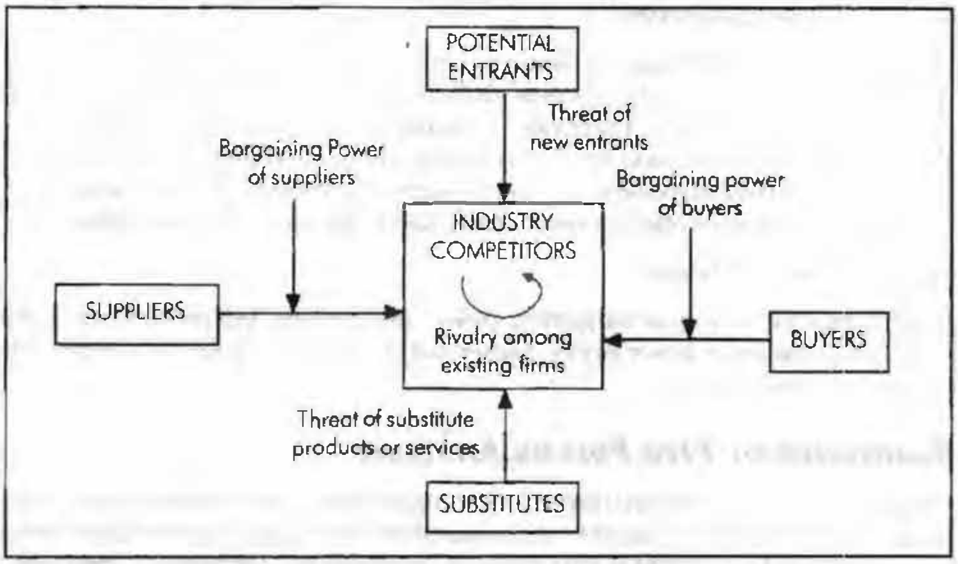
15.14 Industry and Competitive Analysis

It is not only important to carry out environmental analysis, but also the complete analysis of the structure of the industry of which the firm is a part. Herein, we are also externally focused to the extent that we are examining the various facets of business but it targets only the industry in which the enterprise is in and all its competitors, current players and future entrants.

Michael E Porter has made a significant contribution by propounding the technique of 'Five Forces Analysis'. It is a very exhaustive methodology available for carrying out the industry and competition analysis in depth and covers all aspects of business that would affect profitability of the company now and in the future.

Five Forces' Analysis

The technique has been illustrated in the form of a diagram as below.



Michael Porter has identified the following five sources of competition:

- Rivalry among existing firms
- Threat from new entrants
- Threat from suppliers (by integrating forward)
- Threat from substitute products and services
- Threat from buyers (by integrating backward)

We shall examine each one of them separately.

Rivalry among the Existing Firms

This constitutes analysis of the complete industry. Industry may be described as a group of firms that produce products that are close substitutes. Although there is a debate regarding the concept of substitutahility in terms of products, processes and geographic markets, we would assume that the boundaries of industry are already well defined. Firms are most concerned about the extent of competition among the existing players in the industry.

Threat from New Entrants

Entry marks the beginning of production and/or sale of products by a new firm or an existing firm through the process of diversification. Entrants threaten the incumbents in two ways viz.,

Notes

- Taking market share away from the incumbents and reducing their profits
- Increasing competition when new entrants introduce new products, etc. for consolidating their market position.

Bargaining Power of Suppliers

Concept of suppliers should be extended to cover supplies of materials and services. We know that the suppliers of capital exercise a great deal of influence on the borrowers. Representatives of financial institutions are on the Boards of many companies; a number of them have the option of converting their loans into equity. In India, a large number of financial institutions play a critical role when firms are not able to function. Even suppliers of people related services play a crucial role by providing professional services like tax advisors, doctors, teacher, etc. However, since most of them are not organised, they do not exercise as much influence as the trade unions which are organised and often function as a wing of political parties in India.

Threats from Substitute Sellers

Every business has competition; in some cases we may be competing for selling products while in other cases, we might compete for buying resources of inputs, etc. This threat can be real or a possible one. There can be another form of threat when companies not manufacturing substitute products are in competition i.e., when they are competing to partake a part of your disposable income by attracting you to buy their products, then these firms although not offering functionally substitute products, pose a threat.

Bargaining Power of Buyers

Similar to, but the reverse of bargaining power of suppliers, buyers compete with the industry by insisting on lower prices, higher quality and/or services which could be at the expense of profitability.

Advantages of Five Forces Analysis

Michael Porter's five forces analysis is a very major technique in strategic planning and management as it helps to identify the competitive forces and their relative strengths and weaknesses. This insight is very useful in evolving the competitive strategies and how to position the firm in competitive environments. The major advantages are:

- Identifies key competitive forces at work
- Determines underlying forces driving these competitive forces
- Rate of change in these forces and their impact on competition
- Status of competitors in respect of these forces, their competitive standing and positioning
- Ways of influencing these forces by weakening suppliers and buyers and by reducing the threats of new entrants and substitute suppliers as well as current rivals
- Identify early signals of distant threats to the profitability of the industry and how to combat it on a long-term basis.

Competition

We must understand competition before we can analyse it. For a good knowledge on competition, we must learn about market and market structure. These have been described below:

Market

George Stigler and Robert Sherwin (1985) have defined market as "the set of suppliers and demanders whose trading establishes the price of a good".

Two sellers are in the same market when production and pricing decisions of one materially affect the level of production and price the other seller can charge.

Thus, two products are in the same market if they are close substitutes. Two products are close substitutes when:

- They have same or similar functional performance characteristics
- They are used for same or similar occasions
- They are selling in the same geographical market.

Market Structure

Market structure refers to the number and characteristics of firms in it. Some markets are dominated by a few players like soft drinks or soaps and toiletries whereas other markets may be having many players like fresh flowers, computers, etc. Market structure decides how firms compete and the level of profitability they can achieve.

There are two methods of measuring the market structure:

(i) ***N-firm concentration ratio:*** It is a way of describing the distribution of market among the top four to eight firms – usually four or eight firms are used as a basis. logic being that a market depends upon the top four or eight firms rather than the very small companies at the lower fringe. In this, the data is compiled and tabulated in terms of the market share of top four firms of the industry.

(ii) ***Hertfindal index or its reciprocal:*** Hertfindal Index (HI) is calculated mathematically. It is the sum of squares of market share of all firms in the market viz.,

$$HI = \Sigma(Si)2$$

Where, Si = Market share of firm i

Illustration

If two firms have a share of 50 % each of a market, then

$$HI = (0.5) + (0.5) = 0.5$$

Reciprocal of $HI = 1 / 0.5 = 2$

For computing HI, market shares less than 1% are not computed as its square becomes very insignificant.

Nature of Competition

It can be galuged from the composition of the market as below.

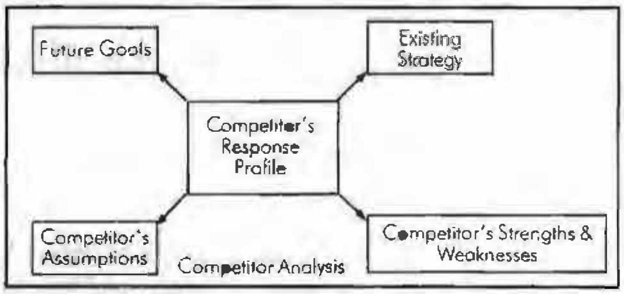
S.No.	Type of Competition	HI	Degree of Competition	Intensity of Price Competition
1.	Perfect competition	<0.2	Very many sellers	Fierce
2.	Monopolistic competition	0.2	Many sellers of similar products	Fierce or light price competition depending upon product differentiation
3.	Oligopoly	0.2 to 0.6	A few sellers	Fierce or light price competition depending upon inter-firm rivalry.
4	Monopoly	>0.6	Few (one) seller	Light unless threatened by new entry

Notes

Competitors' Analysis

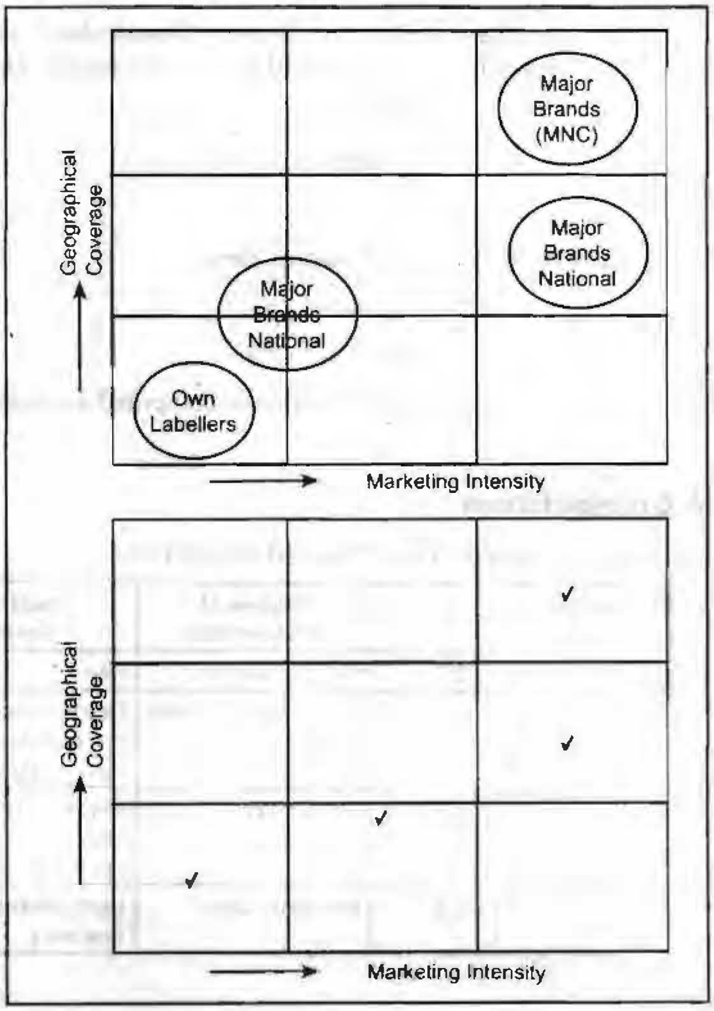
Strategy is always competitive in nature – it is the positioning of the firm in the competitive environment so as to ensure that its future actions are distinct from its competitors in order to ensure greater value to its customers and consequently to itself.

Although there is a need for undertaking a detailed analysis of competitors, it is usually not done comprehensively. A detailed framework is illustrated in the Figure below.



15.15 Strategic Group Mapping

The problem with the industry analysis is that the entire industry may not have any well defined geographic boundaries and we are not able to uncover any strategic spaces which may be remaining uncovered and hence become market areas of special interest to strategy planners. Strategic Group Analysis is another technique from the stable of Michael Porter who has changed the way managers look at their own operations and management of the future of corporations.



We analyse the entire industry and try to fine-tune various players into certain groups or clusters. For example, each industry today may have the following clusters of firms:

- International brands marketing nationally across the entire geographic territory
- National brands operating across the entire geographic territory
- Regional brands active in specific markets within the entire territory
- Local brands selling in niche markets

We look at the entire industry and determine the various groups they belong to and carry out their mapping as shown.

The intention is to relate marketing intensity with the geographical spread of the different clusters in order to determine the strategic space.

