BA IN MANAGEMENT

COURSE MATERIAL FOR

STRATEGIC MANAGEMENT

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CHAPTER ONE: INTRODUCTION
NATURE OF STRATEGIC MANAGEMENT

Learning Objectives:

- *Explain the concept of strategic management*
- *Describe how strategic decisions differ from other decisions that managers make*
- *Name the benefits and risks of a participative approach to strategic decision making*
- *Understand the types of strategic decisions for which different managers are responsible*
- *Describe a comprehensive model of strategic decision making*
- *Appreciate the importance of strategic management as a process*
- *Give examples of strategic decisions that companies have recently made*

1.1 Introduction

The term 'strategy' is drawn from the armed forces. It is a strategic plan that interlocks all aspects of the corporate mission designed to overpower the enemy or the competitor. An appropriate strategy is considered to be essential to face adverse situations such as cut-throat competition.

Strategy may imply general or specific programmes of action outlining how the resources are deployed to attain goals in a given set of conditions. If these conditions change, the strategy also changes. Strategies give direction for the achievement of objectives necessary through the deployment of resources.

In this unit, we would attempt to understand the meaning and purpose of strategy, its formulation, implementation and evaluation.

1.2 Meaning of Strategy

Strategy was originally a term applied to warfare; it was defined as 'the art of planning and directing larger military movements and the operations of war.' The term 'strategy' is derived from the Greek word *strategos,* which means generalship – the actual direction of military force, as directed from the policy governing its deployment. The term was first used around 360 BC, when the Chinese military strategist Sun Tzu wrote The Art of War, a work which is said to have influenced the thinking of many modern Japanese businesses, and has led to a number of thoughts about how the 'art' can be applied to modern business.

What the concept actually means? Fundamentally, it is about the *purpose* of the business, why it exists and what it exists to do. From this '*mission'* the strategy will define the activities or *projects* that the business will adopt in order to achieve it. The projects that deliver the strategy demand the use of *resources.* Resources have a cost and so represent an *investment* in the business. Critically, a strategy will define how these resources will be used to *compete* against the other businesses that are trying to attract customers' valuable money. A strategy gives the firm a *competitive advantage*. A competitive advantage is the basis for a relationship with customers, which is beneficial to both customers and supplying company. A good strategy will make this relationship resistant to competitive attack. It will make it *sustainable*. Despite its importance, or perhaps because of it, there is no one, single universally agreed definition of strategy. Every authority gives his/her own version.

One of the earliest contributors, Alfred D Chandler, defined strategy as: 'the determination of the basic long-term goals and objectives of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out these goals'.

William F. Glueck (in Business Policy and Strategic Management) defines strategy as: 'a unified, comprehensive, integrated plan… designed to ensure that the basic objectives of the enterprise are achieved'.

Hill and Jones (in Strategic Management Theory) define strategy as: 'a specific pattern of decisions and actions that managers take to achieve superior organizational performance'.
Thompson and Strickland (in Strategic Management) defines strategy as: 'the pattern of actions and business approaches managers employ to please customers, build an attractive market position, and achieve organizational objectives; a company's actual strategy is partly planned and partly reactive to changing circumstances'.

As defined by Christensen and others, Business Policy or strategic management is "the study of the functions and responsibilities of senior management, the crucial problems that affect success in the total enterprises, and the decisions that determine the direction of the organization and shape its future."

This definition covers many aspects of business policy. Firstly, it is considered as the study of the functions and responsibilities of the senior management related to those organizational problems, which affect the success of the total enterprise. Secondly, it deals with the determination of the future course of action that an organization has to adopt. Thirdly, it involves choosing the purpose and defining what needs to be done in order to shape the character and identity of an organization. Lastly, it is also concerned with the mobilization of resources, which will help the organization to achieve its goals.

Looking at these definitions we can say that strategy is about:

- ✓ A game plan or course of action or pattern of actions or competitive moves or business approaches that manager's employ in running a company
- ✓ A strategy is the means used to achieve the ends (objectives)
- ✓ Strategy is both proactive (intended) and reactive (adaptive)
- ✓ Strategies are partly visible and partly hidden to outside view

1.3 Strategy as an Emergent Process

Traditional view on strategy emphasized that strategy is the outcome of a formal planning process and that top management plays the most important role. In recent years several scholars have advocated an alternative view of strategy that has called into question the traditional planning-centric view. These scholars have two main criticisms; one focuses upon the unpredictability of the real world, while the other looks at the role lower-level managers can play in the strategy making.

Intended strategy is the strategy that managers talk about and say they want to see come into effect (this is the strategy included in formal strategic plans). Some elements of this (but by all means not all) will become part of the strategy managers attempt to put into effect. This is the deliberate strategy. Those parts of the intended strategy that are not made deliberate are the unrealized elements of the strategy. The deliberate strategy will become manifest in the final strategy, the realized strategy, that the organization adopts. However, the realized strategy will also contain another element, the **Emergent strategy**. In Minitzberg's view, emergent strategies are the unplanned responses to unforeseen circumstances, and they often arise from autonomous action by individual employees deep within the organization. They are not the product of formal

top-down planning mechanisms. Minitzberg maintains that they are often successful and may be more appropriate than intended strategies.

Henry Minitzberg has incorporated the above ideas into a model of strategy development that provides us with a more encompassing view of what strategy actually is. The model has five elements as depicted in figure below:

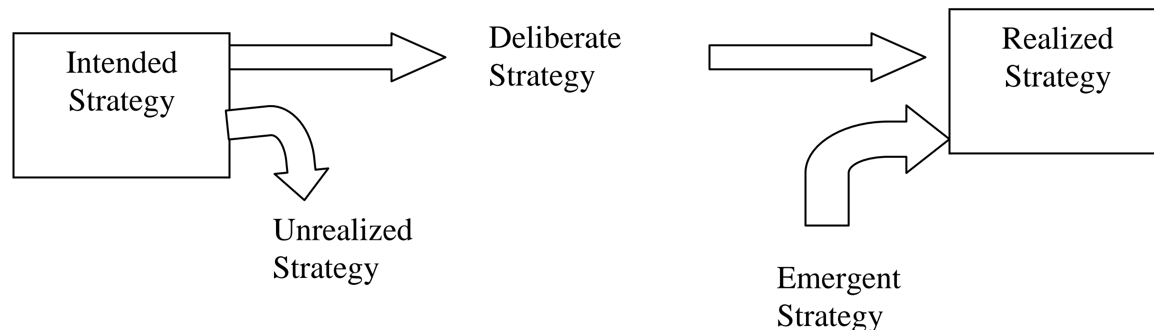


Figure 1-1 Minitzberg's model of strategy development

1.4 Meaning of Strategic Management

Strategic management has been defined and interpreted differently by various authors.
William F. Glueck (in Business Policy and Strategic Management) defined Strategic management as a stream of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives. According to this definition the end result of strategic management is a strategy or a set of strategies for the organization.

According to Arthur D. Sharplin (1985) defined Strategic management as the formulation and implementation of plans and the carrying out of activities relating to the matters which are of vital, pervasive, or continuing importance to the total organization.

H. Igor Ansoff (in Strategic Management, 2007) defined Strategic management as a systematic approach to a major and increasingly important responsibility of general management to position and relate the firm to its environment in a way which will assure its continued success and make it secure from surprises.

We observe that different authors have defined strategic management differently. Strategic management is considered as either decision-making or planning, or the set of activities related to the formulation and implementation of strategies to achieve organizational objectives. The emphasis in strategic management is on those general management responsibilities which are essential to relate the organization to the environment in which a way that its objectives may be achieved.

1.4.1 Characteristics of Strategic Management

The term strategic management has tended to become associated particularly with the delegated systems described earlier. Different writers will inevitably describe the elements of strategic management in slightly different ways. However, they normally tend to cover: Analyzing the environment, Making choices about direction, Implementation.

A. Long Term Focus

A focus on the longer–term does not mean that no attention is paid to the present. On the contrary, there is emphasis on regular monitoring, but that monitoring should be designed to inform longer–term prospects and the results should be used to take action focused on improving the prospects of meeting longer–term objectives. Action plans, projects and budgets should flow from the strategy, they should not determine the strategy.

B. Top management involvement

Top management need to take the formulation of longer–term strategy seriously and should themselves play a major role in that process. They need to ensure that the organization has an overall sense of direction, that they have consciously reviewed and determined objectives for the longer term, and that there are coherent strategies to meet those objectives.

C. Shared vision

A shared vision implies:

- That conclusions are communicated to all those within the organization who take decisions, probably everyone.
- Involvement in the planning process, both through consultation and through a proper mixture of top–down and bottom–up
- A strategy which is truly corporate, with meaning for everyone in the organization.

Implementation of strategy depends upon actions taken by people throughout the organization, so a wide understanding of critical factors is essential.

D. Creates the future

If the concern is with the longer term, strategies should not look simply like extrapolation of the past. Serious though needs to be given to 'creating the future. The strategy should therefore address thoroughly the scope of future activities and market choices. It should be sensitive to the underlying requirements of customers and to the wide constituency of stakeholders rather than loyal to what has always been done. There should be a strong element of the proactive.

E. Monitoring the strategic

Monitoring must be continuous, but it must also focus on the strategic. The relationship between the items monitored in–year and the longer–term objective must be clear. Monitoring therefore needs to embrace items such as customer perceptions, underlying quality, efficiency and capability as well as immediate financial performance.

F. Continuous decision–making

With strategic management the idea of continuous decision–making is emphasized, in contrast to the potentially stop–start decision–making process of an annual planning cycle. However, it is important to guard against continuous decision–making which degenerates into erratic decision–making.

G. Clear links from strategy to operations

The underlying thought here is very close to that explained earlier in relation to monitoring. Action plans, projects and budgets should flow from the strategy; they should not effectively determine the strategy. The need for action plans, projects and budgets has to be stressed; long–term objectives and vision are not sufficient in themselves. People throughout the organization need to know what is expected of them.

H. Structures and processes support strategy

If an organization is set up on functional lines, is it capable of an effective customer orientation? Do management and communication processes ensure that strategic issues are rapidly shared and resolve, or do such issues tend to submerge and reappear? Is the strategy consistent with the culture of the organization, the accepted norms of behaviour? Do personal reward, promotion and recruitment systems support and reinforce the qualities required in the longer term to deliver the strategy successfully?

1.5 Levels at Which Strategy Operates (Overview)

Businesses, especially conglomerates, are arranged in a hierarchical way. The business as a whole may be made up of a collection of smaller businesses. These may be grouped into divisions. These divisions may also be known as profit centers or strategic business units (SBUs). Each one of the SBUs has its own functional departments.

This ordering of business activity suggests a hierarchical ordering of strategy as illustrated in figure 1.2 below:

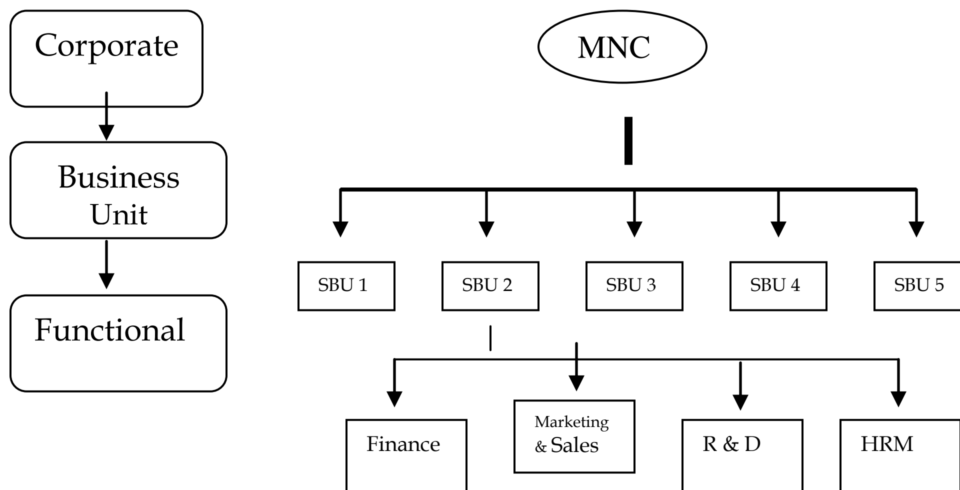


Figure 1.2: Levels at which strategy operates

1.5.1 Corporate Strategy

Corporate Strategy is regarded as encompassing the aims and objectives of the organization together with the means of how these are to be achieved. It is, by definition, holistic, i.e., it embraces all of the company's different businesses and functions. Andrews defined corporate strategy as: 'the pattern of major objectives, purposes or goals and essential policies or plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be'. Chandler believed that it should also be concerned with 'the allocation of resources necessary for carrying out these goals'.

In defining its corporate strategy, the firm has to satisfy the sometimes-contradictory expectations of several differing constituencies including, obviously, customers as well as suppliers, shareholders, and employees.

It is widely believed that corporate strategy should address the essentials of the organization, namely, the “what”, “why”, “how”, and “when”, of the organization. It is concerned with “what businesses is the company in or would like to be in?” Secondly, it embraces “why the company is in business?” i.e., the specific sales, profit, and rate of return and growth targets it has or should have. Thirdly, the company needs to define “how” it aims to achieve those targets, such as the technologies it will use, the markets it is or should be operating in, and the products it markets or should market in order to achieve those objectives. Finally, the company needs to decide “when” it aims to achieve those goals and the period over which it defines its strategy.

1.5.2 Business strategy or competitive strategy

Business strategy or competitive strategy is empowered to make key decisions about current and future strategy within the framework of the overall corporate strategy. It seeks to determine how an organization should compete in each of its businesses. For a small organization in only one line of business or the large organization that has not diversified into different products or markets, the business-level strategy typically overlaps with the organizations corporate strategy.

For organizations in multiple businesses, however, each division (SBUs) will have its own strategy that defines the products or services it will offer, the customers it wants to reach, and the like. For example, Pepsi Co. has different business-level strategies for its various business units – Soft drinks (Pepsi, Slice, Mountain Dew), Snacks (Frito-lay and Rold Gold pretzels), Other Beverages (Tropicana juices, Aquafina bottled water, All Sport sports drinks, and Lipton tea), and Quaker Oats. Each division has developed its own unique approach for competing.

The essence of business strategy is achieving sustainable competitive advantage. It has three aspects: (1) deciding what product/service attributes (lower costs and prices, a better product, a wider product line, superior customer service, emphasis on a particular market niche) offer the best chance to win a competitive edge; (2) developing skills, expertise, and competitive capabilities that set the company apart from rivals; and (3) trying to insulate the business as much as possible from the effects of competition.

On a broader internal front, business strategy must also aim at uniting strategic initiatives in the various functional areas of business (Finance, HR, Marketing, R&D, Customer service etc.).

Strategic actions are needed in each functional area to support the company's competitive approach and overall business strategy. Strategic unity and coordination across the various functional areas add power to the business strategy.

1.5.3 Functional Strategy

Functional Strategy seeks to determine how to support the business-level strategy. A firm needs a functional strategy for every competitively relevant business activity and organizational unit – for R&D, Production, Marketing, Customer service, Distribution, Finance, HR, IT, and so on. Functional strategies, while narrower in scope than business strategies, add relevant detail to the overall business game plan by setting forth the actions, approaches, and practices to be employed in managing a particular functional department or business process or key activity. They aim at establishing or strengthening specific competencies and competitive capabilities calculated to enhance the company's market position and standing with its customers

1.6 Strategic Management Process

The definitions quoted above give us the idea that, as a process, strategic management consists of different phases, which are sequential in nature. Most authors agree that there are five essential phases in the strategic management process, though they may differ with regard to the sequence, emphasis or nomenclature. The strategic management process, as illustrated in figure below, is a five-step process that encompasses Strategic Planning, Implementation, and Control.

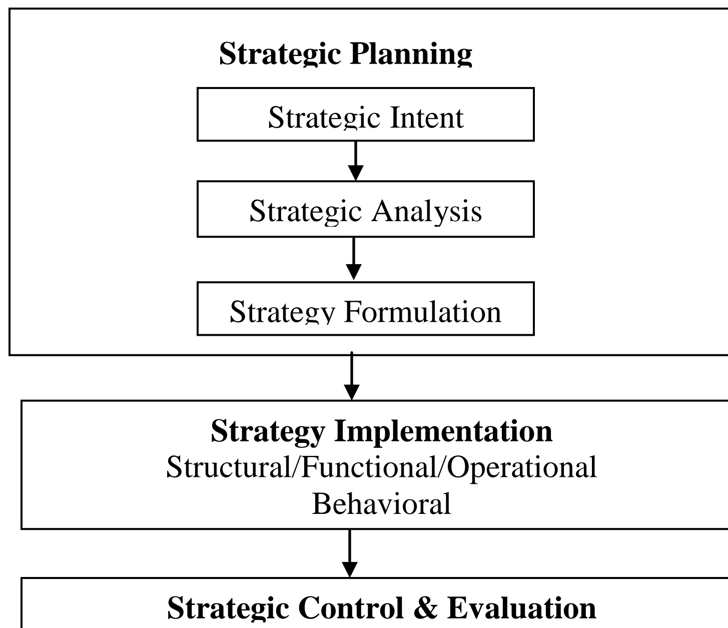


Figure 1.3 Strategic Management Process

Elements in Strategic Management Process

Each phase of the strategic management process consists of a number of elements, which are discrete and identifiable activities performed in logical and sequential steps. As many as twelve different elements could be identified in the models provided by various authors. From the literature on business policy, most or all of the following activities are considered as parts of the strategic management process:

1. Defining business;
2. Setting mission;
3. Determining purpose;
4. Establishing objectives;
5. Performing environmental appraisal;
6. Doing corporate appraisal;
7. Evolving strategic alternatives;
8. Exercising strategies choice;
9. Formulating strategies;
10. Preparing strategic plan;
11. Implementing strategies; and
12. Evaluating strategies.

In brief we present a bird’s eye view of the different elements of the process.

I. The hierarchy of strategic intent lays the foundation for the strategic management. The element of vision in the hierarchy serves the purpose of stating what an organization wishes to achieve in long run. The mission relates an organization to society. The business definition explains the business of an organization interim of customer need and alternative technologies. The objective of an organization states what is to be achieved in a given time period.

II. Environmental and organizational appraisal helps to find out the opportunities and threats in the environment and the strengths and weaknesses of the organization in order to create a match between them. In such a manner opportunities could be availed of and the impact of threats neutralized in order to capitalize on the organizational strengths and minimize the weakness.

III. Strategic alternatives and choice are required for evolving alternative strategies, out of the many possible options, and choosing the most appropriate strategy or strategies in the light of environmental opportunities and threats and corporate strengths and weaknesses. The procedures (or processes) used for choosing strategies involve strategic analysis and choice. The end result of this set of elements is a strategic plan which can be implemented.

IV. For the implementation of strategy, the strategic plan is put into action through six sub-processes:

- Project implementation: It deals with setting up the organization.
- Procedural implementation: It deals with different aspects of the regulatory framework within which organization has to operate.
- Resource allocation: It relates to the procurement and commitment of resources for implementation.
- Structural: The structural aspects of implementation deal with the designing of appropriate organizational structures and systems and reorganizing to match the structure to the needs of the strategy.

- Functional: The functional aspects relate to the policies to be formulated in different functional areas. The operational implementation deals with productivity, process, people , and peace of implementing the strategies.
- Behavioral: The behavioral aspects consider the leadership style for implementing strategies and other issues like social, responsibility, business ethics, organizational culture and corporate policies.

V. The last phase of strategic evaluation appraises the implementation of strategies and measures to organizational performance. The feedback from strategic evaluation is meant to exercise strategic control over the strategic management process. Strategies may be reformulated, if necessary.

1.7 Strategic Management Approaches

A) Industrial Organization (I/O) Model

The industrial organization (I/O) model explains the external environment is a dominant influence on a firm's strategic actions. The model specifies that the industry in which a company chooses to compete has a stronger influence on performance than do the choices managers make inside their organizations. The firm's performance is believed to be determined primarily by a range of industry properties, including economies of scale, barriers to market entry, diversification, product differentiation, and the degree of concentration of firms in the industry.

I/O model steps

1. Study the external environment, especially the industry environment.
2. Locate an industry with high potential for above average returns.
3. Identify the strategy called for by the attractive industry to earn above average returns.
4. Develop or acquire assets and skills needed to implement the strategy.
5. Use the firm's strengths (its developed or acquired assets and skills) to implement the strategy.

B) The Resource-Based Model

The resource-based model assumes that each organization is a collection of unique resources and capabilities. The *uniqueness* of its resources and capabilities is the basis for a firm's strategy and its ability to earn above-average returns.

- ✓ **Resources** are inputs into a firm's production process, such as capital equipment, the skills of individual employees, patents, finances, and talented managers. In general, a firm's resources are classified into three categories: physical, human, and organizational capital and resources are either tangible or intangible in nature.
- ✓ **Capability** is the capacity for a set of resources to perform a task or an activity in an integrative manner. Capabilities evolve over time and must be managed dynamically in pursuit of above-average returns.
- ✓ **Core competencies** are resources and capabilities that serve as a source of competitive advantage for a firm over its rivals. Core competencies are often visible in the form of organizational functions.

Resource-Based model steps

1. Identify the firm's resources. Study its strengths and weaknesses compared with those of competitors.
2. Determine the firm's capabilities. What do the capabilities allow the firm to do better than its competitors?
3. Determine the potential of the firm's resources and capabilities in terms of a competitive advantage.
4. Locate an attractive industry.
5. Select a strategy that best allows the firm to utilize its resources and capabilities relative to opportunities in the external environment.

1.8 Business Ethics and Strategic Management

What is Ethics?

Ethics is a collection of moral principles and rules of conduct accepted by part or all of the members of a society. Ethics guides behavior based on beliefs about what is right or wrong. The sources of these beliefs may be tradition, religion or reasonable judgment about what is best for the individual and society as a whole.

Meaning of Business Ethics

Business ethics means the behavior of a businessman while conducting a business, by observing morality in his business activities.

The behavior of a businessman has more impact within the business organization than outside. So, he should obey the laws even though he may personally believe them to be unjust or immoral. If the businessman feels that the provisions of laws are unjust, he can take steps to change the provisions instead of disobeying them.

A businessman should observe morality not only in business activities but also in non-business activities. Such observation of morality is not required out of fear for punishment. He should observe ethics inspired by his own interest in his business and society as a whole. The reason is that, there is no distinction between a businessman and his business. According to Drucker, every individual and organization in society should abide by certain moral codes and that there is no separate ethics of business.

Definition of Business Ethics

In the words of Robert Gwinner and others, "Business ethics may be defined as those principles, practices and philosophies that are concerned with moral judgments and good conduct, as they are applicable to business situations."

In the words of Rogene A. Buchholz, "Business ethics refers to right or wrong behavior in business decisions."

Thomas M. Garrett, defines business ethics as "Business ethics is concerned primarily with the relationship of business goals and techniques to specifically human ends."

Business ethics may be defined as a set of moral rules and principles to protect the interest of customers, employees, society, business unit and the industry as a whole.

Importance of Business Ethics

The development of a business has an impact on the lifestyle of a businessman. The behavior of a businessman has close relationship with his lifestyle. Hence, it is necessary to observe business ethics for the following reasons.

1. ***Survival of the business unit***

Businessmen should consider the interest of the business unit. Unethical practices of businessmen will lead to the closure of business unit. The closure of a business unit does not only create problems to business but also to employees and the society in general.

Normally, good behavior is rewarded and bad behavior is punished. Since, a business is an economic institution, it aims at maximizing profits. The behavior of a businessman is affected by some of the factors such as leadership qualities, integrity, knowledge, skills, influence and exercising power. Businessmen are expected to protect their units in all respects.

2. Growth of business unit

Whenever a businessman observes ethics strictly, definitely the particular business unit well gets developed. A business could not be run in such a manner as is detrimental to the interest of society or business itself. So, it is argued that there should be some business ethics for the growth of a business.

3. Earning goodwill

The prime objective of any business is to earn profit. At the same time, no business is allowed to earn profit without following business ethics. If business ethics are properly followed by a business, automatically that particular business unit earns a good name among the public.

4. Improving the confidence

Business ethics are necessary to improve the confidence of the customers, employees, and the like. If confidence is infused, customers and employees will popularize the name of excellent consumer services of the particular business unit.

5. Maintaining Inter-relationship

No business functions separately or independently. Each business has close relationship with another business even though the nature and size of the other business differs. The proverb, "No tree can be considered as a forest" attests this fact. It is expected that each business unit should have a smooth relationship with others. The inter-relationship of business is maintained by adopting business ethics.

6. Solving social problems

If a businessman observes ethics in his business, the public have no difficult in having their wants fulfilled. There is no bargaining between the businessman and public. There is a fair treatment of an employee by him. This will avoid social problems like strike, lockout, etc.

Principles of Business Ethics

Some of the principles of business ethics developed by various known authorities are explained below:

1. Service motive should be in the first place rather than profit motive, even though the very purpose of any business is to earn profits.
2. There is no discrimination against any particular group of people, say the rich, the poor, the high, he low, the caste, the religion, etc.
3. Fullest satisfaction should be available to consumers.
4. There is no lack of consideration for clean environment.
5. Human feelings are properly considered while rendering service.
6. There is no wastage or misuse of available scarce resources.
7. Business must be a dynamic and efficient one.
8. Business should provide quality products at reasonable price.
9. Business must maintain or improve standard of living.
10. There must be healthy competition.
11. Employees have no fear regarding the security of job. In other words, there should be job security to employees.
12. Businessman must be sincere in payment of fair wages.
13. Better working conditions or environment should be provided.
14. Efficient employees are properly motivated and recognised.
15. Employees are requested to participate in management.
16. Monetary and non-monitory incentives must be available to employees.
17. Businessman must pay taxes promptly and obey other obligations promptly.
18. Business unit must avoid unfair trade practices like hoarding, black- marketing, etc.
19. There should be no formation of cartel agreements to control production, price, etc
20. Businessman must disclose all relevant information to needy persons
21. Businessman must prepare genuine books of accounts and presents before all authorized persons as and when required by them.
22. He should protect the interests of its members at the time of amalgamations, absorption and the like.
23. He should be ready to extend mutual cooperation and mutual help.