Student Activity

Carry out a detailed analysis of the industry taking into account the trends in entertainment and education industry globally and recommend a possible strategy for your client.

15.16 Summary

The essence of environmental analysis is to learn about the trend of change and how they are going to impact on the business of the firm in future and incorporate those changes proactively so as to aim at a good strategic fit. We cannot aim to reach the stars but we can certainly move forward by looking at the polestar.

Managers must familiarise themselves with the wide spectrum of possible external influences so that they can focus on the relevant environments which impact on the company business. Knowledge of these techniques can help each enterprise to develop its own compass that can continue to guide it into the stormy future.

15.17 Keywords

Micro Environments: These are those environmental factors that are more relevant to the line of business the firm is operating in and are often referred to as industry environments.

Mega Environments: These are the total environments that have impact on the firm's business.

Relevant Environments: Dependent upon the product lines and markets a firm is in, the entire range of micro or mega environments may not be applicable and may not be relevant to a company.

15.18 Review Questions

1. Should we start with designing the vision and mission of the firm first? Support your position with justifications.
2. What are the mega, micro and relevant environments? Describe them briefly.
3. Describe the mechanism of PEST analysis.
4. If a company wants to undertake an extended analysis of its mega environments, describe the method you would recommend.
5. What is impact analysis? Describe the procedure with the help of an example.

6. Describe scenario building technique of analysing the composite influences of various external factors? Discuss their suitability and relevance for environmental analysis.
7. Describe five forces analysis. How does it help improve the profitability of a firm?

15.19 References and Further Readings

- Porter, M. E. (2019). Competitive strategy: Techniques for analyzing industries and competitors (2nd ed.). Free Press.
- Hill, C. W. L., Schilling, M. A., & Jones, G. R. (2019). Strategic management: Theory and cases: An integrated approach (13th ed.). Cengage Learning.
- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage (22nd ed.). McGraw-Hill Education.
- Grant, R. M. (2021). Contemporary strategy analysis (11th ed.). Wiley.
- Pisano, G. P. (2020). Creative construction: The DNA of sustained innovation.Public Affairs.

Unit 16 Variables in Competitive Environments

Unit Structure

16.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Identify the critical success variables in competitive environments
- Analyse the internal resource
- Make value chain analysis
- Recognise the primary and support activities

16.1 Introduction

Critical success factors have been a very popular means of planning, implementing and reviewing strategy ever since the concept was introduced in the early 1960s. Kenichi Ohmae, in his classic – The mind of the strategist, the art of Japanese business, states that all of industry leaders started by deployment of strategy based on critical success factors. In other words, the promising companies which could not make it to the top or those leading companies that fumbled when faced with real competition, had their failures rooted in their inability to identify the factors critical for their environment or lacked the understanding and will to exploit those factors through concentration of resources and efforts to the scale required.

16.2 Critical Success Variables in Competitive Environments

How do we attain and sustain a competitive advantage in real life? Kenichi Ohmae, in his book, The mind of the strategist: Business Planning for Competitive Advantage, has suggested the followings four ways:

- Identifying and reinforcing strength in the critical success variables
- Exploiting competitors' weakness and building relative superiority
- Pursuing aggressive improvements by challenging taken-for-granted rules
- Deriving maximum benefits from strategic degrees of freedom.

Notes

Identifying and Reinforcing Strength in the Critical Success Variables (CSV)

These success variables can be identified out of the followings:

- Product or service
- Market or user class
- Production capacity and capability
- Technology
- Marketing and sales methods
- Logistics and distribution methods
- Exploitation of natural resources
- Size and growth
- Returns and profit

There are two approaches to identifying CSVs of a business:

1. Dissecting the market and shortlisting the key success factors from the above.
2. Comparing the successful and not-so-successful firms and finding the missing critical success factors in the losing firms.

History of successful firms would suggest that the surest shortcut to success is to jump quickly to the top by concentrating on major resources early, becoming really good at them and then moving to consolidate a lead in other functions by using the profits that have accrued from achievement of early top status.

"All of today's leaders without exception, began by bold deployment of strategies based on key factors for success", Kenichi Ohmae (1983).

Exploiting Competitors' Weakness and Building Relative Superiority

A firm must undertake competitor merchandising, buy their product and strip it down to individual component. This tear down exercise will facilitate comparison of each and every component. It helps finding areas of strength and weakness with respect to the competitors. This technique has been developed into a management tool known as, 'Reverse Engineering'. The strip down exercise enables the competing company to devise various strategies to exploit opponent's weakness and build up relative superiority.

Pursuing Aggressive Improvements and Challenging Taken-for-granted Rules

The underlying principle is to sharpen the querying mind and question every assumption with the confidence that yesterday's best can be bettered today. It has often led to revolutionary breakthroughs in devising new products, processes, procedures and policies.

This approach brings in directional change in a firm's strategic thinking because it encourages questioning – why we are doing what we are doing in sharp contrast to a grooved mindset of focusing on how to do faster whatever we are doing.

Deriving Maximum Benefits from Strategic Degrees of Freedom

There may be a limited scope in effecting improvements in the CSVs chosen to secure positioning for the firm that imparts it the competitive advantage. Kenichi Ohmae suggests that in such cases we must explore all the degrees of freedom and endeavour to go beyond those degrees of freedom because that alone will move you out of the current mindsets and seek fundamental, drastic and dramatic improvements in the products, processes and practices.

16.3 Internal Resource Analysis

As an essential part of the investigation to determine our own strengths and weaknesses, we necessarily turn to internal resources that must be examined critically to bring out the following:

- Resources we use well and are very good at
- Resources that are not performing well
- Resources that are contributing but are not up to the expected level
- Resources that are weak but are required to be in top gear for the success of business

Corporations make use of a large variety of resources for carrying out the activities required for the business. There are numerous ways of grouping these resources and we can look at them in the following categories:

- Physical resources
- Financial resources
- Human resources
- Informational resources
- Intangible resources

Let us discuss them one by one.

Physical Resources

These are the physical assets of the company. The analysis should be carried out comprehensively and should cover the following aspects:

- Age of the asset
- Condition of the asset
- Capability of the asset
- Location and its current market value, etc.

The physical assets may comprise of the following:

1. *Land and buildings:* The analysis should cover all physical assets including office buildings, their location and their current market value and classified into one of the four groups stated above. For many firms, non-performing assets situated at prized locations become the starting point of strategy formulation and implementation.
2. *Plant, equipment and accessories:* Every enterprise scrutinises its plants, equipment and accessories critically with respect to their age, condition and capability and takes necessary action to prevent disrepair and deterioration. Maintenance and replacement of plant and equipment is an economic and paying decision and management should change their mindsets to take full advantage of it.

3. *Materials:* These comprise of raw, intermediate and a large number of maintenance and consumable materials involving investment of working capital, storage space, equipment, etc. leading to very high cost of carrying inventories. Managers must examine the justification of holding inventories and devise management systems to move towards zero inventory. Holding inventory adds to the cost of operations but does not increase its value in any way. On the contrary, when materials are held in stock, there are chances of spoilage, deterioration, obsolescence and pilferage. Besides, we have to insure it against fire, theft, etc. Introduction of Just-in-Time system can help the firm towards zero inventory but not without upgrading to high quality working.

4. *Products:* These are the finished products of the firm. The chain of supply to the end user must be short and trim. Longer the chain, more is the detention time during its journey to the end consumer and higher the inventory required to service it. Consequently, costs add up and prices increase making it difficult to compete. Managers must ensure that there is suitable inventory control which is different and unconventional in the sense that, besides looking at the fast moving items of sales, it keeps a watchful eye on non-moving or very slow moving items and disposes them off before they become a liability.

Financial Resources

Money is the common denominator for all business activities; there is nothing free in business. The value of money must be amply clear to managers. Cricket matches are won not only by scoring runs but also by saving runs while fielding the opponents. In this connection, following aspects are important:

1. *Sources of own funds:* Managers must be clear about the sources of own funds – whether these are arising out of retained profits or by trading a non-performing asset or through the relations and friends of promoters.

2. *Securing long-term capital:* This could be in the form of share equity or long-term loans for financing expansion. In recent years, financial and development institutions have acquired considerable clout when they participate in share equity or loans, etc. The track record of profitability and dividend payments can help as much as the image of the company and its role in social projects that are in accordance with social and/or national priorities.

3. *Managing relationships with shareholders, bankers, etc:* Networking with important shareholders, understanding their expectations is conducive to a firm's ability to raise funds in future. Relationships built over time are like bank balance in saving accounts; they can be useful in helping during difficult phases in business.

   Financial institutions are known to have sanctioned loans provided the named incumbents continue to head the enterprise.

4. *Managing cash:* Prudent management of cash is important; firms must do an in depth study to reconfirm that cash management is done discreetly and no impetuous decisions are implemented leading to frequent problems of cash-out situation.

5. *Managing receivables and payables:* Considering the high cost of money, firms must make efforts to collect their receivables in quick time for which more realistic terms of payment have to be devised. It is a common practice to offer financial incentive by way of giving discounts for timely payments. Besides, there is always a trade off between cost of collection and the amount of bad debt. These days, agencies that offer their services for collecting so called bad debts on 20 or 30% commission are also available in large cities.

Human Resources

It is said that most organisations have not been able to galvanise more than 30% of the human potential despite various democratic measures for proactive people management. The importance and relevance of providing strategic leadership to the team is crucial to achieving long-term goals. In the ultimate analysis, as stated by a contemporary Indian religious philosopher, leaders only manage men who, in turn, operate machines, utilise materials and deploy funds. Treating human beings at par with other resources would be a mistake for it constitutes a very resourceful resource. Following aspects must be examined in depth.

1. ***Critical skills and their numbers:*** If an enterprise wants to become a first class outfit in marketing and sales, it has to recruit top-notch marketers and position them in responsible jobs. Similarly, if a company wants to be very good in finance, it will have to take specific steps to hunt for them and place them at higher positions in the hierarchy.
2. ***Capability of human resource:*** Often senior management tends to underestimate the capabilities of their staff. Managers must design challenging opportunities for their subordinates and test them out from time to time so that they get exposed to varying situations in order to understand their capabilities. It is interesting to know from the staff themselves what their capabilities are and how to put them to effective use. This reduces the possibilities of misfits and people progress along career paths in which they are interested. Both organisation and individual gain in the process.
3. ***Intriguing resource:*** Human resource is the only resource that has a mind that thinks and has a heart that beats. It should never be equated to a gadget in the production system. Managers must design jobs such that they make demands on the employees thinking faculties and these should be organised in such a way that they excite the heart from time to time. Only after we ensure these two aspects, managers can hope to win over employees' enthusiasm, initiative and loyalty.
4. ***Self-autonomy:*** Every individual seeks recognition, importance and respect. Managers must design a certain amount of autonomy in the job and provide some free space around the job so that individuals can grow and develop while performing these tasks. This prevents straight jacketing of individuals into slots that they find suffocating and stifling. This will lead to employee involvement, interest and they would perform their jobs more enthusiatically.
5. ***Extraordinary management skills:*** Managers must be encouraged to acquire cognitive skills in selecting right jobs for implementation. Most managers spend their working time doing the job right with all the diligence and care whereas they can contribute significantly better by choosing the right job, this imbibes leadership traits in the managers who can become extraordinary managers.