24. Business should act as a particular in the development of nation.
25. He should follow proper communication system at all levels.
26. He should not make promises that could not be fulfilled.
27. Business assets should not be utilized by its owner or employees for personal use.
28. Employees are allowed free speech in the work place.
29. Business unit should follow proper personnel policy with regard to promotion, transfer and the like.
30. Businessman should not indulge in politics.

Factors Affecting Business Ethics

Business ethics reflects its responsibility, authority, and dignity. So, the business organization wants to conduct its business without affecting the interest of society and the business itself by assuming responsibility, exercising authority and maintaining dignity. But there are some factors affecting the observation or adoption of business ethics. These are:

1. ***Unhealthy competition***

Businessman adopts unfair trade practices to have an edge over other competitors. This will ruin business in the long run. Gentle- man businessman does not prefer unhealthy competition.

2. ***Abnormal profit motive***

The very purpose of starting a business unit is to earn profit. Only a lesser amount of profit is earned during the initial period of business. But, the businessman wants to earn more profits by economizing establishment expenses.

3. ***Political interference***

Political parties approach the businessman to get donation. Now, the businessman is not ready to deny it, as it would affect the smooth running of business. The donation given to a political party is considered unnecessary expenses from the business point of view. This will affect profit and the smooth running of business.

4. ***Political uncertainty***

The policy of government affects the business ethics to some extent. If a number of governments are in power for short periods, there is every chance for changes in the policies of the government. A stable government alone does not affect business ethics.

5. ***Unjust legislation***

An act is passed only after through discussion. But, the person who participates in the discussion does not know the practical difficulties and practices and no business experience. So, a legally right practice may not be ethically right.

6. ***Corruption***

The government through its officials regulates a business. Straightforward and able officials are working in the government departments. However, the businessman does not appreciate the approach or behavior of some government officials.

7. ***Lack of ethical attitude***

A businessman wants to stand out distinctly form other fellow businessman. At the same time, he does not prefer to practice business ethics in spite of his sound knowledge of them.

8. ***Lack of education***

Here, education refers to the knowledge of ethical value. Businessman wants to follow business ethics strictly but he does not know what is the business ethics relating to his business.

9. ***Non cooperation of workers***

Workers or employees do not care about the business ethics. They want just to do their work as quickly as possible for remuneration. The impact of non-adoption of business ethics affects the business and not the workers or employees.

10. Red-Tapism

The existence of red- tapism also affects the business ethics. Business unit should get prior permission of the government for all its proceedings at every stages of development. Red-tapism is found to be at its maximum in the issue licenses and in the taxation policy:

Costs and Consequences of Corruption.

- Corruption erodes confidence in leadership and weakness the structure of political organization, the bureaucracy and the development.

- Creates social unrest and undermines the legitimacy of the government as well as the public sector.
- Cuts the revenue of the government and increases poverty.
- Decreases funds that should be directed to public utilities.
- Diverts money away from infrastructure and causes deterioration of roads, railways, communication and other public utilities.
- Increases the size of unofficial economy, reduces legitimacy of market economy, creates an unleveled playing field and reduces productivity.
- The poor, who have access to money and cannot afford to bride, will be the ultimate loser.
- Slow down cooperation between public and private citizens.
- Corruption reduces foreign and domestic investment incentives.
- Corruption strips away dignity and pride and it has also other consequences.

Consequences of Illegal Business

- It reduces revenue of the government and increase poverty.
- It creates unstable market situation
- May result in liquidation of legal business by taking their market share
- May offer deceptive products and others.

DISCUSSION QUESTION

1. Explain the relationship between Strategy and strategic management. Briefly describe the benefits of strategic management.
2. What is your understanding about strategy as an emergent process?
3. Define the following concepts:
    (a) Proactive planning
    (b) Proactive management
    (c) Strategy
    (d) Strategic management
4. Briefly explain characteristics of strategic management
5. Why is strategy evaluation important?
6. What are the five common phases in the strategic management process?

7. What are the different elements in the strategic management process?
8. Which of the strategy levels is most concerned with social, ethical, or public issues? Discuss the characteristics of this level.
9. Identify the steps involved in the strategic management process. In which step is a concern for social issues planning most evident? Explain.
10. What factors affecting Business ethics
11. Briefly explain the strategic management approaches organizations tend to adopt

CHAPTER TWO

THE BUSINESS VISION, MISSION & VALUES

Learning Objectives:

- *Describe a company vision and explain its values*
- *Explain why the mission statement should include the company's markets, and its principal technology*
- *Explain which goal of a company is most important: survival, profitability, or growth*
- *Discuss the importance of company philosophy, public image, and company self concept to stockholders*
- *Give examples of the newest trends in mission statement components: customer emphasis, quality, and company vision*
- *Describe the role of a company's board of directors*
- *Explain agency theory and its value*

2.1 Stakeholders Analysis

Stakeholders are those individuals, groups and organizations who will be impacted by or who are likely to be interested in the organization's strategic plan and the planning process. Included are all who believe, rightly or wrongly, that they have a stake in the

organization's future and not merely those whom the planning team believes have a reasonable or legitimate right to such a stake.

The approach to stakeholder analysis adopted here implies that we should treat as stakeholders any individual, any formal or informal grouping of individual or any institution which both wishes to and is able to affect our organization's future. The power to affect public sector organizations can probably be split broadly into four categories:

- ***Direct power over resources***: usually associated with the formal power to issue directions stemming from a hierarchical relationship.
- ***Power of political influence***: basically an indirect power over resources arising from the ability to influence those who have direct power.
- ***Power over production***: people on whom the organization depends to produce the service but whom it cannot control without ultimately an element of consent.
- ***Power over the environment***: in which the organization operates, whether through direct regulation, general legislation or influence on the market place.

A company's stakeholders are individuals or groups that have an interest, claim, or stake in the company, in what it does and how well it performs. Stakeholders can be divided into two: ***direct stakeholders*** (i.e. those engaged directly in transactions with the organizations goods and services) and ***indirect stakeholders*** (i.e. those not necessarily engaged in direct transactions but nevertheless significantly affected by the organizations activities) as shown in figure below:

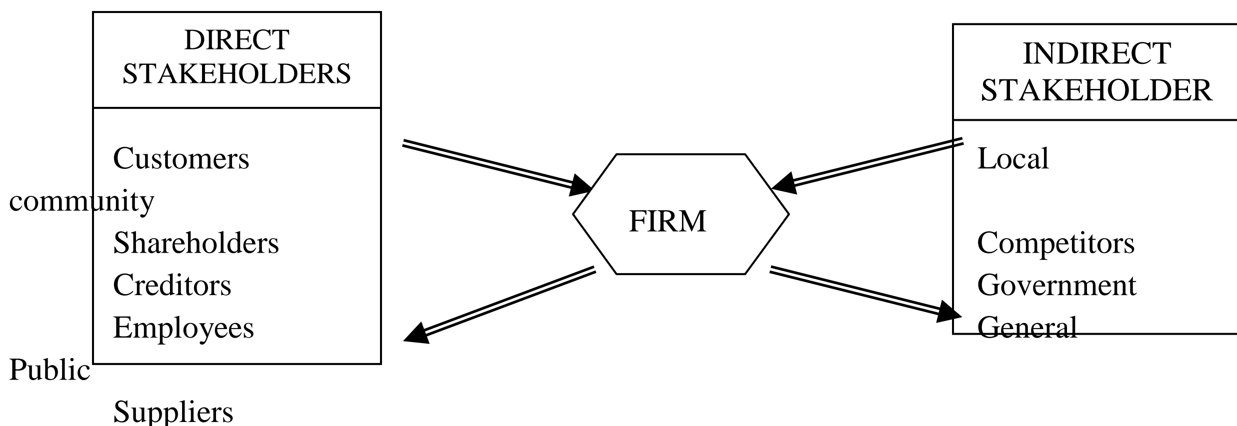


Figure 2.1 Stakeholders and the Business Firm

All stakeholders are in an exchange relationship with the company. Each of the stakeholder groups listed in the figure above supplies the organization with important resources (or contributions), and in exchange each expects its interests to be satisfied (by inducements or rewards).

Customers provide a company with its revenues, and in exchange they want high-quality reliable products that represent value for money. Shareholders provide the company with capital and in exchange expect an appropriate return on their investment. Employees provide labour and skills and in exchange expect commensurate income, job satisfaction, job security, and good working conditions.

Creditors provide the company with debt capital and in exchange they seek repayment of interest and principal on time. Suppliers provide a company with inputs, and in exchange they seek revenues and dependable buyers.

Local communities provide the company with local infrastructure, and in exchange they want company's to be responsible citizens. Governments provide a company with rules and regulations that govern business practice and maintain fair competition, and in exchange they want company's that adhere to these rules. The general public provides companies with national infrastructure, and in exchange it seeks some assurance that the quality of life will be improved as a result of the company's existence.

A company must take these claims into account when formulating its strategies, or else stakeholders may withdraw their support. For example, shareholders may sell their shares, employees may leave their jobs, and customers may buy elsewhere. Suppliers may seek more dependable buyers. Local communities may oppose the company's attempts to locate its facilities in their area, and the general public may form pressure groups, demanding action against companies that impair the quality of life. Any of these reactions can have a disastrous impact on the firm.

A company cannot always satisfy the claims of all stakeholders. The goals of different groups may conflict, and in practice few organizations have the resources to manage all

stakeholders. For example, an employee's claim for higher paychecks can conflict with consumer's demands for reasonable prices and shareholders demands for wealth maximization. Often the company must make choices. To do so, it must identify the most important stakeholders and give highest priority to pursuing strategies that satisfy their needs. Stakeholders' impact analysis can provide such identification.

Typically, stakeholder impact analysis follows these steps:

1) Identify stakeholders
2) Identify interests and concerns of stakeholders
3) Identify what claims stakeholders are likely to make on the organization.
4) Identify the stakeholders who are most important from the organization's perspective.
5) Identify the resulting strategic challenges.

Such an analysis enables a company to identify the stakeholders most critical to its survival and to make sure that the satisfaction of their needs is paramount. Most companies that have gone through this process quickly come to the conclusion that there are three stakeholders groups that must be satisfied if a company is to survive and prosper: Customers, Employees, and Stockholders.

Stakeholder Mapping or Power-Interest Matrix:

Stakeholder mapping can be useful both for identifying stakeholders and managing their relationships. Figure below classifies stakeholders in relation to the power they hold and the extent to which they are likely to show interest in the organizations strategies.

POWER	LOW (Level of Interest)	HIGH (Level of Interest)
HIGH	KEEP SATISFIED	KEY PLAYERS
LOW	MINIMAL EFFORT	KEEP INFORMED

Figure 2.2 Stakeholder Mapping or Power/Interest Matrix

The matrix indicates the type of relationship, which the organization needs to establish with each stakeholder group. Clearly, the acceptability of strategies to the ***key players***

(Quadrant I) should be major consideration during the formulation and evaluation of new strategies. Often the most difficult relationship to plan is with stakeholders in Quadrant IV since they may suddenly reposition to Quadrant I and frustrate the adoption of new strategy. Similarly, then needs of stakeholders in Quadrants II & III need to be properly addressed – largely through information.

2.2 Hierarchy of the Strategic Intents

Strategic intents, often put as a hierarchy, refer to the purposes the organization strives for. These may be expressed in terms of a hierarchy of strategic intent. Broadly stated, these could be in the form of a vision and mission statement for the organization as a corporate whole. At the business level of a firm these could be expressed as the businesses definition. When stated in precise terms, as an expression of the aims to be achieved operationally, these may be the goals and objectives. Strategic intent lays down the framework within which firm would operate, adopts a predetermined direction, and attempt to achieve their goals.

The hierarchy of strategic intent incorporates:

- The Vision
- The Mission
- The Business Definition
- The Goals and Objectives

2.2.1 The Vision

Vision is aspirations, expressed as strategic intent to be achieved and that should lead to an end. That end is the vision of an organization or an individual. It is what the firm or a person would ultimately like to become.

For instance some of you say in 10 years, or maybe even earlier, would like to become general managers managing an SBU in a large, diversified multinational corporation. Or some others among you would like to believe that you will be an entrepreneur in 10-15 years owning your own company dealing with IT services and employing cutting-edge technology to serve a global clientele. A firm thinks like that too.

A firm may have a vision of entering the new millennium with the confidence of a learning, knowledge-base and happy organization. In the coming decade, we will become

the most cost competitive organization in the industry." A vision, therefore, articulates the position that a firm would like to attain in the distant future.