   Every organisation requires both ordinary and extraordinary managers but the latter can propel the company to achieving corporate goals in quick time.

Informational Resources

Information is knowledge and knowledge is power. This resource is emerging as the most powerful input in the process of decision making at all levels. Its relevance and importance for aiding strategic planning and decision making can not be overestimated. Informational resources form a link in managers' ability to measure, evaluate and coordinate areas under their control. Following aspects are critical:

(i) ***Internal data and information:*** Managers must carry out a study of their current operations and satisfy themselves that adequate data is collected and processed into information which decision makers find useful while doing their respective jobs. An essential ingredient of jobs at all levels is the decisions and actions individuals take. Collection and compilation of data should start from the operational levels.

(ii) *Competition data and information:* Business extends into the marketplace and one cannot conduct business without collecting and compiling data about competitors and industry. The data about competitors does not become available easily beyond what is published in the form of annual reports, publicity brochures and product catalogues. Perhaps in the coming years, industrial intelligence services will be available to satisfy this demand which is going to be sought more and more. There is a lot of learning that can be derived from industry and competition data and used as a benchmark to improve ones own operations to match the performance with the industry leaders and then to outstrip them.

Some useful data may also be available from the industry and trade associations.

(iii) *Environment data and information:* A lot of information bureaus are already offering their services on a commercial scale. However, the data that can be useful for instituting benchmarking projects are difficult to come by and special efforts may be involved. Sometimes, engaging professional consultants in particular areas facilitates access to this type of relevant data. These inputs are required to finalise the parameters for the benchmarking project. Most firms are, if approached properly, prepared to share their experience in the design and operation of these parameters. Environmental information for inter-firm comparison cuts across the industry and trade barriers and takes the company to benchmark globally to become one of the best in the world.

Intangible Resources

Intangible resources are no longer intangible because these are very valuable in the competitive marketplace. For example, goodwill has always been understood in India as an asset that is valuable and can be traded, if required. Intangible resources cover the followings:

(i) *Brand name:* Companies are now realising the importance and value of brand management and building up brand equity. They are busy committing major expenditures to gain a competitive advantage.

Thums up and Kwality brands have taken a beating after they were acquired by larger corporations. The brand has to be continuously nurtured and tended to glory.

(ii) *Corporate image:* Enterprises have to create a climate within the organisation that can guide the priorities of the company when it comes to social and ethical values and projects of direct interest to the society and the nation. An equal opportunity employer or an employer who would play fair in his dealing with the customers, suppliers and employees alike. These are deeply set beliefs and values – managers cannot be fair to customers until they have embedded the style of being fair to their suppliers and employees. Corporate image can be a big asset in times of crisis like war, etc.

(iii) *Good contacts:* Good contacts and networking with customers, community and the government can lead the company to building lasting friendships and associations.

16.4 Control over Resources

While auditing the role and importance of resources, we need to examine not only the resources that the company has but also those resources that it can access because of its contacts, image and brand equity.

16.5 Value Chain Analysis

Concept of value is not new in the industry. It originated during the peak of second world war when Larry D Miles, working for the US Navy, developed the technique of Value

Notes

Analysis. It has later also been described as Value Engineering because it developed as a total concept from concept to design, engineering, procurement, operations and maintenance covering the entire life cycle of products, processes and procedures.

Student Activity
Discuss the role of brand valuation in making strategy.

16.6 Summary

Critical success variables should be highlighted if the organisation has to secure a strategic positioning for a cutting edge in competitive environments.

Internal resource analysis is a good starting point for identifying our own strengths and weaknesses – it throws up a lot of issues and problems which need to be attended to if the company has to succeed in the competitive environment. This audit should cover all the resources – physical, financial, human, informational and intangible.

While carrying out this audit, we should review both, the resources directly within the control of the firm and those it can access to, with the contacts and relationships cultivated over time.

Value chain analysis has become a very powerful tool for examining the value chain of the firm and the total value chain.

16.7 Keywords

Physical Resources: These are the physical assets of the company.

Inbound Logistics: These cover receiving, storing and distribution of input materials and resources to machining, assembly, testing and other activities.

Outbound Logistics: It includes collection, storage and distribution of products to customers and also warehousing, material handling, transportation, etc.

Procurement: This process, currently referred to as Outsourcing, involves acquiring various resource inputs to the primary activities and takes place across all functions of the company.

16.8 Review Questions

1. What are the critical success variables in competitive environment?
2. Write a note on internal resource analysis.
3. What are the key strategy for managing financial and human resources?
4. Define value chain analysis.

16.9 References and Further Readings

- David, F. R., & David, F. R. (2018). Strategic management: A competitive advantage approach, concepts and cases (16th ed.). Pearson.
- Johnson, G., Whittington, R., Scholes, K., Angwin, D., &Regnér, P. (2020). Exploring strategy: Text and cases (12th ed.). Pearson.
- Kaplan, R. S., & Norton, D. P. (2020). The balanced scorecard: Translating strategy into action. Harvard Business Review Press.

1999

- Hill, C. W. L., & Jones, G. R. (2019). Strategic management: An integrated approach (13th ed.). Cengage Learning.

Unit 17 Cost and Value Drivers

Unit Structure

17.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Explain the total value chain
- Describe the product portfolio analysis
- Define BCG matrix
- Describe General Electric (GE) Business Screen
- Explain Arthur D Little's Life Cycle Analysis

17.1 Introduction

Every organisation has to take two central strategic decisions viz.,

- Which strategic area will drive the business concept and impart direction to it?
- What areas of excellence it should cultivate to keep the strategy in good shape?

It has to choose the value drivers which must be honed, sharpened and enhanced and look for areas which are adding costs more than what can be justified as their value adding capability from the customer point of view.

It is useful to look at the entire value chain within the organisation and classify the activities into the following three categories:

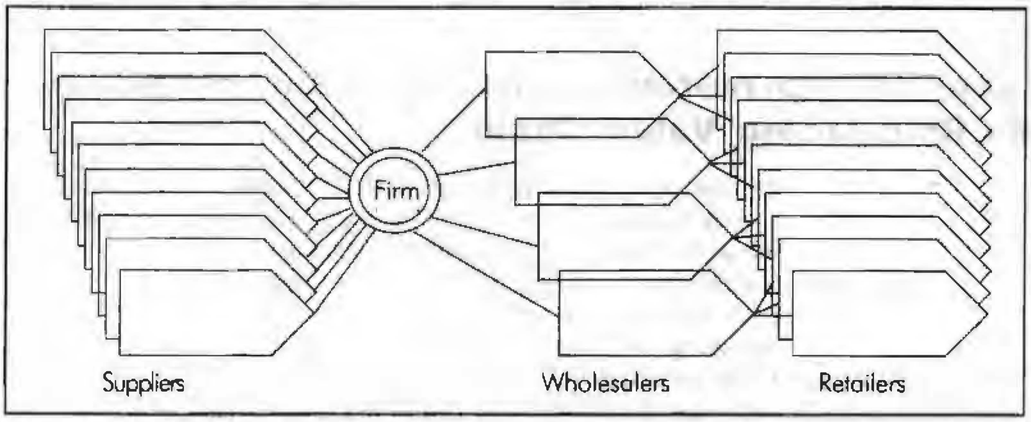
- Real Value Adding (RVA)
- No Value Adding (NVA)
- Business Value Adding (BVA)

Of the above, NVA activities are cost drivers and should be eliminated and BVA activities cannot be eliminated and hence, should be brought down to an irreducible minimum. Consequently, the proportion of RVA activities will increase in proportion. Besides, we can further sharpen the skills for performing RVAs better.

17.2 Total Value Chain

Notes

No enterprise can deliver value to the customer individually. It needs the help of suppliers who supply a large number of items it cannot make in-house and the active involvement of its wholesalers and retailers so that it can reach the end consumers effectively and efficiently. If we take this into account, the total value chain of a company would be as shown.



Thus, the capability of an individual firm to deliver value is very much dependent upon its vendors and suppliers who should be treated as business partners and long-term and durable relationships with them must be cultivated.

Similarly, wholesalers form an important link in the value chain extending towards the customer. They play a vital role and should be cultivated on a long-term bilateral working relationship. There is no place for adversarial roles that must be mutually reinforcing. Business relationships last if everyone makes money commensurate with their respective effort and investment.

Performance at the retailers' level is the most critical area as it interfaces with the end consumers. Their active involvement and their cooperation in organising window display, sales promotion campaigns and customer care is paramount for the success of the business. There is thus a greater need to interact with the retailers and make it easier for them to communicate effectively with the customers.

17.3 Importance of Linkages in the Value Chain

Whether at the level of individual organisation or at the level of total value chain, bonds among the various links in the chain are important. If the two departments like marketing and production go together well, it may be viewed as a strong point. Similarly, if marketing and sales are able to synergise well with the servicing function, it can enhance value delivered to the end user.

What is true within the organisation is more so for the total value chain. If suppliers respond better and faster to the purchaser, it is a positive strength that a company can build upon further. The suppliers should be viewed as your own workstation or capacities but not located at your own premises. If we have perfect understanding with the wholesalers and respond quickly to mutual needs and expectations, the relationship can facilitate delivery of better value to the end consumer. Similarly, retailers are part of the same link and should be treated with due concern and consideration.

It must be always remembered that the total chain is as strong as the weakest link in the entire chain. Such weak links should be identified and supported to overcome their weaknesses as that would add to the overall effectiveness of the value chain, which should be the common concern of every one in the value chain.

This total chain should be subjected to the same scrutiny of identifying the activities and classifying them into the three categories:

Notes

- Real Value Adding (RVA)
- No Value Adding (NVA)
- Business Value Adding (BVA)

This is a comprehensive method of identifying the value drivers and cost drivers in the total chain and strategies can be worked out for enhancing the value delivery to the end users.

17.4 Role of Information/Communication Technology in Reinforcing Value Chain

When two groups or individuals link up together, the role of telephones or other forms of communication links becomes rather important. With the recent advancements in computer networking, information and communication technologies, this aspect has assumed greater importance. All organisations must examine the economics of changing over to computer based telecommunication links to make these business links stronger so that you can connect with the remotest comer of your territory instantaneously. You or your wholesalers' salesperson can easily link up either way so the business deals can be clinched faster. It also permits quicker responses to customer and salesperson queries and helps overcome the problems of time and distance. This aspect is increasingly becoming important in doing business today. Large scale computerisation of business, creating intranets and using i:ntemets for accelerating the pace of comm1.1nication has enabled companies to deliver better value to the customer. Similarly, voice—response systems are useful in accepting customer complaints round the dock and giving them feedback in quick timeAlthough, perhaps not that well highlighted by Michael Porter, the need to integrate various links within the ,value chain wilI make for stronger and more durable relationships and enable companies to deliver better value to the customer.