Vision has been defined in several different ways. Kotter (1990) defines it as a "description of something (Ian organization, corporate culture, a business, a technology, an activity) in the future". El-Namki (1992) considers it as a "mental perception of the kind of environment an individual, or an organization, aspires to create within a broad time horizon and the underlying conditions for the actualization of this perception". Miller and Dess (1996) view it simply as the "category of intentions that are broad, all-inclusive, and forward thinking". The common strand of thought evident in these definitions and other definitions relates to 'vision' being future aspirations that lead to an inspiration to be the best in one's filed of activity.

The Benefits of Having a Vision

Parikh and Neubauer (1993) point out the several benefits accruing to an organization having a vision. Here is what they say:

- Good visions are inspiring and exhilarating
- Visions represent a discontinuity, a step function and a jump ahead so that the company known what it is to be.
- Good visions help in the creation of a common identity and a shared sense of purpose
- Good visions are competitive, original and unique. They make sense in the marketplace as they are practical
- Good visions foster risk-taking and experimentation
- Good visions foster long-term thinking
- Good visions represent integrity; they are truly genuine and can be used for the benefit of people.

The Process of Envisioning

The Process of envisioning can occur in one or more of the following ways

- Can occur through solitary introspection by a leader;
- It can occur through the interaction of a group that shares leadership;

- It can occur through interaction between a leader and a group of followers or through any combination of these;
- It can emerge suddenly and holistically;
- It can emerge slowly and incrementally through interactions among group members;
- It can be inductive or deductive;
- It can be fixed or shift over-time but it always is future focused;
- Involves a high degree of success;
- Is relatively stable over-time and
- 1s inspirational
- It concentrates on the end goal (the desire future state) not the means to reach the goal.

The Reasons for Envisioning

The following are quotations related to reasons for envisioning

- "Vision without action is merely a dream, that action without vision merely passes the time, but vision with action change the world"
- Vision is a perceived need for a common vision and sense of teamwork;
- A realization that the organization's current operational success was no guarantee for the future;
- An opportunity to exploit a new opportunity or deal with a new threat; and
- The need to pass the torch and carry it;
- Where there is no vision the people perish
- Whatever, the mind of men can conceive and believe it can achieve"
- A man becomes what he thinks about most of the time
- Belief creates the actual fact
- Your imagination is your preview of life's coming attractions
- Whatever you want, wants you

<u>Guideline for Developing a Vision Statement</u>

1. *The vision statement includes vivid description of the organization as it effectively carries out its operations.*
2. *Developing a vision statement can be quick culture-specific, i.e., participants may use methods ranging from highly analytical and rational to highly creative and divergent, e.g., focused discussions, divergent experiences around daydreams,*

sharing stories, etc. Therefore, visit with the participants how they might like to arrive at description of their organizational vision.

3. *Developing the vision can be the most enjoyable part of planning, but the part where time easily gets away from you.*
4. *Note that originally, the vision was a compelling description of the state and function of the organization once it had implemented the strategic plan, i.e., a very attractive image toward which the organization was attracted and guided by the strategic plan. Recently, the vision has become more of a motivational tool, too often including highly idealistic phrasing and activities which the organization cannot realistically aspire.*

2.2.2 The Mission

Current thought on mission statements is based largely on guidelines set forth in the mid 1970s by Peter Drucker, often called "the father of modern management" for his pioneering studies at general Motors Corporation and for his 22 books and hundreds of articles. Harvard Business Review calls Drucker, age 79, "The preeminent management thinker of our time."

Drucker says asking the question, "What is our business?" is synonymous with asking the question, "What is our mission?" An enduring statement of purpose that distinguishes one organization from other similar enterprises, the mission statement is a declaration of an organization's "reason for being." It answers the pivotal question, "What is our business"? A clear mission statement is essential for effectively establishing objectives and formulating strategies.

Sometimes called a creed statement, a statement of purpose, a statement of philosophy, a statement of beliefs, a statement of business principles, a vision statement, or a statement "defining our business," a mission statement reveals the long-term vision of an organization in terms of what it wants to be and whom it wants to serve. All organizations have a reason for being, even if strategists have not consciously transformed this into writing. As illustrated in a carefully prepared statement of mission is widely recognized by both practitioners and academicians as the first step in strategic management.

A business mission is the foundation for priorities, strategies, plans, and work assignments. It is the starting point for the design of managerial jobs and, above all, for the design of managerial structures. Nothing may seem simpler or more obvious than to know what a company's business is. A steel mill makes steel, a railroad runs trains to carry freight and passengers, an insurance company underwrites fire risks, and a bank lends money. Actually, "what is our business?" is almost always a difficult question and the right answer is usually anything but obvious. The answer to this question is the first responsibility of strategists. Only strategists can make sure that this question receives the attention it deserves and that the answer makes sense and enables the business to plot its course and set its objectives.

We can perhaps best understand a business mission by focusing on a business when it is first started. In the beginning, a new business is simply a collection of ideas. Starting a new business rests on a set of beliefs that the new organization can offer some product or service, to some customers, in some geographic area, using some type of technology, at a profitable price. A new business owner typically believes that the management philosophy of the new enterprise will result in a favorable public image and that this concept of the business can be communicated to and will be adopted by, important constituencies. When the set of beliefs about a business at its inception are put into writing, the resulting grows, owners or managers find it necessary to revise the founding set of beliefs, but those original ideas usually are reflected in the revised statement of mission.

Business mission statements can often be found in the front of annual reports. Mission statements often are displayed throughout a firm's premises, and they are distributed with company information sent to constituencies. The mission statement is a part of numerous internal reports, such as loan requests, supplier agreements, labor relations contracts, business plans, and customer service agreements. Barnett bank's current mission statement is as follows:

Barnett's mission is to create value for its owners, customers and employees by creating and capitalizing on market leadership positions to sell and service a broad range of high quality, profitable financial services. Our sales emphasis will be full service to others. We will operate at the lowest possible cost consistent with maintaining high service quality and market leadership.

A good mission statement describes an organization's purpose, customers, products or services, markets, philosophy, and basic technology. According to Vern McGinnis, a mission statement should 91) define what the organization is and what the organization aspires to be (2) be limited enough to exclude some ventures and broad enough to allow for creative growth (3) distinguish a given organization from all others, (4) serve as a framework for evaluating both current and prospective activities, and (5) be stated in terms sufficiently clear to be widely understood throughout the organization.

Some strategists spend almost every moment of every day on administrative and tactical concerns, and strategists who rush quickly to establish objectives and implement strategies often overlook developing a mission statement. This problem is widespread even among large organizations. Approximately 40 percent of large corporations in America have not yet developed a formal mission statement, including Walt Disney Company, Grumman Corporation, and Wal-Mart Stores. However, 60 percent do have a formal mission document. An increasing number of organizations every day are developing formal mission statements.

Some companies develop mission statements simply because they fell it is fashionable, rather than out of any real commitment. However, as will be described in this chapter, firms that develop and systematically revisit their mission, treat it as a living document, and consider it to be an integral part of the firms culture, realized great benefits, Johnson & Johnson (J&J) is an example firm. J&J managers meet regularly with employees to review, reword, and reaffirm the firm's mission. The entire J&J workforce recognizes the value that top management places on this exercise, and they respond accordingly.

The Importance of a Clear Mission

The importance of a mission statement to effective strategic management is well documented in the literature. A recent study comparing mission statements of Fortune 500 firms performing well and firms performing poorly concluded that that high performers have more compressive that organizations carefully develop a written mission statement for the following reasons:

1. To ensure unanimity of purpose within the organization.
2. To provide a basis, or standard, for allocating organizational resources.
3. To establish a general tone or organizational climate.
4. To serve as a focal point for individuals to identify with the organization's purpose and direction; and to deter those who cannot from participating further in the organization's activities.
5. To facilitate the translation of objectives into a work structure involving the assignment of tasks to responsible elements within the organization.
6. To specify organizational purposes and the translation of these purposes into objectives in such a way that cost, time, and performance parameters can be assessed and controlled.

The Process of Developing a Mission Statement

As indicated in the strategic-management model, a clear mission statement is needed before alternative strategies can be formulated and implemented. It is important to involve as many managers as possible in the process of developing a mission statement, because through involvement, people become committed to an organization.

A widely used approach to developing a mission statement is to first select several articles about mission statements and ask all managers to read these as background information. Then ask managers to personally prepare a mission statement for the organization. A facilitator, or committee of top managers, then should merge these statements into a single document and distribute this draft mission statement to all managers. A request for modifications, additions, and deletions is needed next, along with a meeting to revise the document. To the extent that all managers have input into and support the final mission statement document, organizations can more easily obtain

managers' support for other strategy formulation, implementation, and evaluation activities. Thus, the process of developing a mission statement represents a great opportunity for strategists to obtain needed support from all managers in the firm.

During the process of developing a mission statement, some organizations use discussion groups of managers to develop and modify the mission statement. Some organizations hire an outside consultant or facilitator to manage the process and help draft the language. Sometimes an outside person with expertise in developing mission statements and unbiased views can manage the process more effectively than an internal group or committee of managers. Decisions on how best communicate the mission to all managers, employees, and external constituencies of an organization are needed when the document is in final form. Some organizations even develop a videotape to explain the mission statement and how it was developed.

A recent article by Campbell and Yeung emphasizes that the process of developing a mission statement should create an "emotional bond" and "sense of mission" between the organization and its employees. Commitment to a company's strategy and intellectual agreement on the strategies to be pursued do not necessarily translate into an emotional body hence strategies that have been formulated may not be implemented. These researchers stress that an emotional bond comes when an individual personally identifies with the underlying values and behavior of a firm, thus turning intellectual agreement and commitment to strategy into a sense of mission. Campbell and Yeung also differentiate between the terms vision and mission, saying vision is "a possible and desirable future state of an organization" that includes specific goals, whereas mission is more associated with behavior and with the present.

The Nature of Business Mission

A Declaration of Attitude: A mission statement is a declaration of attitude and outlook more than a statement of specific details. It is usually broad in scope for at least two major reasons. First, a good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies and strategies

without unduly stifling management creativity. Excess specificity would limit the potential of creative growth for the organization. On the hand, an overly general statement that does not exclude any strategy alternatives could be dysfunctional. Apple Computer's mission statement, for example, should not open the possibility for diversification into pesticides, or Ford Motor Company's into food processing. As indicated in the Global Perspective, French mission statements are more general than British mission statements.

Second, a mission statement needs to be broad to effectively reconcile differences among and appeal to an organization's diverse stakeholders, the individuals and groups of persons who have a special stake or claim on the company. Stakeholders include employees, managers, stockholders, boards of directors, customers, suppliers, distributors, creditors, governments (local, state, federal, and foreign), unions, competitors, environmental groups, and the general public. Stakeholders affect and are affected by an organization's strategies, yet the claims and concerns of diverse constituencies vary and often conflict. For example, the general public is especially interested in social responsibility, whereas stockholders are more interested in profitability. Claims on any business may literally number in the thousands, and often include clean air, jobs, taxes, investment opportunities, career opportunities, equal employment opportunities, employee benefits, salaries, wages, clean water, and community services. All stakeholders' claims on an organization cannot be pursued with equal emphasis. A good mission statement indicates the relative attention that an organization will devote to meeting the claims of various stakeholders. More and more firms are becoming environmentally proactive in response to the concerns of stakeholders.

Reaching the fine balance between specificity and generality is difficult to achieve, but is well worth the effort. George Steiner offers the following insight on the need for a mission statement to be broad in scope:

An effective mission statement arouses positive feelings and emotions about an organizational; it is inspiring in the sense that it motivates readers to action. An effective

mission statement generates the impression that a firm is successful, has direction, and is worthy of time, support, and investment.

It reflects judgments about future growth directions and strategies based upon forward-looking external and internal analyses. A business mission should provide useful criteria for selecting among alternative strategies. A clear mission statement provides a basis for generating and screening strategic options. The statement of mission should be dynamic in orientation, allowing judgments about the most promising growth directions and those considered less promising.

A resolution of Divergent Views: What are the reasons some strategists are reluctant to develop a statement of their business mission? First, the question, "What is our business?" can create controversy. Raising the question often reveals differences among strategists in the organization. Individuals who have worked together for a long time and who think they know each other may suddenly realize that they are in fundamental disagreement. For example, in a college or university, divergent views regarding the relative importance of teaching, research, and service are often expressed during the mission statement development process. Negotiation, compromise, and eventual agreement on important issues is needed before focusing on more specific strategy formulation activities.

"What is our mission?" is a genuine decision; and a genuine decision must be based on divergent views to have a chance to be a right and effective decision. Developing a business mission is always a choice between alternatives, each of which rests on different assumptions regarding the reality of the business and its environment. It is always a high-risk decision. A change in mission always leads to changes in objectives, strategies, organization, and behavior. The mission decision is far too important to be made by acclamation. Developing a business mission is a big step toward management effectiveness. Hidden or half-understood disagreements on the definition of a business mission underlie many of the personality problems, communication problems, and irritations that tend to divide a top-management group. Establishing a mission should never be made on plausibility alone, should never be made fast, and should never be made painlessly.

A Customer Orientation: A good mission statement reflects the anticipations of customers. Rather than developing a product and then trying to find a market, the operating philosophy of organizations should be to identify customers' needs and then provide a product or service to fulfill those needs. Good mission statements identify the utility of a firm's products to its customers. This is why AT&T's mission statement focuses on communication rather than telephones, Exxon's mission statement focuses on energy rather than oil and gas, Union Pacific's mission statement focuses on transportation rather than railroads, and Universal Studios' mission statement focuses on entertainment instead of movies. The following utility statements are relevant in developing a mission statement:

Do not offer me things.
Do not offer me clothes. Offer me attractive looks.
Do not offer me shoes. Offer me comfort for my feet and the pleasure of walking.
Do not offer me a house. Offer me security, comfort, and a place that is clean and happy.
Do not offer me records. Offer me leisure and the sound of music.
Do not offer me tools. Offer me the benefit and the pleasure of making beautiful things.
Do not offer me furniture. Offer me comfort and the quietness of a cozy place.
Do not offer me things. Offer me ideas, emotions, ambience, feelings, and benefits.
Please, do not offer me things.

A major reason for developing a business mission is to attract customers who give meaning to an organization. As indicated in the information technology perspective, bank customers increasingly desire online services and home banking. This change is requiring many banks to rethink their mission. A classic description of the purpose of a business reveals the relative importance of customers in a statement of mission:

It is the customer who determines what a business is. It is the customer alone whose willingness to pay for a good or service converts economic resources into wealth and things into goods. What a business thinks it produced is not of first importance, especially not to the future of the business and to its success. What the customer thinks he/she is buying, what he/she considers value, is decisive it determines what a business

is, what it produces, and whether it will prosper. And what the customer buys and considers value is never a product. It is always utility, meaning what a product or service does for him. The customer is the foundation of a business sand keeps it is existence.

A Declaration of Social Policy: The words social policy embrace managerial philosophy and thinking at the highest levels of an organization. For this reason, social policy affects the development of a business mission statement. Social issues mandate that strategists consider not only what the organization owes its various stakeholders but also what responsibilities the firm has to consumers, environmentalists, minorities, communities, and other groups. After decades of debate on the topic of social responsibility, many firms still struggle to determine appropriate social policies.

The issue of social responsibility arises when a company establishes its business mission. The impact of society on business and vice versa, is becoming more pronounced each year. Social policies directly affect a firm's customers, products and services, markets, technology, profitability, self-concept, and public image. An organization's social policy should be integrated into all strategic management activities, including the development of a mission statement. Carroll and Hoy assert that corporate social policy should be designed and articulated during strategy formulation, set and administered during strategy implementation, and reaffirmed or changed during strategy evaluation. The emerging view of social responsibility holds that social issues should be attended to both directly and indirectly in determining strategies.

Firms should strive to engage in social activities that have economic benefits. For example, Merck and Company recently developed the drug ivermectin for treating river blindness, a disease caused by a fly-borne parasitic worm endemic in poor tropical areas of Africa, the Middle East, and Latin America. In an unprecedented gesture that reflected its corporate commitment to social responsibility. Merck then made ivermectin available at no cost to medical personnel throughout the world. Merck's action highlights the dilemma of orphan drugs, which offer pharmaceutical companies no economic incentive for development and distribution.

Despite differences in approaches, most American companies try to assure outsiders that they conduct business in a socially responsible way. The mission statement is an effective instrument for conveying this massage. The Norton Company, for example, concludes its mission statement by saying:

In order to fulfill this mission, Norton will continue to demonstrate a sense of responsibility to the public interest and to earn the respect and loyalty of its customers, employees shareholders, and suppliers, and the communities in which it does business.

Components of a Mission Statement

Mission statements can and do vary in length, content, format, and specificity. Most practitioners and academicians of strategic management consider an effective statement to exhibit nine characteristics or components. Since a mission statement is often the most visible and public part of the strategic-management process, it is important that it includes all of these essential components. Components and corresponding questions that a mission statement should answer are given here.

1. ***Customer: Who are the firm's customers?***

We believe our first responsibility is to the doctors, nurses, and services (Johnson & Johnson).

Products or services: What are the firm's major products or services?

AMAX's principal products are molybdenum, coal, iron one, copper, lead, zinc, petroleum and natural gas, potash, phosphates, nickel, tungsten, silver, gold, and magnesium (AMAX).

Standard Oil Company (Indiana) is business to find and produce crude oil, natural gas, and natural gas liquids; to manufacture high quality products useful to society from these raw materials; and to distribute and market those products and to provide dependable related services to the consuming public at reasonable prices. (Standard Oil Company)

2. ***Market: Geographically, where does the firm compete?***

We are dedicated to the total success of Coming Glass Works as a worldwide competitor. (Coming Glass Works) Our emphasis is on North American markets, although global opportunities will be explored (Blockway)

3. ***Technology: Is the firm technologically current?***

Control Date is in the business of applying micro-electronics and computer technology is in two general areas: computer-related hardware; and computing-enhancing services, which include computation, information, education and finance (Control Data). The common technology in these areas is discrete particle coatings (Nashua)

4. ***Concern for survival, growth, and profitability: is the firm committed to growth and financial soundness?***

In this respect, the company will conduct its operations prudently, and will provide the profits and growth which will assure Hoover's ultimate success. (Hoover Universal)

To serve the worldwide need for knowledge at a fair profit by gathering, evaluating, producing and distributing valuable information in a way that benefits our customers, employees, authors, investors, and our society. (McGraw-Hill)

5. ***Philosophy: What are the basic beliefs, values, aspirations, and ethical priorities of the firm?***

We believe human development to be the worthiest of the goals of civilization and independence to be the superior condition for nurturing growth in the capabilities of people. (Sun Company)

It's all part of the Mary Kay philosophy a philosophy based on the golden rule. A spirit of sharing and caring where people give cheerfully of their time, knowledge, and experience. (Mary Kay Cosmetics)

Self-concept: What is the firms distinctive competence or major competitive advantage?

Crown Zellebach is committed to leapfrogging competition within 1,000 days by unlashing the constructive and creative abilities and energies of each of its employees. (Crown Zellerbach)

6. ***Concern for public image: Is the firm responsive to social, community, and environmental concerns?***

To share the world's obligation for the protection of the environment. (Dow Chemical)

7. ***Concern for employees: Are employees a valuable asset of the firm?***

To recruit, develop, motivate, reward, and retain personnel of exceptional ability, character and dedication by providing good working conditions, superior leadership,

compensation o the basis of performance, an attractive benefit program, opportunity for growth, and a high degree of employment security. (The Wachovia Corporation).

To compensate its employees with remuneration and fringe benefits competitive with other employment opportunities inn its geographical area and commensurate with their contributions toward efficient corporate operations (Public service Electric and Gas company)

Guideline for *Developing a Mission Statement*

1. *As it is most basic, the mission statement describes the overall purpose of the organization.*
2. *If the organization elects to develop a vision statement before developing the mission statement, ask "Why does the image, the vision exist -- what is its purpose?" This purpose is often the same as the mission.*
3. *Developing a mission statement can be quick culture-specific, i.e., participants may use methods ranging from highly analytical and rational to highly creative and divergent, e.g., focused discussions, divergent experiences around daydreams, sharing stories, etc. Therefore, visit with the participants how they might like to arrive at description of their organizational mission.*
4. *When wording the mission statement, consider the organization's products, services, markets, values, and concern for public image, and maybe priorities of activities for survival.*
5. *Consider any changes that may be needed in wording of the mission statement because of any new suggested strategies during a recent strategic planning process.*
6. *Ensure that wording of the mission is to the extent that management and employees can infer some order of priorities in how products and services are delivered.*
7. *When refining the mission, a useful exercise is to add or delete a word from the mission to realize the change in scope of the mission statement and assess how concise is its wording.*
8. *Does the mission statement include sufficient description that the statement clearly separates the mission of the organization from other organizations?*

What's the difference between Mission and Vision?

Why be mission driven? So employees and owners never lose sight of their greater purpose for existing in the first place.

Without the unwavering focus on mission and vision *it's much too easy to get mired in the day-to-day routine* — which businesses are chock full of. Without mission and vision, businesses are boring.

Companies which don't bother to distinguish them at all: They have a separate Values Statement (thank goodness), but if you ask them to tell you of their Vision, and then of their Mission, they'll give you the same answer for both questions. So what is the difference? Does it matter?

The short answer is that it only matters if you use them. Vision Statements and Mission Statements can be power-packed drivers in a company culture when they are done right, and when they are used to release the potent energy within the people who make up that company. (Don't for a moment think that companies are made up of anything else.) The best missions and visions become mantras for action; they're catalysts. The worst ones are those pretty, carefully crafted ones up on the walls in frames that are long and detailed: too much to memorize and remember, too much to bother with at all. No one pays attention to them, and no one lives them. Rotate them with famous quotations or snippets from eloquent speeches and no one will even notice, because none of the real people in the company say those things.

That old guideline that a mission describes *"what business you're in and who your customer is"* barely gets anyone up in the morning. How hum. Keep the trees in the ground, for it's not worth wasting the paper you draft it on.

You don't need your mission or your vision to state the obvious; you want them to state the exceptional and extraordinary, to boast of your edge-teetering leaps of faith, and the wild dreamings of every possibility you want explored every single day. You need them to create chatter, thrilled whispers, passionate debate and evangelism. You want people inside and outside your organization to talk about them constantly because they're fascinating, enticing, and enthralling. You couldn't possibly contain their passion on the company bulletin board if you tried.

Let them be controversial. Let them beg discussion and explanation. They should answer these better questions: *How will we make a difference every single day, improving the quality of life itself? How can we work on only what really matters to us, and to everyone? Why is it that this world can't possibly be a great place without the magic we work? Why is it that we are so special, so damned good, and so fanatically courageous?* Put unbusiness-like words in them, like Beauty. Uprising. Character. Notoriety. Caring. Wear your values on your sleeve and speak them.

So what's the difference? As simply as one can say it, your mission is what you do best every day, and your vision is what the future looks like because you do that mission so exceedingly well. In fact, one may like to compare them to another old debate: *management versus leadership.*

For MISSION —— think: **Managing** with greatness and untamed strength, improving everything daily.

For VISION —— think: **Leading** with inspiration and courage, obsessed with future possibility, in a love affair with change.

MISSION will feed into the confidence of your organization by feeding this ever-present self-talk: *"We can do this, and we are the ones ordained to do this, for we are the best at it."* Mission will churn out revolutionary ideas about the mundane, banishing mediocrity.

VISION creates that momentum of growing anticipation about the future, where change is embraced as a step closer to that very compelling picture of what's coming next. The excitement about the future trumps any apprehension about the uncertain — change is recognized as the catalytic converter it is.

Six Attributes of Successful, Long-term CEOs

1. ***Creating, Communicating and Executing a Clear Vision, Goals and Strategy***. An executive's success is affected by the ability to communicate a vision for a company's future, helping employees to navigate through change and motivating them to achieve specific goals.
2. ***Delivering Results.*** Today's businesses – especially those publicly held - emphasize the bottom-line more than ever. Tolerance levels for poor performance are dropping. There is little margin for error. That makes the ability to produce results a very important factor impacting tenure.

3. ***Acting with Integrity***. Those who operate with integrity consistently adhere to a code of conduct and have an underlying value system that is manifested through their behavior.

4. ***Maintaining Key Relationships***. To have a long-term view you need to have strong political ties, good shareholder relations and the skills and knowledge to allow people to understand and buy into the long-term view. A successful relationship with the board of directors is of particular importance.

5. ***Exhibiting Appropriate Leadership Style and People Skills***. A poor leadership style and people skills ultimately have a negative impact on an executive's tenure at their own firm. Some executives can clearly get the job done quickly, but the 'dead bodies' left in their wake can take years for the organization to recover.

6. ***The Cultural Fit***. A candidate for a top job might look great on paper, but must be culturally compatible in order to build relationships and add true value. Often, hiring managers or boards emphasize the need to challenge old thinking and move in new directions. But if an executive is too far out of step with an organization, the resulting culture clash can overwhelm the benefits.

2.2.3 Business Value

Values are Beliefs that are shared among the stakeholders of an organization. Values drive an organization's culture and priorities. Each person in an organization can have their own set of values, shaping what they believe to be good and just. Yet, when an organization's members share a common set of values, determining what they see as worthwhile activities, ethical behavior and moral responsibilities, this can have a strong impact on the strategic direction. Such widely embraced organizational values also contribute to a clear sense of organizational identity, attracting some individuals, while repelling others. Although it can be useful to explicitly state the values guiding the organization, to be influential they must become embodied in the organization's culture.