17.5 Management of Value Chain

In recent years, considerable thought and effort has been devoted to the challenges of delivering higher and higher value to the customers so as to earn a space in their heart. It has been described mathematically as below.

$$\text{Value} = \frac{\text{Value} \times \text{Service}}{\text{Time} \times \text{Cost}}$$

Correspondingly, management of value chain should involve these four aspects:

Time Management

One of the earliest metrics used for increasing productivity, delivery, availability and flexibility, it focuses on reduction in manufacturing or service cycle time and speeding up responses to speed ahead of competition. Introduced into management by the famous Fredrick W Taylor, father of scientific management, it leads us to developing time based strategies to combat competition. In the current context of marketing warfare to gain a strategic positioning in competitive environments, it may involve the followings:

1. ***Reduction in lead time***
   (a) In design
   (b) In engineering
   (c) In procurement
   (d) In conversion

(e) In delivery

(f) In inventory

2. *Reduction in time to market*

   (a) From concept to delivery

   (b) From order booking to delivery

3. *Faster responses*

   (a) To changes in market forces

   (b) To seniors, peers and subordinates

Notes

Cost Management

Cost awareness started making its impact from 1940s; this aspect necessarily includes the time management – time is money, too. The focus is on saving expenses as they are incurred. There are always three possibilities in working life – some of us are more prone to doing 'futile' things i.e., doing something that may be useful but incurring so much expenditure that it becomes an exercise in futility because the gains cannot justify the expenditure incurred. The other extreme is doing the impossible – carrying out tasks so cheaply and with so much of hard work that in normal circumstances, it would be difficult to achieve. Most other options fall in between and as managers, we have to learn to choose the most appropriate way of doing things. This approach implies developing cost based strategies which, in essence, imply reduction in costs in the following areas:

- Design and engineering
- Procurement of materials and inventory
- Conversion
- Quality assurance
- Outbound logistics and distribution
- General sales administration

Quality Management

Concept of quality gained prominence during 1960s and would perhaps continue to drive the corporate world. Quality incorporates both the time and cost metrics. Since quality has been linked to customers' needs and wants, it has become both dynamic and strategic and is playing a major role in developing quality oriented strategies to outwit and out-manoeuvre the competitors. It directs us to the following aspects:

- *Customer focus*
  - Meeting customers' requirements
  - Surprising customers by exceeding their expectations
  - Caring, caressing and cajoling customers
- *Functional performance*
  - Appropriate fitness for use
  - Closer integration with customer operations
  - Anticipating customers future needs and desires
- *Reducing process variability*
  - Robust designs
  - Six sigma technique
  - Taguchi's methods

- *Elimination of waste*
  - Implementing Just-in-Time systems for launching a total war on waste in all forms
  - Pollution reduction by changing over to cleaner technologies
  - Noiseless and serene workplaces and environments
- *Continuous improvements (Kaizen)*
  - In products
  - In processes
  - In procedures
  - In policies

Service Management

An emerging concept of 1990s, it incorporates all the other metrics of time, cost and quality. It embraces all facets of working life because simultaneous to selling tangible goods to customers, rendering services is crucial and can make or mar the prospect of your marketing and selling efforts. Service oriented strategies cover the following aspects:

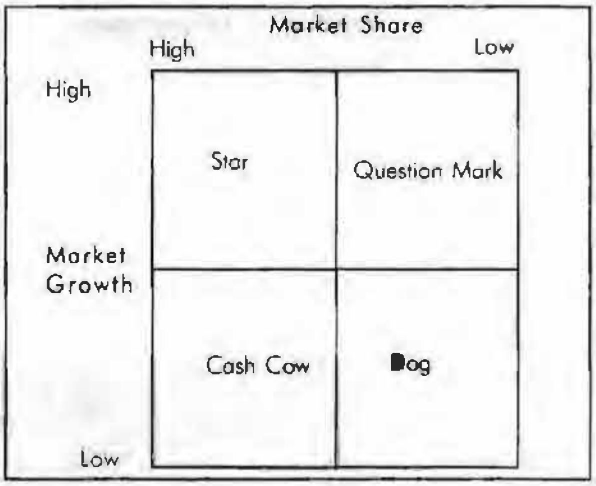
- Customer support
- Product support
- Product service
- Flexibility in meeting customer demands
- Flexibility in meeting changes in the market

17.6 Product Portfolio Analysis

Most companies deal with multiple products that may be bundled together or divided into various profit centres or Strategic Business Units (SBUs). We have to examine these firms having a large number of products in their portfolio to understand their weaknesses or strengths in the market place. It is perhaps easy to understand that these products may be passing through different stages of their life cycle viz., introduction, growth, maturity or decline. We, therefore, must reassure ourselves whether our product portfolio is balanced or not. What are the gaps and how to go about filling them up?

BCG Portfolio Matrix

Boston Consulting Group (BCG) portfolio matrix is one of the early techniques and has become very popular over years because of its simplicity. It involves drawing up the matrix between the 'Market Share' and 'Market Growth' as shown below.



Notes

Accordingly, it divides the entire range of products into four categories:

1. *Stars:* These are the firms' products that are doing well in the growing market. However, since the market is in the growth phase, it requires to be nursed so that it remains in tune and we do not miss out on any roadblocks or opportunities that may crop up. The application and engagement of resources would also continue at a reasonably high level. If firm wants to gain further on market share, it may have to spend heavily. Being in the growth stage, as it gains experience, costs of operations come down.

2. *Problem children or question mark:* These products are also in the growing market but their market share is not high. Usually firms spend more money on these products but these efforts do not result in increase in the market share.

   The product (s) are question mark or problem children and continue to drain the firm's resources and energy as margins remain poor.

3. *Cash cows:* These are those products that have already achieved high market share but are now in the maturity phase i.e., the total market demand has stabilised and so has the firm's market share. There is no need to increase the marketing expenses; on the contrary, conditions permitting, resources can be withdrawn. Consequently, costs of marketing and sales are reduced and profit margins are high – it becomes the cash provider for other product lines that are not doing well.

4. *Dogs:* As the name implies, these are those products for which the market share is low and the products are either in static (mature) market or in declining phase well past the saturation point. It presents the worst combination of market share and market growth. These products become a drain on firm's energy and resources and are candidates for divestment strategy.

GE Business Screen

There are a number of matrices that have been used by different firms and reputed consultants. GE Business Screen has been used more widely. It was originated by the General Electric of USA and is a matrix between a firm's 'competitive position' and 'market attractiveness'. The matrix is illustrated below:

Industry Attractiveness	Competitive Position: Strong	Average	Weak
High	Invest	Invest	Wait & Watch
Medium	Invest	Wait & Watch	Divest
Low	Wait & Watch	Divest	Divest

The possible inferences that can be drawn from the matrix are shown in the respective matrix cells.

1. *Investment and growth strategies:* If the products are in the top left corner cells as shown, it points out good growth prospect because your competitive position is medium to strong and the industry in which you are operating, has a medium to high rating in terms of attractiveness now and in the foreseeable future.

2. *Wait and watch tactics:* If the product line falls in the middle cells as shown, the firm is strongly advised to wait and watch for sometime for the situation to concretise. It is expected to be a short wait as one cannot wait endlessly in a given situation.

Notes

3. ***Divestment strategies:*** As explained in the beginning, quitting a business or withdrawal can also be a worth-while proposition and should not be thrown out of hand. It is a tricky situation though, because usually the best price is often offered by one of your erstwhile competitor!

The real purpose in undertaking these analysis is to ascertain the balance of product portfolios of the firm and its competitors.

17.7 Arthur D Little's Life Cycle Analysis

This technique owes its origin to Arthur D Little Consultants who have also been active in India in recent years. This is a very detailed matrix analysis as it links market position of the firm with the industry or products' different stages of life cycle. Also known as Product-Market Evolution Analysis, it examines the four stages of product life cycle and five possible market competitive positions as set out below:

	Embryonic	Growth	Maturity	Decline
Dominant	Fast grow Start up	Fast grow Cost leadership Renew Defend	Defend Cost leadership Renew Fast grow	Defend Cost focus Renew Grow with Industry
Strong	Start up Differentiate Fast grow	Fast grow Catch up Cost leadership	Cost leadership Renew, Differentiation focus Differentiate Grow with Industry	Find niche Hold niche Hang in Grow with industry
Fovourable	Start up Differentiation Fast grow	Differentiation focus Catch up Grow with industry	Harvest, Hang in Find and Hold niche, Renew, Turnaround Differentiation focus Grow with industry	Retrench Turnaround
Tenable	Start up Grow with Industry Focus	Harvest Catch up, Find niche Hold niche, Hang in Turnaround Focus Grow with industry	Harvest Turnaround Find niche Retrench	Divest Retrench
Weak	Find niche Catch up Grow with Industry	Turnaround Retrench	Withdraw Divest	Withdraw

The above is a convenient and comprehensive set of strategies developed by Arthur D Little Consultants'. All that we are required to do is to undertake a realistic appraisal of the current classification of the product lines and possible strategy options can be read directly from the above matrix.

17.8 Analysis of Product Portfolio Balancing

A well diversified firm may have a good distribution, spread and balance of products among various cells of the matrix analysis described above, but it may not be so. We must examine this aspect of the product portfolio analysis in depth.

The process is being explained by taking the example of BCG analysis of a firm.

Notes

- *Tackling problem child:* It was clear to us that these products are in the growing market but the firm is not able to partake in terms of higher share of the market. To overcome such problems, we need to devote more time and resources on these products and also invest in further product development and/or development of new markets. The firm can do so only if it has some cash cows in the stable because cash required for product development and/or market development must be provided by some segment of business within. Another possibility is to sell 'dogs' and generate some cash resources.
- *Divestment strategies:* Managers must understand that it is better to be less emotional about the product portfolios and take more objective decisions. If there is a dog in the manger, it is going to impact upon the profitability of the firm. Many enterprises have improved their market value by getting out of businesses that were no longer fetching; in fact, in many cases, earlier one gets out of it, better would be the price it can command.
- *Focusing on 'stars':* Stars need 'gazing' if they have to be the cash cows of tomorrow. They need managerial attention, effort and support. Managers should never let these products become victims of neglect and callousness. We must always remember that a bird in hand is worth at least two, if not more, in the bush.

Student Activity

Discuss the practical implication of BCG matrix.

17.9 Summary

All the four dimensions of value viz., time, cost, quality and service continue to present us a panorama of strategic options of delivering better value to the customer. Value enhancement has to be developed as a way of life if we have to drive the passions of managers towards continuously receding goals in our journey to excellence. Product portfolio analysis provide an insight into the current weaknesses and strengths in the product lines of the firm. This analysis is also carried out for competitors in order to understand their strengths and weaknesses. BCG matrix, GE business screen and Life Cycle analysis provide an array of methodologies that managers can choose from and develop a better understanding of not only their operations but also that of the competitor.

17.10 Keywords

Stars: These are the firms' products that are doing well in the growing market.

Cash Cows: These are those products that have already achieved high market share but are now in the maturity phase i.e., the total market demand has stabilised and so has the firm's market share.

Dogs: As the name implies, these are those products for which the market share is low and the products are either in static (mature) market or in declining phase well past the saturation point.

17.11 Review Questions

1. What is the role and importance of value chain network? How can it help in enhancing value delivery to customers?
2. What are the four important dimensions of value? How can these form the basis for developing appropriate strategies to outwit competitors?
3. What is the objective of product portfolio analysis?
4. Describe the BCG matrix analysis and explain how to go about tackling problem child without having any cash cow in the firm's portfolio?

Notes

5. What is life cycle analysis? Describe the outline of the matrix. Also elucidate its usefulness in strategic planning and management.