In management, business value is an informal term that includes all forms of value that determine the health and well-being of the firm in the long run. Business value expands concept of value of the firm beyond economic value to include other forms of value such

as employee value, customer value, supplier value, managerial value, societal value and so on.

Guideline for Developing a Values Statement

1. *Values represent the core priorities in the organization's culture, including what drives members' priorities and how they truly act in the organization, etc. Values are increasingly important in strategic planning. They often drive the intent and direction for "organic" planners.*
2. *Developing a values statement can be quick culture-specific, i.e., participants may use methods ranging from highly analytical and rational to highly creative and divergent, e.g., focused discussions, divergent experiences around daydreams, sharing stories, etc. Therefore, visit with the participants how they might like to arrive at description of their organizational values.*
3. *Establish four to six core values from which the organization would like to operate. Consider values of customers, shareholders, employees, and the community.*
4. *Notice any differences between the organization's preferred values and its true values (the values actually reflected by members' behaviors in the organization). Record each preferred value on a flash card, then have each member "rank" the values with 1, 2, or 3 in terms of the priority needed by the organization with 3 indicating the value is very important to the organization and 1 is least important. Then go through the cards again to rank how people think the values are actually being enacted in the organization with 3 indicating the values are fully enacted and 1 indicating the value is hardly reflected at all. Then address discrepancies where a value is highly preferred (ranked with a 3), but hardly enacted (ranked with a 1).*
5. *Incorporate into the strategic plan, actions to align actual behavior with preferred behaviors.*

2.2.4 Goals and Objectives

Goals denote what an organization hopes to accomplish in a future period of time. They represent a future state or an outcome of the effort put in now. A broad category of financial and non-financial issues are addressed by the goals that a firm sets for itself.

Objectives are the ends that state specifically how the goals shall be achieved. They are concrete and specific in contrast to goals which are generalized. In this manner, objectives make the goals operational. While goals may be qualitative, objectives tend to be mainly quantitative in specification. In this way they are measurable and comparable.

In strategic management literature there has been confusion with regard to the usage of these terms: goals and objectives. The meaning assigned to these terms is sometimes in contrast to what we have adopted here. Also, often they are used inter changeably. (In fact, the first edition of this book used these terms in a sense opposite to what we are using now. We stand corrected. There is overwhelming evidence available now, as inferred from recent strategic management literature, that goals connote the boarder sense of the term objectives.) Still we would prefer to use only the term objective to denote both. After all, it must be remembered that objectives. Are the manifestations of goals, whether qualified and specifically stated or not. Besides, it is more convenient to use one term rather than both every time one refers to a future state or the outcome of an effort.

Any organization shall always have a potential set of goals. It has to exercise a choice from among these goals. This choice must be further elaborated and expressed in terms of operational and measurable objectives.

Role of Objectives

Objectives play an important role in strategic management. We could identify the various facets of such a role as shown below.

- Objectives define the organization’s relationship with its environment. By stating its objectives, an organization commits itself to what it has to achieve for its employees, customers and society at large.

- Objectives help an organization to pursue its vision and mission. By defining the long-term position that an organization wishes to attain and the short-term targets to be achieved, objectives help an organization in pursuing its vision and mission.
- Objectives provide the basis for strategic decision-making. By directing the attention of strategists to those areas where strategic decisions need to be taken, objectives lead to desirable standards of behavior and, in this manner, help to coordinate strategic decision-making.
- Objectives provide the standards for performance appraisal. By stating the targets to be achieved in a given time period and the measures to be adopted to achieve them, objectives lay down the standards against which organizational as well as individual performance could be judged. In the absence of objectives, an organization would have no clear and definite basis for evaluating its performance.

Managers who set objectives for themselves and their organizations are most likely to achieve them tan those who do not specify their performance targets. The importance of the role that objectives play in strategic management could be aptly summed up in the truism: if one does not know where one has to go, any path will take one there.

Characteristics of Objectives

Objectives, as measures of organizational behavior and performance, should possess certain desirable characteristics in order to be effective. Given below are seven such characteristics.

1. *Objectives should be understandable.* Because objectives play an important role in strategic management and are put to use in a variety of ways, they should be understandable to those who have to achieve them. A chief executive who says that 'something ought to be done to set things right' is not likely to be understood by his managers. Subsequently, no action will be taken, ort even a wrong action might be taken.
2. *Objectives should be concrete and specific.* To say that 'our company plans to achieve a 12per cent increase its sales'. The first statement implies a concrete and specific objective and is more likely to lead and motivate the managers.

3. *Objectives should be related to a time frame.* If the first statement given above is restated as 'our company plans to increase its sales by 12 percent by the end of two years', it enhances the specificity of the objective. If objectives are related to a time frame, then managers know the duration within which they have to be achieved.
4. *Objectives should be measurable and controllable.* Many organizations perceive themselves as companies which are attractive to work for. If measures like the number and quality of job applications received, average emoluments offered, or staff turnover per year could be devised, it would be possible to measure and control the achievement of this objective with respect to comparable companies in a particular industry, and in general.
5. *Objectives should be challenging.* Objectives that are too high or too low are both demotivating and, therefore, should be set at challenging but unrealistic levels. To set a high sales targets in a declining market does not lead to success. Conversely a low sales target in a burgeoning market is easily achievable and, therefore, leads to a suboptimal performance.
6. *Different objectives should correlate with each other.* Organizations set many objectives in different areas. If objectives are set in one area disregarding the other areas such an action is likely to lead to problems. A classic dilemma in organizations, and a source of interdepartmental conflicts, is setting sales and production objectives. Marketing departments typically insist on a wider variety of products to cater to a variety of market segments while production departments generally prefer to have greater product uniformity in order to have economies of sale. Obviously, trade-offs are required to be made so that different objectives correlate with each other, are mutually supportive, and result in synergistic advantages. This is especially true for organizations which are organized on a profit-centre basis.
7. *Objectives should be set within constraints.* There are many constraints internal as well as external which have to be considered in objective-setting. For example, resource availability is an internal constraint which affects objective-setting. Different objectives compete for scarce resources and trade-offs are necessary for

optimum resource utilization. Organizations face many external constraints like legal requirements, consumer activism and environmental protection. All these limit the organization's ability to set and achieve objectives.

In sum, objective-setting is a complex process. We will further examine a few issues relevant to objectives, in order to understand this complex process.

Goal

"By increasing its production sales quantitatively and qualitatively, to be profitable, with fair price and to make sure the existence of the enterprise in the market"

Objectives

- "to produce and sell Detergent Soaps such as powder, Bar and Liquid
- To erect suffocation plant and produce raw material for soap production
- To produce and sell caster oil and other types of vegetable oil.
- To use the full capacity of the enterprise in order to increase production.
- To increase sales capacity and sales all produced products.
- To improve management and employee performance
- To generate workable environment in the organization
- To decrease the operating cost of the enterprise from 5% to 3%.
- To increase the income of the enterprise from 6.7% to 12.5%, because there is tangible decrement on the cost of imported raw material when we compare it from previous plan period.
- To provide training for personnel
- To engage generally any other business conductive to the attachment of purposes.

Issues in Objective-setting

There are many issues which have a bearing on different aspects of objective-setting. Here we shall deal with six such issues.

1. ***Specificity.*** Objectives may be stated at different levels of specificity. At one extreme, they might be very broadly stated as *goals* while at the other they might be specifically stated as *targets.*

Many organizations state corporate as well as general, specific, functional, and operational objectives. Note that specificity is related to the organizational levels for which a set of objectives has been stated. Indian Airlines stated corporate, general, as well as, particular objectives. One of its corporate objectives was to provide safe, economic, and reliable air transportation. One of its particular objectives, in the financial area, was to generate a specific amount of resources every year not only for meeting existing requirements but also to provide for growth. The issue of specificity is resolved through stating objectives at different levels, and prefixing terms, such as, corporate, general and particular so that they serve the needs for performance and its evaluation.

2. ***Multiplicity***. Since objectives deal with a number of performance areas, a variety of them have to be formulated to cover all aspects of the functioning of an organization. No organization operates on the basis of a single or a few objectives. The issue of multiplicity deals with different types of objectives with respect to organizational levels (e.g. higher or lower levels), importance (e.g. primary or secondary), ends (e.g. survival or growth), functions (e.g. marketing or finance), and nature (e.g. organizational pr personal). Another issue, related to multiplicity, is the number and type of objectives to be set. Too few or too many objectives are both unrealistic. Organizations need to set adequate and appropriate objectives so as to cover all the major performance areas.
3. ***Periodicity***. Objectives are formulated for different time periods. It is possible to set long-term, medium-term and short-term objectives. Generally, organizations determine objectives for the long and short-term. Whenever this is done, objectives for different time periods have to be integrated with each other. Long-term objectives are, by nature, less certain, and are therefore stated in general terms. Short-term objectives, on the other hand, are relatively more certain, specific, and comprehensive. One long-term objective may result in several short-term objectives; many short-term objectives converge to form a long-term objective. For example, a long-term objective may be continual profitability. Short-term objectives which support continual profitability may be the return on

investment, profit margin, return on net worth, and so on, computed on a yearly basis.

4. ***Verifiability.*** Each objective has to be tested on the basis of its verifiability. In other words, it should be possible for a manager to state the basis on which to decide whether an objective has been met or not. Only verifiable objectives can be meaningfully used in strategic management. Related to verifiability is the question of quantification. A definite way to measure any objective is to quantify it. But it may be neither possible nor desirable to quantify each and every objective. In such cases, qualitative objectives have to be set. These objectives could also be verified but not to the degree of accuracy possible for quantitative objectives. For example, a qualitative objective may be stated as to create a congenial working environment within the factory. In order to make such an objective verifiable, the value judgment of informed expects both insiders and outsiders could be used. A few quantitative measures could also be devised which can serve as indicators of a congenial working environment. Some of these could be staff turnover, absenteeism, accident rates, productivity figures, and so forth. In sum, it can be said that the issue of verifiability could be resolved through a judicious use of a combination of quantitative and qualitative objectives.
5. ***Reality.*** It is a common observation that organizations tend to have two sets of objectives official and operative. Official objectives are those which organizations profess to attain while operative objectives are those which they seek to attain in reality. Probably no one would be in a better position to appreciate the difference between these two objectives than a harried client of a public sector bank who, on being maltreated by an arrogant bank employee, looks up to find a poster of a smiling and beautiful girl with folder hands looking down at him. The poster carries the caption: 'Customer service with a smile'! Many organizations state one of their official objectives as the development of human resource. But whether it is also an operative objective depends on the amount of resources allocated to human resource development.

6. ***Quality.*** Objectives may be both good and bad. The quality of an objective can be judged on the basis of its capability to provide a specific direction and a tangible basis for evaluating performance. An example of a bad objective is: 'To be the market leader in our industry'. It is insufficient with respect to its measurability. To restate the same objective as: 'To increase market share to a minimum of 40 percent of the total with respect to Product A over the period of the next two years and to maintain its thereafter' turns it into a good objective since it is specific, relates to performance, is measurable, and provides a definite direction.

Decapitating what we have said in this and the previous subsection, it can be stated that objectives have a number of characteristics and a variety of issues are involved in setting those. The determination of objectives is, therefore, a complex task. Further, two important questions need to be asked: what objectives are to be chosen for achievement and how are they to be determined. We attempt to answer the first question in the following subsection and the second in the next.

How are Objectives Formulated?

From the foregoing discussion, it is clear that organizations need to set objectives at different levels, of various types and for different time periods, and that such objectives should possess certain desirable characteristics and should resolve certain issues before being used. The question that we now face is: how are objectives formulated? For an answer, we shall consider the factors that have to be taken into account for the formulation of objectives.

Glueck identified four factors that should be considered for *objective-setting*. These factors are: the forces in the environment, realities of an enterprise's resources and internal power relationships, the value system of top executive, and awareness by management of the past objectives of the firm. Here is a description of each of these factors.

1. ***The forces in the environment***. These take into account al the interests some times concluding but often conflicting of the different stakeholders in an

organization. Each group of stakeholders, whether they are company employees, customers, or the government, put forward a set of claims or has expectations that have to be considered in setting objectives. It is important to note that the interests of various stakeholders may change from time to time, necessitating a corresponding shift in the importance attached to different objectives.

2. ***Realities of enterprise's resources and internal power relationships***. This means that objectives are dependent on the resource capability of a company as well as the relative decisional power that different groups of strategists wield with respect to each other in sharing those resources. Resources, both material and human, place restrictions on the objective-achieving capability of the organization and these have to be considered in order to set realistic objectives. Internal power relationships have an impact on objectives in different ways. A dominant group of strategists, such as, the board of directors, or an individual strategist, such as, a chief executive, may wield considerable power to set objectives in consonance with their respective views. Again, since power configurations within a firm are continually changing, the relative importance attached to different objectives may also vary over a period of time.
3. ***The value system of the top executive***. This has an impact on the corporate philosophy that organizations adopt with regard to strategic management in general and objectives in particular. Values, as an enduring set of beliefs, shape perceptions about what is good or bad, desirable or undesirable. This applies to the choice of objectives too. For example, entrepreneurial values may result in prominence being given to profit objectives while a philanthropic attitude and values of social responsibility may lead to the setting of socially-oriented objectives.
4. ***Awareness by management***. Awareness of the past objectives and development of a firm leads to a choice of objectives that had been emphasized in the past due to different reasons. For instance, a dominant chief executive lays down a set of objectives and the organization continues to follow it, or deviates marginally from it in the future. This happens because organizations do not depart radically from

the paths that they had been following in the recent past. Whatever changes occur in their choice of objectives take place incrementally in an adaptive manner.

Keeping in view the four factors described above, we observe that objective-setting is a complex task which is based on consensus-building and has no precise beginning or end. Vision and mission provide a ‘common thread’ to bind together the different aspects of the objective-setting process by providing a specific direction along which an organization can move.

There is enough practical evidence to suggest that strategists do not, in reality, follow a well-balanced, integrated, and comprehensive approach to objective-setting. In fact, they might start with asking the question: what do we have to achieve in order to be successful in our business? The next subsection takes up this question for discussion.

DISCUSSION QUESTIONS

1. Evaluate the following three mission statements based Mission statement evaluation criteria

I. American Home Products

American Home Products Corporation makes a significant contribution to health care worldwide as a leader in researching, developing, manufacturing and marketing products that meet important health needs.Our prescription drugs, nutritional, over-the-counter medications, and medical devices, supplies and instrumentation benefit millions of people. We also produce and market well-known quality food brands in the United States and Canada.

We are focused on improving health care by finding and commercializing innovative, cost-effective therapies and technologies. Key to our efforts are efficient manufacturing, global distribution and marketing, and strict financial controls.

In 1992, American Home Products Corporation achieved record sales and earnings, and the company increased its dividend for the 41st consecutive year.

II. Apple Computer

It is apple's mission to help transform the way customers work, learn and communicated by providing exceptional personal computing products and innovative customer services.

Apple will make a difference: our products, services and insights will help people around the world shape the ways business and education wil be done in the 21st century.

III. BellSouth Corporation

BellSouth Corporation provides information services in local exchange and exchange access markets in its nine-state franchised territory. It also provides communications and computer systems through its entities, in both the nine-state region and other major U.S. and international markets.

2. Briefly discuss types of direct and indirect stakeholders and how they relate to the organization with examples?
3. Discuss how stakeholders mapping or power interest matrix is conducted?
4. What benefit do organization acquires for having a vision statement and the reason for formulating a vision statement?
5. Discuss the importance of a clear mission statement to firms.
6. Briefly explain the nature of mission statement:
    a. A Declaration of attitude
    b. A resolution of divergent view
    c. A customer orientation
    d. A declaration of social policy
7. What are the components of mission statement? Explain each using examples.
8. What is the difference between vision and mission statement?
9. Briefly discuss characteristics of objectives and the issues in setting objectives
10. Choose an industry with a clear leader, and then examine the differences between the leader and one or two of the other competitors in the industry. How do the strategies differ? What has the leader done differently? Or what different things has the leader done?

CHAPTER THREE

EXTERNAL ENVIRONMENTAL ANALYSIS

Learning Objectives

- *Understand the concept of environment as a whole*
- *Understand the concept of competitive advantage and its importance*
- *Be familiar with Michael Porter's Five-Forces Model of competition*
- *Know the benefits and limitations of each of the basic forms of competitive advantages*
- *Understand the effect of competition on business*
- *Assess the forces of competition*
- *Examine the dimensions of competitive strategies*
- *Learn how to cope up with a competitive environment.*

3.1 Why Environmental analyses?

Strategic managers need to analyze the environment, since environmental factors are primary influencers of strategy. Environmental analysis gives the strategic manager time to anticipate opportunities and to plan alternative responses to those opportunities. It also helps them to develop an early warning system either to prevent threats or develop strategies which may turn a threat to the organization's advantage.

One could make a wrong/ inadequate environmental scanning or over estimate his capacity. Again, if there are two people crossing together, coordination between the two become necessary as in absence of proper coordination one or both of them may get stuck.

Similarly organizations also have carry out detailed environmental scanning before planning for their operation. As an organization, we have to reach some specific goal and we have also certain capacity. SWOT analysis; therefore, becomes necessary in the planning process. And when there are a number of people working in the organization, suitable level of coordination and understanding are also equally important.

Apart from knowing the environment itself, the behavior of the environment has also to be understood as the response pattern depend upon behavioral situations.

Depending up on the behavior, reactions or responses from the organization could be as under:

a) Reactive, i.e., to respond after something has happened.
b) Inactive, i.e., no response at all
c) Preactive, i.e., to predict and prepare
d) Proactive, i.e., to influence the decision and plan accordingly.

The primary responsibility for environmental analysis rests with the top management. If the firm is a multi-business firm, the responsibility is also shared by the heads of the strategic business units. Research staff usually helps and advise top management.

The environment of any organization is “the aggregate of all conditions, events and influences that surround and affect it”. Since the environment influences an organization in multitudinous ways, it is of crucial importance to understand it. The concept of environment can be understood by looking at some of its characteristics.

Environment exhibits many characteristics. Some of the important, and obvious, characteristics are briefly described here.

1. *Environment is* ***complex.*** The environment consists of a number of factors, events, conditions, and influences arising from different sources. All these do not exist in isolation but interact with each other to create entirely new sets of influences. It is difficult to comprehend at once what factors constitute a given environment. All in all, environment is a complex phenomenon relatively easier to understand in parts but difficult to grasp in its totality.
2. *Environment is* ***dynamic.*** The environment is constantly changing in nature. Due to the many and varied influence operating, there is dynamism in the environment, causing it to change its shape and character continuously.
3. *Environment is* ***multifaceted.*** What shape and character an environment will assume depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers.

4. *Environment has* ***a far-reaching impact.*** The growth and profitability of an organization depends critically on the environment in which it exists.

Environmental Scanning

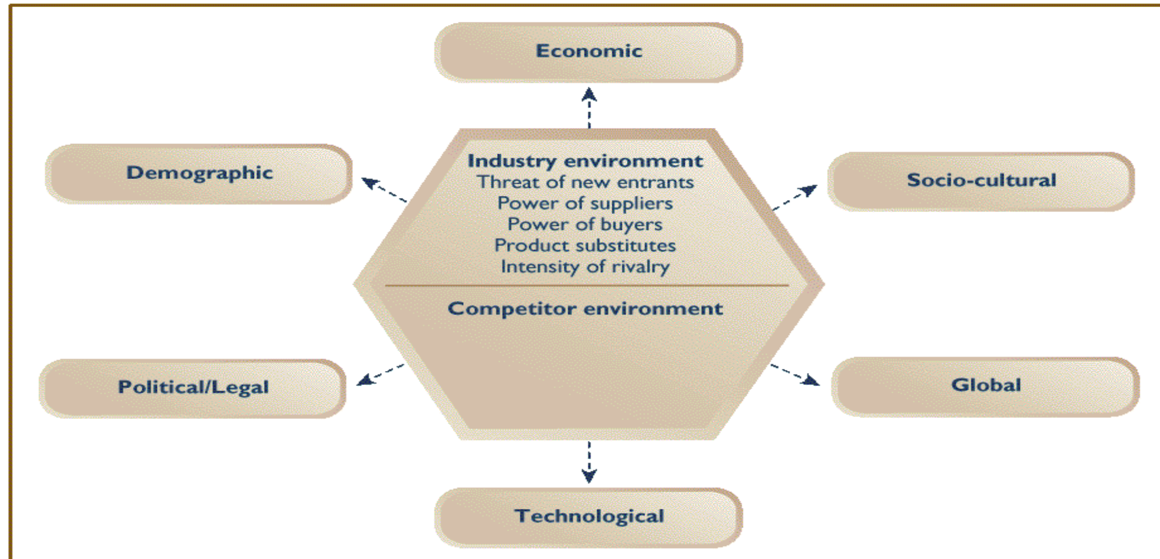
In the two preceding sections, we have seen how organizations can comprehend the environment in which they exist, identify their environment, and classify it into different sectors. In this section, we turn to the methods and techniques employed by the organizations to monitor their environment and to gather data to derive information about the opportunities and threats that affect their business. The process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business is known as environmental scanning.

The external environment in which an organization exists consists of a bewildering variety of factors. These factors (may also be termed as influences) are events, trends, issues, and expectations of different interested groups. These factors are explained below:

- ***Events*** are important and specific occurrences taking place in different environmental sectors.
- ***Trends*** are the general tendencies or the courses of action along which events take place.
- ***Issues*** are the current concerns that arise in response to events and trends
- ***Expectations*** are the demands made by interested groups in the light of their concern for issues

3.2 Types of environment

Environment can be classified as *internal* i.e. within the organization and *external* environment in general. General environment can be viewed from different dimension like political and legal, economic, socio-cultural, and technological (PEST). The environmental analysis includes the study of all there dimensions and their interplay as well as its impact.



Analytical Tools of Environmental Analysis

Scanning

- Identifying early signals of environmental changes and trends
- During scanning, the firm often deal with ambiguous, incomplete, or unconnected data & information
- Scanning techniques that are used for volatile environment is inappropriate for a firm in a stable environment

Monitoring

- Detecting meaning through ongoing observations of environmental changes & trends among those spotted by scanning
- By monitoring trends, firms can be prepared to introduce goods & services at the appropriate time to take advantage of the opportunities these trends provide
- Scanning & monitoring are important when a firm competes in an industry with high technological uncertainty
- Scanning & monitoring can provide the firm with information & serve as a means of importing new knowledge about markets & how to successfully commercialize new technologies

Forecasting

- Developing projections of anticipated outcomes based on monitored changes & trends
- When forecasting, analysts develop:
- feasible projections of what might happen & how quickly, as a result of the changes & trends detected through scanning & monitoring

Assessing

- Determining the timing & importance of environmental changes & trends for firms' strategies & their management
- The intent of assessment is to specify implications for the organization
- Without assessment, the firm is left with data that may be interesting but are of unknown competitive relevance

3.2 EXTERNAL ENVIRONMENT ANALYSIS

The external environmental analysis consists of:

- The general environment
- The industry environment
- The competitor analysis

3.2.1 General/ Macro-External Environment

The general environment can be viewed from different angles. Some of these are political and legal, economic, socio-cultural, and technological environments (PEST). Let us, now discuss each of these environments in some detail.

Political and Legal/ Regulatory Environment

This can also be called as political environment. Presently, the central, state and local governments of many countries are increasing affecting the operations of almost all business. The governments may legislate on matters like wage and price control, safety and health at work, location of the plants, waste treatment, etc. Government policies about its relationship with business can change over time. With the change in government, the policies of the firms and the complexion of threats and opportunities

may also change. Hence, a strategy manager should also examine the legal and regulatory environment.

Some **Political**, **Governmental**, & **Legal** Variables

- Tax laws
- Environmental protection laws
- Level of government subsidies
- Antitrust legislation
- Terrorist activities
- Import/Export regulations
- Fiscal and monetary policies
- Lobbying activities
- Size of Government budget
- Local, state and national elections

Economic environment

These are a variety of economic factors which affect demand and supply for products and services and their prices. The state of the economy at present and in the future does affect the fortunes and strategies of the firm. The specific factors that a firm would be interested to analyze are the stage of the business cycle, inflationary or deflationary situation, monetary policies, fiscal policies, balance of payments, structure of the economy can help or hinder the achievement of a firm's objectives and load to success or failure of the strategy. For example, recession generally leads to unemployment which would ultimately result in reduction of sales. If the interest rates are increased, then the funds needed for investment may become costly. Corporate tax policies can encourage some firms for expansion, diversification, modernization, etc.

Key **Economic** Variables

- Availability of credit
- Level of disposable income
- Interest rates
- Inflation rates
- Federal Government budget deficits
- Unemployment trends
- Consumption patterns
- Value of the dollar in world markets
- Stock market trends
- Import/Export factors
- Demand shifts
- Price fluctuations
- Fiscal policies
- Tax rates
- European Economic Community (EEC) policies

- Organisation of Petroleum Exporting Countries (OPEC) policies

Social environment

The values and attitudes of people affect strategy. The following examples would illustrate the importance of social factors:

a. The Indonesian family planning program recognized early that an important environment barrier was the socio-cultural attitudes of people towards fertility control. The religious leaders opposed the program.

b. For years most married stayed home. Now, most of them are working. That has caused a problem to those firms which sell their goods from door to door. But it has also increased the business to restaurants, crèches, cooked foods, readymade spices. Etc.

c. In nuclear power plants, because of presence a radioactive elements, guidelines and procedures for decommissioning are stipulated, much in advance of actual decommissioning, resulting in national and international criteria for radiation protection, transport and waste disposal and environmental safety during various stages of decommissioning. Since 1980, more than 65 reactors have been decommissioned the world over, and the accumulated experience is shared by all the member countries of the international Atomic Energy Agency (IAEA).