6. What are the pitfalls of carrying these analyses singly? How can these be overcome in a team approach?

17.12 References and Further Readings

- Wheelen, T. L., Hunger, J. D., Hoffman, A. N., & Bamford, C. E. (2018). Concepts in strategic management and business policy: Globalization, innovation and sustainability (15th ed.). Pearson.
- Barney, J. B., & Hesterly, W. S. (2019). Strategic management and competitive advantage: Concepts and cases (6th ed.). Pearson.
- Grant, R. M. (2021). Contemporary strategy analysis (11th ed.). Wiley.
- De Kluyver, C. A., & Pearce, J. A. (2021). Strategy: A view from the top (6th ed.). Pearson
- Saloner, G., Shepard, A., &Podolny, J. (2022). Strategic management (2nd ed.). John Wiley & Sons.

Unit 18 Analysis of Skills and Competence

Notes

Unit Structure

18.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define core competencies
- Describe the tests for core competencies
- Make financial ratio analysis
- Define organisational culture
- Identify the factors influencing organisational culture
- Explain the mapping stakeholder's expectations

18.1 Introduction

Organisations need capability to manage its business – operations, finance, marketing, human resources, etc. The way these resources are linked together in a value chain is often the source of competitive advantage. These resources have also been described as non-tradeable assets of the company.

In strategic management, we start with environmental analysis for uncovering threats and opportunities and then determine internal strengths and weaknesses of the firm. We identify the markets the firm should serve and then proceed to position its products and services in order to outflank the competitors. We tend to assume that we can always acquire and develop the resources and capabilities and thus achieve our goals and objectives.

18.2 Concept of Core Competencies

Concept of core competencies is not recent; it has been evolving over the last few decades. Selznick used it way back in 1948 and it has been used by several authors during the last ten years. It may be described as the organisational rent of the resources possessed and controlled by the company. The view of economic rent ensues from the resources and their capabilities.

If we draw up a matrix between 'competitive advantage' and 'resources and their competence', it would look as shown.

	Competitive Advantage Same as Competitors (Easy to Initiate)	 Better than Competitors (Difficult to Initiate)
Resources	Threshold Resources	Unique Resources
Competence	Threshold Competence	Unique Competence

It looks at these resources in four components viz.,

1. ***Threshold resources:*** These are the minimal level and skills of resources required to stay in that business or industry and can be easily imitated by others in the industry.
2. ***Unique resources:*** These are the special bundle of resources which a firm has acquired over time, developed, refined and honed with experience which are unique to it. These cannot be easily imitated by the competitors.
3. ***Threshold competence:*** Corresponding to the possession and control of threshold resources, its competence is of the minimum adequate level that is just enough to carry on business in that industry.
4. ***Unique competencies:*** In line with the unique resources in the possession of the company or the resources it can access to because of the strong linkages it has built over time, it has competencies that are unique and cannot be easily imitated by the competitors.

18.3 Resources

These are the factors of production owned and/or controlled by the firm. Their strategic importance is based on the fact that the profits earned by the firm are 'returns on resources'. Profits from an attractive industry come from superior plant and equipment, differentiated products and possession of patents and trademarks/brands which have built up reputation over time. These margins result from the entry barriers that depend upon economies of scale, capital equipment and unique experience accumulated by the company. These cannot be easily acquired or imitated by the competitors. Grant has said that, "Resources are the founts from which firm's profits flow". Resources may be tangible or intangible; it is the intangible resources that are more important. These do not appear in the profit and loss statement of the company. Even when these are identified to be of value, they are difficult to value objectively. However, their value can be inferred; in the event of a sale, it is the difference between the purchase price and the book value that in common parlance is called the 'goodwill'.

Notes

These intangible resources may be classified into:

Human Intangible Resources

Although human beings are tangible but their skills, experience, etc. are not. It is very difficult to measure their value since much of it emanates from the way they work together in teams and groups. Brain equity is being increasingly seen as a crucial asset in winning marketing wars in the future.

Non-human Intangible Resources

Brand names in the possession and control of the company are the most prominent examples of this resource. Difficult to value, their value is beyond doubt. These days, it is measured as a ratio between the stock price and the book value. Corporations like Coca Cola top the list with a ratio of 62.

This ratio also reflects the expectations of the market in terms of future growth. Protecting brand becomes a strategic obsession with these firms.

18.4 Capabilities

Capability may be described as a firm's ability to deploy a mix of resources to achieve a goal. Capabilities may be thought of as intermediate products generated by the firm to enhance productivity of its resources – it is the special ability of the firm to bring out higher output from its resources. The way these resources are configured and utilised determines the organisational capability of the firm now and in the future.

Researchers have agreed that organisational routines and rituals – the way we do things here, are critical determinants of company's capabilities. Appropriate proportion of organisational culture, styles of leadership, management control and reward systems need to be properly mixed so as to realise full potential of the capabilities of the resource.

18.5 Understanding Core Competencies

C K Prahalad and Gerry Hamel talk of architects and maintenance engineers; they stress the need of more architects than maintenance engineers in a firm. According to them core competencies are built by integrating the strategic internal architecture of the firm as a whole. They are of the opinion that more relevant than product portfolio is the portfolio of core competencies and managers should focus on identifying, cultivating and exploiting these core competencies.

In the short run, we may perceive that competitiveness comes from price performance of the products and services and the costs and quality of the products as they offer differential advantage. Competence comes from ability to build at lower cost and more speedily than the competitors, it spawns revolutionary products and services, it is the ability to adapt quickly to changes in the market place and ability to coordinate and integrate multiple technologies across various functions and SBUs. Core competence is rooted in the culture of the organisation and has evolved over many years – it helps the firm to 'focus on roots and not the leaves'.

A firm cannot be good at more than five or six core competencies. According to Tampoe (1994), core competencies:

- Are essential for a company
- Engender core products of the company

- Facilitate strategic decisions of the firm
- Accomplish the mission and vision of the company

Notes

18.6 Characteristics of Core Competencies

In view of the foregoing, we can list the following characteristics of core competencies:

- Invisible to the competitors
- Difficult to imitate
- A mix of skills, resources and processes
- A capability that can sustain over time
- Is greater than the competence of individuals
- Is marketable and commercially viable
- Are few in number.

18.7 Tests for Core Competencies

Grant has suggested the following four tests for isolating core competencies:

- Appropriability
- Durability
- Transferability
- Replicability

These are described below.

Appropriability

It relates to the basic question of who owns and who is the beneficiary of the core competence. In legal terms, a firm owns its physical assets like buildings, machinery, etc. but not its human assets. Skills of a specialist like computer expert are owned by that individual and not by the company.

Durability

It varies widely among the core competencies. Brand names like Life Buoy, Sunlight, etc have been with us for decades. Physical and tangible assets have much shorter lives and are less durable; technological changes are shortening product life cycles and technology life cycles. Even patents have an average life of 20 years inclusive of the product development, testing, registration, etc. There is a trend towards reduction in the durability of human assets; they are also becoming obsolete faster. Those with marketable skills move away from permanent jobs and contract their services and skills in the open market!

Transferability

How long do these resources stay with a firm? Some competencies are with small firms that are closely held by large conglomerates who sell them overnight and consequently, core competence stands transferred to another corporation.

Replicability

Replicability relates to the ease of imitation by the competitors. Properly patented inventions cannot be easily replicated. There are some skills that can be easily acquired by hiring the services of a consultant. Once again, core competencies deeply embedded in rituals and routines of the organisation and developed historically within the company are difficult to imitate and thus form the kernel of core competencies.

Notes

18.8 Financial Ratio Analysis

The assessment of financial position of an organisation is an important part of the overall internal analysis in order to determine the strengths and weaknesses of the firm or any of its divisions/profit centres. This should be used in conjunction with the other methods as outlined already.

Financial analysis is a part of the larger study of measurement of the different aspects of a firm's performance.

18.9 Management Ratios

In order to understand the impact of any event occurring in the firm, we measure it by comparing it with another event or data that is related to it in some way. For example, if we maintain the distance traveled by individual cars run by the company and we relate it with another data pertaining to the fuel consumed, we obtain a ratio or an index, which is kilometer traveled per litre of the fuel consumed. This ratio measures the efficiency of the cars run.

18.10 Types of Financial Ratios

Financial ratio analysis measures the overall performance of a business. These measures indicate the extent to which a company is meeting some or all of its key objectives. Likewise, these analysis also reveal the constraints that the firm is experiencing now or is likely to face in the future.

As an integral part of financial analysis, we compile the following types of ratios:

- Profitability ratios
- Liquidity ratios
- Leverage ratios
- Activity ratios
- Investment ratios

These have been described below.

Profitability Ratios

A number of ratios are worked out to understand the profitability of the firm.

1 *Gross profit margin*

This is calculated as a ratio of $\frac{\text{Sales} - \text{Cost of goods sold}}{\text{Sales revenue}}$

This measures the total margin available to cover the operating expenses and the possible profits.

2. *Operating profit margin*

This is calculated as a ratio of $\frac{\text{Profit before taxes and interest}}{\text{Sales Revenue}}$

This is an indication of the firm's profitability from the current operations without taking into account the interest charges accruing from the capital borrowed.

Notes

3. ***Net profit margin or Net return on sales***

   This is computed as a ratio of $\dfrac{\text{Profit after taxes}}{\text{Sales revenue}}$

   This indicates the profit after tax per rupee of the sales; lower values indicate that either firm's prices are low or its costs are high.

4. ***Return on Total Assets***

   This is calculated in two ways: $\dfrac{\text{Profit after taxes}}{\text{Total assets}}$ or $\dfrac{\text{Profit after taxes + interest}}{\text{Total assets}}$

   This measures return on total investment in the firm. Sometimes the ratio is calculated by adding interest to profits after taxes because total assets are financed not only by the firm but also by the creditors.

5. ***Return on stockholders' equity or return on net worth***

   This is computed as a ratio of $\dfrac{\text{Profit after taxes}}{\text{Total shareholders' equity}}$

   This is a good measure of the rate of return on stockholders' investment in the enterprise.

6. ***Return on common equity***

   This is calculated as a ratio of $\dfrac{\text{Profit after taxes} - \text{Preferred stock dividends}}{\text{Total shareholders' equity} - \text{Par value of preferred stock}}$

   This is an indication of the rate of return on the investment that the owners of common stock have made in the enterprise.

7. ***Earnings per Share (EPS)***

   This is computed as a ratio of $\dfrac{\text{Profit after taxes} - \text{Preferred stock dividends}}{\text{Number of shares of common stock outstanding}}$

This shows the earnings available to the owners of common stock.

The above profitability ratios reflect how effectively the firm is being run now. Since the ratios mostly relate to profits and profitability, these measures are important indicators of the management's performance.

Liquidity Ratios

Following ratios are worked out for the firm.

1. ***Current ratio or working capital ratio***

   This is compiled as a ratio of $\dfrac{\text{Current assets}}{\text{Current liabilities}}$

   The ratio indicates the extent to which the claims of short-term creditors are covered by assets that are expected to be converted to cash in a period roughly corresponding to the maturity of the liabilities.

2. ***Quick ratio or Acid test ratio***

   This is computed as a ratio of $\dfrac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$

Notes

This measures the firm's ability to pay off short-term obligations without relying upon the sales of its inventories.

3. *Inventory to net working capital*

This is calculated as a ratio of $\dfrac{\text{Inventory}}{\text{Current assets} - \text{Current liabilities}}$

This is an indication of the extent to which the firm's working capital is tied up in inventory.

The liquidity ratios measure the short-term obligations of the firm i.e., the level of short-term liabilities and the firm's ability to pay them from short-term assets. For example, the convention is that the current ratio should be 2 – usually a value in the range of 1.5 to 2 is suggested as ideal targets. However, firms dealing with mostly cash than credit terms of payments may have a ratio nearer to 1. Although the optimum will vary from industry to industry, a thumb rule is that the current assets should be twice that of the current liabilities. The more volatile the business, the higher should be the ratio.

Leverage or Gearing Ratios

We use a number of ratios as below.

1. *Debt to asset ratio*

This is measured as a ratio of $\dfrac{\text{Total debts}}{\text{Total assets}}$

This is a good measure of the extent to which the borrowed funds have been used to finance firm's operations.

2. *Debt to equity ratio*

This is calculated as a ratio of $\dfrac{\text{Total debts}}{\text{Total stockholders' equity}}$

This is a good measure of the proportion of funds provided by the creditors and the funds provided by the owners.

3. *Long-term debt to equity ratio*

This is computed as a ratio of $\dfrac{\text{Long-term debts}}{\text{Total stockholders' equity}}$

This is a popular way of measuring the balance between long-term debt and equity of the firm which is also the long-term capital structure.

4. *Interest coverage ratio*

This is calculated as a ratio of $\dfrac{\text{Profit before interest and taxes}}{\text{Total interest charges}}$

This ratio measures the extent to which earnings of the firm can decline before the firm becomes unable to meet its annual interest costs. This is of vital interest to creditors and bankers.

5. *Fixed charge coverage ratio*

This is compiled as a ratio of $\dfrac{\text{Profit before taxes and interest} + \text{Lease obligations}}{\text{Total interest charges} + \text{Lease obligations}}$

This is a more inclusive measure of the firm's ability to meet all its fixed charge obligations.

Activity Ratios

The important ratios used are:

1. *Inventory turnover*

   This is computed as a ratio of $\frac{\text{Sales revenue}}{\text{Inventory of finished goods}}$

   This ratio when compared to the industry average gives an indication of whether a firm has excessive or inadequate inventory of finished goods.

2. *Fixed assets turnover*

   This is calculated as a ratio of $\frac{\text{Sales revenue}}{\text{Fixed assets}}$

   This is a measure of the utilisation of plant and equipment in terms of sales revenue. It is an index of the sales productivity also.

3. *Total assets turnover*

   This is compiled as a ratio of $\frac{\text{Sales revenue}}{\text{Total assets}}$

   It measures the utilisation of all the firm's assets. When the ratio is below the industry average, it implies that the firm is not generating enough volume of business.

4. *Accounts receivable turnover*

   This is calculated as a ratio of $\frac{\text{Annual credit sales}}{\text{Accounts receivable}}$

   This reflects the average length of time a firm takes to collect the sales made on credit.

5. *Average collection period*

   This is calculated as a ratio of $\frac{\text{Acounts receivable}}{\text{Average daily sales}}$

   Where, the year consists of 365 days.

This indicates the average length of time a firm must wait after making sales before it receives payment.

The above activity ratios indicate how efficiently the firm is using its resources because these ratios relate the turnover with the resources used to generate them.

Investment or Stock Market Ratios

These days it is being accepted that the maximisation of shareholders' value is the prime aim of strategy planning and management, so these ratios are becoming more and more important.

1. *Dividend yield on common stock*

   It is calculated as a ratio of $\frac{\text{Annual dividend per share}}{\text{Current market price of share}}$

   This measures the return to owners in the form of dividends.

2. *Price earnings ratio*

It is measured as the ratio of $\frac{\text{Current market price per share}}{\text{After tax earnings per share}}$

The firms that are growing faster or have less risk exposure tend to have higher price-earnings ratio than those firms that are growing slowly and are subject to higher risks.

3. *Dividend payment ratio*

It is computed as a ratio of $\frac{\text{Annual dividend per share}}{\text{After tax earnings per share}}$

This measures the percentage of profits paid out as dividends.

4. *Cash flow per share*

It is calculated as a ratio of $\frac{\text{After tax profits + Depreciation}}{\text{Number of common shares outstanding}}$

It is a measure of the discretionary funds over and above expenses available for use by the firm.

18.11 Overview of Financial Ratios

The financial ratios cover a comprehensive set of measurements reflecting various facets of an organisation's functions and have emerged as useful tools for strategic planning and management. However, managers should not use them in isolation; their usefulness will be greatly enhanced if these are used in conjunction with the other analytical tools. Following guidelines are suggested for using them:

- At least a period of five years should be considered so that a clear trend, if any, can be identified.
- The ratios should always be compared with the trend in the industry.
- A set of figures should not be taken too literally; usually this is confirmed by other ratios.
- These ratios also need to be considered in combination with other metrics so that right conclusions can be drawn.
- Evaluation of the ratios is more important than the individual figures by themselves.

18.12 Assessing Organisational Culture

Organisations have characteristics in common with each other. However, each also has its unique sets of characteristics and properties. This psychological structure of the organisation is called its Organisational Culture. This can even be experienced by a layman and they use words like climate, atmosphere or milieu interchangeably with culture. Organisational culture is a set of features that:

- Distinguish one from another
- Are relatively enduring over time
- Influence the behaviour of people in the organisation

Organisational culture is like the personality of an individual which has many traits common with other individuals but has some which are unique and its distinguishing traits. As a result, each of us become a unique personality with a unique attitude and behaviour. Thus, culture is distinguishing but has the influence of integrating individuals, groups and organisations.

Notes

Cultural Context of Strategy

Culture has an impact on the beliefs, assumptions and values of individuals and groups within the organisation. A value is a concept, explicit or implicit, which an individual or group regards as desirable and in terms of which, they select from among the alternatives available, the modes, means and ends of an action.

Values are an integral part of a person's thoughts, speech and actions. They are acquired by experience and exposure, cumulative knowledge and intellectual skills. They influence our expectations, attitude and behavior. Thus, they influence the process of choosing the strategy from among various alternatives.

Organisational Culture

Organisations can be described in tangible terms such as organisation structure and in intangible terms such as organisational culture. Description of the culture of an enterprise gives an idea of how it feels like working there. It is the system of shared meaning held by members of the firm that distinguishes it from other firms viz., the shared attitudes, behaviour, beliefs and values. A few suggested characteristics of organisational culture are:

1. *Individual autonomy:* It is the degree of responsibility, freedom and independence the individuals have.
2. *Tolerance of risk:* It is the degree to which employees are encouraged to be creative, innovative and risk taking.
3. *Direction:* It is the degree to which the firms emphasise clarity of objectives and performance objectives.
4. *Integration:* It is the extent to which units within the organisation are encouraged to work in a coordinated manner.
5. *Management contact:* It is the level of communication, assistance and support provided to the subordinates.
6. *Control:* It is the number of rules and regulations and the amount of direct supervision that are used to oversee employee behaviour.
7. *Identity:* It is the extent to which members identify with the organisation as a whole in contrast to their work group or professional circle.
8. *Reward system:* It is the degree to which the firm's reward system viz., salaries, increments and promotion are based on employees' performance.
9. *Tolerance of conflict:* It is the extent to which employees are encouraged to air disagreement, criticisms and conflicts openly.
10. *Pattern of communication:* It is the extent to which the organisation communications are restricted to formal chain of command.

18.13 External Factors Influencing

Culture Two important influences are:

- Values of the society
- Values of the organised group

Values of Society

Although society gives one the impression that it tends to be conservative, changes are continuously taking place in its attitude to work, authority and even concepts like equality, etc. Besides, a firm's activities are also influenced by the constraining legislation, public opinion and the media. These may be further divided into two categories:

Notes

1. *External relationships:* Herein we focus on our attitude and behaviour towards happenings that are thrown on us by factors on which we have little control. For example,
   (a) *Coping with uncertainty:* It is important to understand whether for coping with uncertainly, firm's culture enjoins us to:
      (i) Avoid or tolerate
      (ii) Reduce or accept
      (iii) Manage or adopt
   (b) *Influencing environments:* Whether our culture tells us to:
      (i) Behave proactively or reactively
      (ii) Prefer action or fatalism
   (c) *Assessing truth or reality:* Whether the culture directs us to:
      (i) Analyse facts or logic theoretically
      (ii) Assess the truth inductively or deductively
   (d) *Attitude to change:* Whether the firm's approach would be to:
      (i) Relate to past or future
      (ii) Prefer continuous to step changes
2. *Internal relationships:* These situations might be stated as:
   (a) *Status orientation:* if the firm is status conscious, it will be more inclined to use hierarchy than networking.
   (b) *Individual orientation:* decides whether the firm respects individuals or groups.
   (c) *Social concern:* decides whether the firm is task or social oriented.

Values of Organised Groups

Organised groups and their values have a profound influence upon individual's attitude and behaviour. These groups may be directly related to your work, like trade unions who may be highly institutionalised or those not related to work like the religious groups or political affiliations.

In strategy, we recognise the influence of organisational paradigm and industry recipe who exert dominant influences. There are also a large number of professional and social service bodies who have their own codes of conduct. Many of these cover aspects of quality of service, employment practices or resolution of disputes, etc. All these have a varying degree of influence on the beliefs, assumptions and values of individuals.

18.14 Internal Factors Influencing Culture

There are three layers of internal factors as below.

1. *Values:* These are relatively easy to identify although when committed in writing they tend to get further defined. These values are written as such and they also influence our written statements for the mission, strategies and objectives.
2. *Beliefs:* These are more specific ones viz., the issues people often talk about. At the international level, a belief is emerging that we should not buy goods which are produced by employing children.
3. *Assumptions:* These form the real core of the organisational culture. These are those aspects of values that are taken for granted and people find difficult to identify. These are so deeply embedded into the organisation that until these are brought out and

Notes

challenged, very little will change in the company. These override logical analysis and analytical evaluation about the strategies.

18.15 Types of Organisational Culture

Miles and Snow have studied the impact of culture on the oganisations and suggested following four broad categories:

1. *Defenders:* Firms that are influenced by this type of culture long for a stable and secure place in the market, a niche. They would go in for strategies which call for specialisation like cost leadership which favours efficient working. Consequently, they go in for vertical integration for integrating processes–backwards or forwards. They prefer to focus on price and service to the customer and are at ease with formal planning.
2. *Prospectors:* As the name implies, these firms look for and exploit new products and new markets, prospecting all the time. Such firms are good in monitoring their environments and seize the opportunity for product development and market development with diversified technologies. This is possible only if the firm has a flexible approach, is decentralised and managers are free to take on the spot decisions.
3. *Analysers:* Such management teams try to bring out a match between a new venture and the existing ones by going slow in growth. Their strategies favour market penetration and they are essentially followers in the market. They have a rather complicated process of coordination and believe in intensive planning.
4. *Reactors:* This category of management teams perceive environmental changes but rarely make adjustments either in their style or in their focus until they are forced to.

18.16 Mapping Stakeholders' Expectations

Stakeholder is a person who has a 'stake' in the firm. Dictionary meaning of the word 'stake' is a share or interest, specially financial, in property, a person or a business venture and the like. Stake is the money risked or hazarded in a wager of a game of gambling. In organisations, they represent the various interest groups who have some financial or other gains at risk in the running of the enterprise.

These interest groups influence not only the final selection of the strategy but also its very formulation. It is, therefore, crucial for managers to analyse their relative importance and expectations.

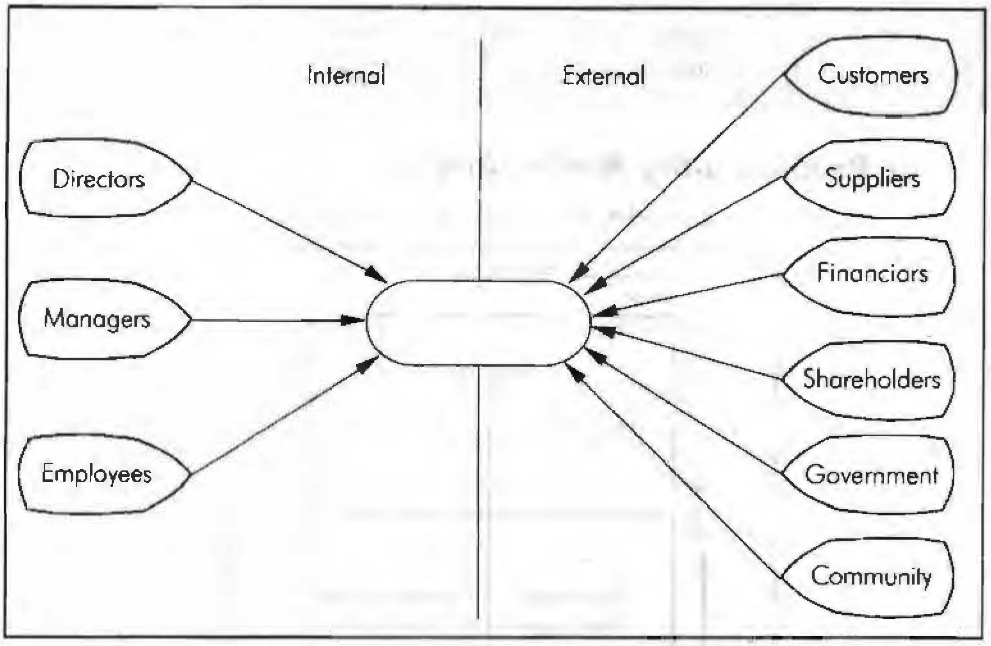
18.17 Stakeholders in a Corporation

Stakeholders can be internal or external to the organisation:

Internal Stakeholders	External Stakeholders
Directors	Customers
Managers	Suppliers
Employees	Financiers
	Shareholders
	Government
	Community

Other pressure entities like environmental and consumer protection groups are also making their presence felt and no enterprise can ignore them. These are shown in the diagram below.

Notes



18.18 Identifying Stakeholders

Expectations of stakeholders can be varied and may even be in conflict with each other. For example, in the event of the firm making high profits, shareholders may want high dividends, employees may want higher wages and salaries, managers may want the surplus to be invested in debottlenecking their operations or creating large capacities for meeting the future demand and higher compensation or reward for increased responsibilities.

Matrix analysis of all the relevant factors for a given issue, by using a simple evaluation scale as below, can help in identifying the stakeholders.

Stakeholder supporting = +

Stakeholder opposing = -

Stakeholder neutral = 0

Stakeholder divided = ?

		Internal Stakeholders					External Stakeholders					
Sl.	Issues											
1.		–	–	–	–	0	–	+	0	–	+	0
2.		?	–	+	–	–	+	–	–	0	–	+
3.												
4.												
5.												
6.												

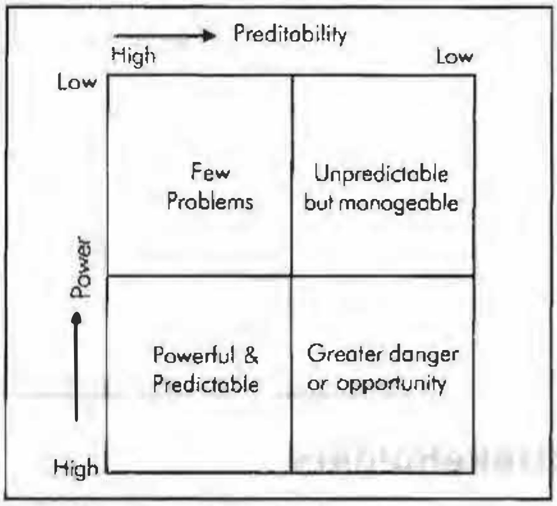
Notes

18.19 Mapping Stakeholders

It is essential not only to identify the stakeholders but also to understand their possible responses and their intensity so as to find ways and means of overcoming them. Managers should aim to secure supporters and collaborators for the strategy and avoid road-blocks, if any. Following two techniques involving 2 x 2 matrix analysis are very useful in mapping the stakeholders' predictability and their interest in the issue(s) at stake.

Power Predictability Matrix Analysis

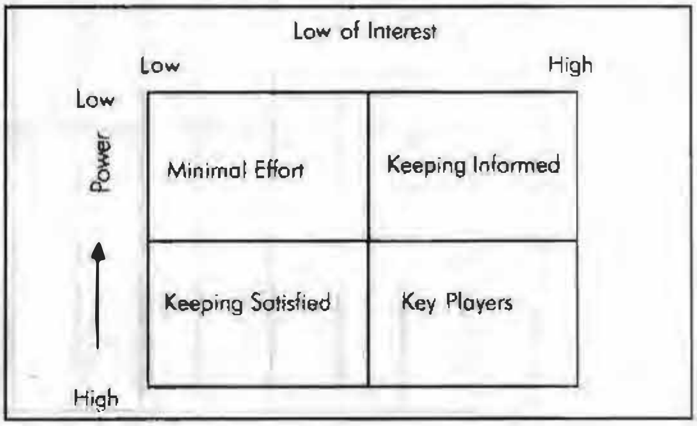
The matrix is as shown. It divides the stakeholders into four groups as below:



1. *Low power and high predictability:* This group does not present any problem but is important because their support for the strategic decision is critical.
2. *Low power and unpredictable:* Although this group is unpredictable, they are easy to manage because they wield little power in the situation.
3. *Predictable and powerful:* This group is powerful but their responses are predictable. They play a significant role in strategy formulation because their possible views will have to be incorporated to make it acceptable to them.
4. *Unpredictable and powerful:* This group presents the greatest danger to the managers formulating strategy since they wield a great deal of power. If strategy can be designed such that they can be roped in and converted into supporters and collaborators of the strategy, it would also present the most attractive opportunity. Opportunity comes with its challenges!

Power Interest Matrix Analysis

This is as shown below. Based on the interest in the issue at stake, we divide them into four groups:



1. *Low power and low interest:* This requires minimal efforts to bring them around to support the strategy.
2. *Low power and high interest:* This group expects to be kept informed and not being taken for granted. Managers aware of the role of communication in organisations can manage this group easily.
3. *High power and low interest:* These are the most difficult because they show little interest in strategy formulation but wield considerable power. Their possible reactions may have to be taken into account while formulating strategy.
4. *High power and high interest:* They are the key players and they also show a keen interest in the strategy. The strategy formulated has to be to be acceptable to this group.

Mapping stakeholders have the following advantages:

- It is a way of assessing the cultural fitness of the new strategy
- It identifies the key opponents and facilitators of the new strategy
- It highlights the need of repositioning the stakeholders so as win their support
- It may lead to proposals to buy over some stakeholders to secure their acceptance of the new strategy.

18.20 Sources of Power of Internal Stakeholders

We are all aware that there are two sources of power of internal stakeholders – positional power and personal power. Each of these is further divided into two types as below.

Positional Power	Personal Power
Reward power	Referent power
Coercive power	Expert power

Positional or hierarchical or legitimate power is used by senior managers to exert influence on strategy but it has a very limited impact if used singly. In fact, most of the disputes in industry originate from the over exercise of the positional power.

Personal power arises from an individual having personal qualities of leadership and a working environment which favours consensus among groups within the organisation. It is believed that one of the most important role of managers is to change and move to an organisational culture which supports the strategy. In this respect, personal power rather than the positional power plays an important role.

Various sources of power of internal stakeholders are:

1. *Control over strategic resources:* The power of resources can change over time but if the strategies support the thrust for market development, managers who control these resources become more important. Likewise, if the strategies favour product development, research and technology resources become more dominant.
2. *Control over specialist knowledge and skill:* If an individual has acquired specific knowledge which is required desperately to support the strategy, he becomes indispensable. Also, if there is a prized area of knowledge or skill in the firm, individuals tend to migrate to it so that they come to acquire skills and knowledge that is valued by the company.
3. *Control over firm's environments:* Individuals who have a good knowledge about the firm's environments are able to exercise greater influence on the strategy and performance of the enterprise. Their power emanates from the fact that they are able to reduce variability in business by predicting and providing for uncertainties. For

Notes

example, by and large, marketing and finance personnel have been able to play bigger roles in strategy formulation when the environments have been turbulent and hence unpredictable.

4. *Autonomy in decision making:* Decision making requires autonomy and exercise of discretion. If individuals are allowed to exercise discretion in their areas of responsibility, they have greater power in the formulation and execution of strategy.

In a conventional way, power of internal stakeholders can be ascertained from the following:

- Title or the designation of individual
- Control over number and volume of resources
- Memberships of powerful bodies
- Size of office
- Size of company car allocated
- Use of personal secretary
- Exclusive computer terminal or networked personal computer, etc.

18.21 Sources of Power of External Stakeholders

External stakeholders also influence many strategic decisions. Their sources of power may emanate from the following:

1. *Dependence for resource acquisition:* If a firm is heavily dependent upon the stakeholder for buying and selling some critical items or services, the concerned agency assumes more power. For example, commercial banks have considerable clout with the firms who borrow money from them.
2. *Dependence for implementation:* Suppliers, wholesalers or retailers become more powerful if they are closely associated with the implementation of strategy. For the same reason, it is true for the internal stakeholders where the power is slowly shifting to logistics and supply chain management.
3. *Dependence for a critical or scarce skill or knowledge:* Sometimes a particular contractor or vendor may exercise major influence because he is supplying the goods and services which are scarce and in limited supply in the market.
4. *Cultivation of internal links:* Some external stakeholders come to exercise higher influence in an enterprise because they have cultivated the right networking with power functionaries within the firm.

The power of external stakeholders can be assessed by the following common indicators:

- Reference to the stakeholder by employees with veneration or respect
- Difficult to switch because of heavy dependence of critical resource or close integration of operations
- Style of negotiation – if a firm is invited to negotiate, it wields more power than the one given a fixed price to accept on 'take it' or 'leave it' basis
- Power symbols like playing golf with bosses or socializing frequently with bosses.

Student Activity

Who are the internal and external stakeholders of an organisation?

18.22 Summary

The concept of core competence is rather important in strategic management because firms seek to secure positioning that can be sustained over a period of time. Profits ensue from the resources and their capability. The combination of resources and how they are linked together would form the kernel of core competencies. Analysis of financial ratios has been found to be very useful in evaluating the performance of the firm from different angles.

Notes

Although organisational culture is considered to be an intangible aspect of an enterprise, researches have confirmed that nurturing of the right culture leads to imbibing of positive values among the members of the firm.

18.23 Keywords

Individual Autonomy: It is the degree of responsibility, freedom and independence the individuals have.

Management Contact: It is the level of communication, assistance and support provided to the subordinates.

Tolerance of Conflict: It is the extent to which employees are encouraged to air disagreement, criticisms and conflicts openly.

18.24 Review Questions

1. How do we identify core competencies? What tests would you suggest and why?
2. What are management ratios? How are they useful for effective management?
3. What is financial ratio analysis? How can it be used for strategic planning and management?
4. What are activity ratios? What inferences can be drawn if we compare these ratios with those of the competitors?
5. Describe leverage ratios. What role do they play in strategy formulation?
6. What are liquidity ratios? Describe their role, if any, in strategic planning.
7. What are the important characteristics of an organsational culture?
8. On the basis of cultural features, describe the various classifications of the firms.

18.25 References and Further Readings

- Johnson, G., Scholes, K., & Whittington, R. (2019). Exploring strategy: Text and cases (12th ed.). Pearson.
- Barney, J. B., & Hesterly, W. S. (2019). Strategic management and competitive advantage: Concepts and cases (6th ed.). Pearson.
- Rothaermel, F. T. (2021). Strategic management (5th ed.). McGraw-Hill Education.
- David, F. R., & David, F. R. (2018). Strategic management: A competitive advantage approach, concepts, and cases (16th ed.). Pearson.

Notes

Unit 19 SWOT Analysis

Unit Structure

19.0 Learning Objectives

At the conclusion of this unit, you should be able to:

- Define SWOT Analysis
- Describe the matrix method of SWOT Analysis
- Explain the role and importance of SWOT Analysis

19.1 Introduction

The major motivation for carrying out analysis of external factors and internal factors is to determine the possible threats and opportunities in the environments and to pinpoint weaknesses and strengths of the firm in comparison with its competitors. Although SWOT analysis is the beginning of the process of strategy formulation, it is the culmination of the external factor and internal factor analysis. Argenti in his book, *Corporate collapse: Causes and Symptoms* wrote in 1976 that, 'before any strategic decision is taken, a detailed SWOT analysis must be undertaken'.

19.2 Identifying Threats, Opportunities, Strengths and Weaknesses

With the help of PEST or PESTLE or total environmental analysis including scenario building exercises, five forces analysis for industry and specific analysis of competitors, we determine the threats to the firm's operations today and in the future as also the possible opportunities. These are listed separately.

Similarly, we identify firm's weaknesses and strengths by undertaking various analysis such as internal resource analysis, value chain analysis including the total value chain, product portfolio and competence portfolio analysis, financial, cultural and stakeholders' analysis.

Thus, the sequence suggested herein may be described as 'TOWS' analysis to emphasise the sequence that should be followed.

19.3 Matrix Method of SWOT Analysis

This is a structured analysis of the firm's current strengths and weaknesses and assess them in relation to the perception of threats and opportunities and determines whether the enterprise is capable of withstanding the challenges ahead.

SWOT analysis should be undertaken by drawing up the matrix table in the following three steps:

Notes

Determining Threats and Opportunities

These should be identified as

Threats	Opportunities
Government giving tax incentives for new investments	Major competitor has entered a new market
Demand is growing in other markets	

Identifying Weaknesses and Strengths

This is done through various analysis but should always be supported by debates and discussions among the team members. The strategy may not be in the formal document in writing; it may be the strategy that is being achieved or realised at present.

Weaknesses	Strengths
Limited product range	Rs 50 crore own funds available
No new product in the pipeline	Production expertise good
Market expected to decline	Marketing skills good although small
Small number of customers	
Small marketing set up	

Carrying out SWOT Analysis in a Matrix Table Form

After extensive experience in drawing up SWOT analysis, it is suggested that we follow this method meticulously by adopting the following method for evaluation.

Strengths and Weaknesses are written in rows and the threats and opportunities are written in the columns. Each strength and weakness is examined with respect to each threat or opportunity and is evaluated as follows:

+ = If it is a positive advantage

- = If it is a negative factor

A typical matrix table is as below.

	Environmental Issues	Threats				Opportunities				Summary +	Summary –
	Main Strengths										
1.		+	+	–	–	–	+	–	–	3	5
2.											
3.											
	Main Weaknesses										
4.		–	–	+	–	+	+	+	+	5	3
5.											
6.											
Summary	+										
	–										

Notes

These evaluations of '+' or '-' are added row wise and column wise. Thus we get a positive or negative score for each column and row, depending upon the number of rows and columns considered.

Having completed this evaluation, it becomes much easier to finalise the real strengths and weaknesses and real threats and opportunities.

This process of evaluation also confirms the view that a particular attribute would be overall plus or minus only in the specific context of the organisational capabilities of the firm.

19.4 Cruciform Method of SWOT Analysis

This is a traditional form of SWOT analysis where the final list of strengths, weaknesses, opportunities and threats are worked out and tabulated as shown below.

STRENGTHS ₹ 50 crore available. Production expertise good. Marketing skills good though small.	WEAKNESSES Limited product range. No new product in the pipeline. Market expected to decline. Small no of customers. Marketing set up is small.
OPPORTUNITIES Major competitor has entered a new market.	THREATS Government giving incentive. for new investment. Demand is growing in other markets.

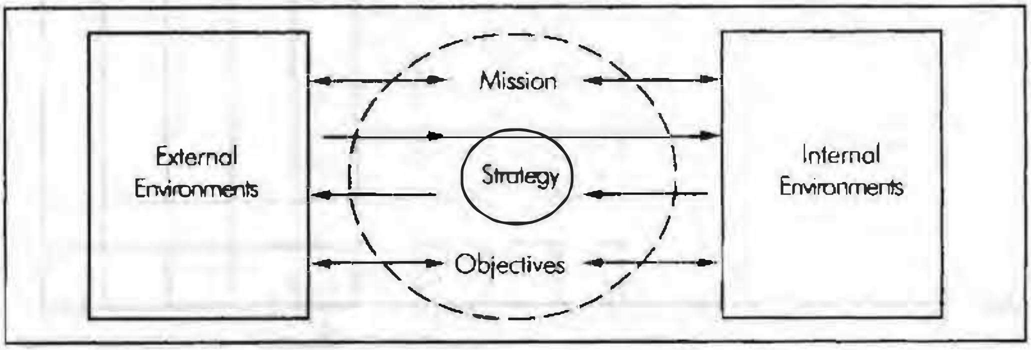
This method jumps the detailed method of evaluating each parameter in the context of the strategy. The factors picked up may be random based on gut feelings rather than resulting from a detailed analysis and evaluation.

19.5 Role and Importance of SWOT Analysis

Strategy can not be formulated in vacuum; it has to be developed in the context of various issues facing the firm. Strategy that a firm chooses must take into account:

- Happenings around the firm (external environments)
- Firm's own capabilities (organisational competencies)
- Missions and objectives of the organisation

This mechanism is shown in the Figure below.



Notes

Since SWOT analysis is an in-depth evaluation of external factors of threats and opportunities and internal factors relating to own strengths and weaknesses, it has a direct link with the strategy. Thus, SWOT is important for strategy formulation for the following reasons:

1. ***Intimate relationship with strategy:*** The direct and close link with strategy has made, SWOT, a powerful and effective process tool. Besides, SWOT is a simple concept because it helps to identify:
   (a) What the firm is good at doing?
   (b) What the firm is weak at doing?
2. *Perceptions of managers:* What makes SWOT a little complicated is the managers having different perceptions of the strengths and weaknesses of the firm. The same is also true when it comes to their perceptions of threats and opportunities.
3. *Process of creativity:* SWOT helps teams to bring out different viewpoints about issues facing the firm. Managers' assumptions are questioned before they are accepted. It leads to healthy debate and discussions, sine qua non of good teamwork.
4. *Curbing internal politics of the firm:* Healthy debates on SWOT cut through the internal politics of the firm, improve relationships and make for better communication, coordination and control.
5. *Threat to status quo:* Because SWOT questions managers' assumptions, it sets out the process of unfreezing and disturbing forces in equilibrium. This process is not threatening to those who are openly and willingly prepared to argue their case.
6. *SWOT is not static:* Evaluation of strengths, weaknesses, opportunities and threats is done in a specific context and timing. The situation and consequently, the SWOT analysis can change over time and should be repeated periodically, say every six months.

19.6 SWOT and Operational Managers

Changes in the environment of the firm may have major implications on how to carry out the operations and even whether these should be done or discontinued. For example:

- Marketing and sales personnel are often the first to notice whiffs of changes in consumer tastes or rumours of a potential new product from a competitor.
- Manufacturing and operations personnel may be the first to hear of new product or production technology or see the potential of a new invention in its early stages of development.
- People in human resources management may be the first ones to hear of the early warning of new policies of competitor from the human resource market or changes in legislation in the offing.

It is true that early warnings of possible changes are often based on rumours, opinions and hearsay; they may not fit into any format of internal reporting system. If operational mangers wait for solid evidence before reporting, it is likely that, owing to lengthy process of its reaching the top, the information may arrive too late. Thus, the firms that investigate the initial rumour gain a head start. Therefore, strategy planners must listen to soft evidences and establish a mechanism of communicating with operational managers so that early signs are transmitted upwards without the risk of being ridiculed, derided or criticised.

19.7 Critiques of SWOT Analysis

SWOT analysis depends on the business the firm is in and the circumstances that may change over time. Just as strengths and weaknesses are context related, opportunities and threats are also context bound.

Notes

SWOT is influenced by missions and objectives of the company. Managers' differing perceptions of priorities or even of the objectives of the firm may reflect in SWOT's relevance to the situation.

Richard Pascale (1991) writes in his book, Managing on the edge that, "nothing fails like success. Winning organisations .... are locked in the embrace of a potentially deadly paradox. The golden adage of 'sticking to your knitting' becomes an epitaph". He goes on to suggest that one recipe to avoid the trap is persistent questioning or inquiry. According to him, "inquiry is the engine of vitality and renewal".

Student Activity

Make SWOT analysis of ICICI Bank.

19.8 Summary

SWOT analysis engenders the spirit of inquiry and analysis of firm's external environments to uncover distant threats and early opportunities. It also enjoins managers to identify strengths and weaknesses in the context of firm's business objectives. SWOT is a process which sharpens skills and perceptions of managers, mitigates internal politics and strengthens forces of change.

19.9 Keywords

SWOT Analysis: SWOT is a process which sharpens skills and perceptions of managers, mitigates internal politics and strengthens forces of change.

PEST Analysis: It means analyzing the political, economic, social and technological environment of the business.

19.10 Review Questions

1. How do we determine the strengths, weaknesses, opportunities and threats of a firm?
2. Describe the matrix method of SWOT analysis.
3. Describe the cruciform method of SWOT analysis.
4. What is the role and importance of SWOT analysis?
5. Highlight the role of operational managers in SWOT analysis and strategy formulation.
6. What is the critiques view of SWOT analysis?

19.11 References and Further Readings

- Thompson, A. A., Peteraf, M. A., Gamble, J. E., & Strickland, A. J. (2020). Crafting and executing strategy: The quest for competitive advantage: Concepts and cases (22nd ed.). McGraw-Hill Education.
- Dess, G. G., Lumpkin, G. T., Eisner, A. B., & McNamara, G. (2022). Strategic management: Text and cases (9th ed.). McGraw-Hill Education.
- Wheelen, T. L., Hunger, J. D., Hoffman, A. N., & Bamford, C. E. (2018). Strategic management and business policy: Globalization, innovation, and sustainability (15th ed.). Pearson.