Key **Social**, **Cultural**, **Demographic** & **Environmental** Variables

- Childbearing rates
- Number of births/ deaths
- Immigration and immigration rates
- Lifestyles
- Attitudes towards business
- Trust in Government
- Average level of Education
- Attitudes towards leisure time
- Pollution control
- Population changes
- Regional changes in tastes and preferences
- Waste management
- Recycling
- Air pollution

Technology Environment

Strategic managers also search for new and better technology that would increase the sales, reduce costs and improve the quality of product. Changing technology can offer major opportunities for improvement and can eliminate major threats. A few examples of products which came in to limelight because of technological developments are; word processors and electronic typewriters in place of manual and electric typewriters, fuel efficient two wheelers like Hero Hondas, kinetic Honda, etc.

Technological advancement affects the product life cycle also. Decrease in product life cycle may result in to increased profits. Technological change may also affect distribution methods, quality and type of raw materials, and the skills of the workforce. Whether technological change comes fast or slow is a function of the creativity of people and entrepreneurs, receptivity of the industry, and availability of finance for R&D activity and global change.

Natural environment

Natural environment also affects strategies. Positive climatic conditions may favor some firms. To support this we give the example. The chairman stated. “Monsoon has also been kind and the excellent rains will give a boost to agricultural production and consequently to the sale of fertilizers. The company chairman further stated: our company is also considering setting up a foundation for environmental research, education information and eco-regeneration.” All this is being done with a view to prepare the company to face the future environmental laws and the emerging needs.

3.2.2 Micro-Environment/Industry analysis

Analysis of the industry environment is focused on the factors & conditions influencing the firm’s profitability in the industry.

An industry is a group of firms producing products that are close substitutes Firms that influence one another including a rich mix of competitive strategies that companies use in pursuing strategic competitiveness & above-average returns.

Compared to the general environment, the industry environment has a more direct effect on the firm’s strategic competitiveness and above-average returns

Porter of the Harvard Business School has convincingly demonstrated. The state of competition in an industry is a composite of five competitive forces:

1. The rivalry among competing sellers in the industry
2. the potential entry of new competitors
3. The market attempts of companies in other industries to win customers over to their own substitute products.
4. The competitive pressures stemming from supplier-seller collaboration and bargaining.
5. The competitive pressures stemming from seller-buyer collaboration and bargaining.

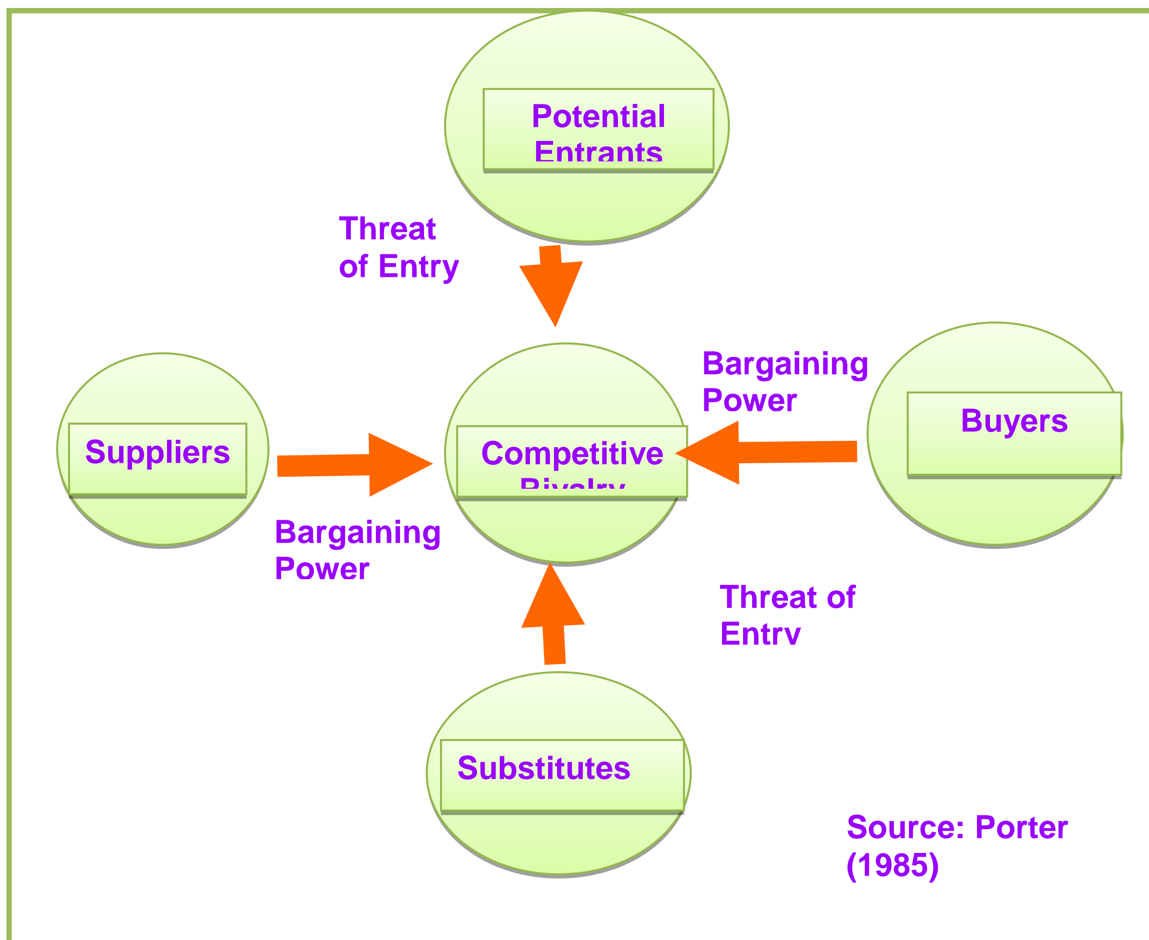


Figure 3.1 Porter’s five force model

1. The Rivalry among Competing Sellers

Is the strongest of the five competitive forces is usually the jockeying for position and buyer favor that goes on among rival sellers of a product or service. In some industries, cross company rivalry is centered on price competition competing to offer buyers the best (lowest) price is typical among internet retailers and the sellers of such standard commodities as nails, plywood, sugar, printer paper, and gasoline. Occasionally, price competition can be so livery that market prices temporarily fall below unit costs, forcing losses on some or most rivals. In other industries, price competition is minimal to moderate and rivalry is focused on one or more of the following offering buyers the most attractive combination of performance features (as occurs in digital cameras), being first to market with innovative products, out competing rivals with higher quality or more durable products, offering buyers longer warranties (as in motor vehicles and replacement tires) providing superior after the sale service or creating a stronger brand image (as) in beer, cigarettes, bottled water electronic brokerage, and quick service restaurants).

Competitive jockeying among cross- company rivals can heat up when a competitor sees an opportunity to better please customers or is under pressure to improve its market share or profitability. The intensity of rivalry among competing sellers is function of how vigorously they employ such tactics as lower prices, snazzier features, expanded customer services, longer warranties special promotions and new product introduction. Rivalry can range from friendly to cutthroat, depending on how frequently and how aggressively companies undertake fresh moves that threaten rivals profitability. Ordinarily, industry rivals are clever at adding new wrinkles to their product offerings that enhance buyer appeal, and they persist in trying to exploit weak nesses in each other's market approaches.

Irrespective of whether rivalry is lukewarm or heated, every company is challenged to craft a successful strategy for competing ideally, one that produces a competitive edge over rivals and strengthens its position with buyers. The big complication in most industries is that the success of any one firm's strategy hinges on what strategies its rivals employ and the resources rivals are willing and able to put behind their strategic efforts. The "best" strategy for one firm depends, in other words, on the competitive capabilities and strategies of rival companies. Such

interdependence means that whenever one firm makes a strategic move, its rivals often retaliate with offensive or defensive countermoves.

This pattern of action and reaction makes competitive rivalry a "war- games" type of contest conducted in a market setting according to the rules of fair competition. In deed , from a strategy making perspective, competitive markets are economic battle fields, with the intensity of cross company rivalry ebbing and flowing a s competitors initiate fresh offensive and defensive maneuvers and as they endeavor to catch buyers' attention with first one mix of weapons (price, performance feature- customer service and other appealing attributes) and then another. Cross-company rivalry is thus dynamic. The current competitive scene is ever- changing as companies act and react, sometimes in rapid- fire order and sometimes methodically, to out compete one another and build customer loyalty.

Regardless of the industry, several common factors seem to influence the tempo of cross company rivalry.

- ✓ ***Rivalry intensifies as the number of competitors increase and as competitors become more equal in size and capability:*** Competition is not as strong in PC operating systems, where Linux is one of the few challengers to Microsoft, as it is in fast foods and restaurants, where buyers have many choices. Up to a point, the greater the number of competitors, the greater the probability of fresh creative strategic initiatives. In addition, when rival are nearly equal in size and capability they can usually compete on fairly even footing making it harder for one or two firms to win the competitive battle and dominate the market.
- ✓ ***Rivalry is usually stronger when demand for the product is growing slowly.*** In a rapidly expanding market, there lends to be enough business for everybody to grow indeed, it may take all of the firm's financial and managerial resources just to keep abreast of the growth in buyer demand, let alone steal rivals' customers. But when growth slows or when market demand drops unexpectedly, expansion minded firms and / or firms with excess capacity often cut prices and deploy other sales increasing tactics, there by igniting a battle for market share that can result in a shake- out of the weak and less efficient firms. The industry then consolidates in to a smaller, but individually stronger number or sellers.

- ✓ ***Rivalry is more intense when industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit volume.*** When a product is perishable, seasonal or costly to hold in inventory, or when demand slacks off competitive pressures build quickly and time one or more firms decide to cut prices and dump excess supplies on the market. Likewise, whenever fixed costs account for a large fraction of total cost such that unit costs tend to be lowest at or near full capacity then firms come under significant pressure to cost prices or otherwise try to boost sales. Unused capacity imposes a significant cost increasing penalty because there are fewer units carrying the fixed cost burden. In such cases, if market demand weakens or capacity utilization for some reason falls off, the pressure of rising unit costs can push rival firms in to secret price concessions, special discounts, rebates, and other sales increasing tactics, thus heightening competition.
- ✓ ***Rivalry is stronger when customers' costs to switch brands are low.*** The lower the costs of switching the easier it is for a rival seller to raid another seller's customers. High buyer switching costs; however, give sellers a more protected customer base and work against the efforts of rivals to promote brand switching among buyers.
- ✓ ***Rivalry stronger when one or more competitors are dissatisfied with their market position and launch moves to bolster their standing at the expense of rivals.*** Firms that are losing ground or in financial trouble often react aggressively by acquiring smaller rivals, introducing new products, boosting advertising discounting prices, and so on. Such actions heighten cross company rivalry and can trigger a hotly contested battle for market share.
- ✓ ***Rivalry increases in proportion to the size of the payoff from a successful strategic move.*** The greater the benefits of going after a new opportunity, the more likely that one or more rivals will initiate moves to capture it. Competitive pressures nearly always intensify when several rivals start pursuing the same opportunity. Buy.com. Furthermore, the size of the strategic payoff can vary with the speed or retaliation. When competitors respond slowly (or not at all), the initiator of a fresh competitive stratagem that is not easily surmounted. The greater the benefits of moving first, the more likely some competitor will accept the risk and try it.

- ✓ ***Rivalry tends to be more vigorous when it costs more to get out of a business than to stay in and compete.*** The higher the exit barriers (and thus the more costly it is to abandon a market), the stronger the incentive for existing rivals to remain and compete as best they can, even though they may be carning low profits or even incurring losses.
- ✓ ***Rivalry becomes more volatile and impredic table the more diverse competitors are in terms of their visions, strategic intents, objectives, strategic resources, and countries of origin.*** A diverse group of sellers often contain one or more mavericks willing to rock the boat with unconventional moves and "rule breaking" market approaches, thus generating a livelier and less prodicable competitive environment. Globally competitive markets often contain rivals with different views about where the industry is headed and a willingness to employ perhaps radically different competitive approaches. Attempts by cross border rivals to gain stronger footholds in each other's domestic markets usually boost the intensity or rivalry, especially when the aggressors have lower costs or products with more attractive, especially when the aggressors have lower costs or products with more attractive features. For instance, Motorola has recently faced vigorous competition in cell phones from Europe- based Nokia and Erickson, largely because, unlike Motorola, they moved aggressively to make their cell phones work on both analog and digital wireless systems.
- ✓ ***Rivalry increases when strong companies outside the industry acquire weak firms in the industry and launch aggressive, well-funded moves to transform their newly acquired competitors into major market contenders.*** A concerted effort to turn a weak rival into a market leader nearly always entails launching well-financed strategic initiatives to dramatically improve the competitor's product offering, eccite buyer interest, and win a much bigger market share actions that, if successful, put added pressure on rivals to counter with fresh stregic moves of their own.

Two facts of rivalry need to be underscored. First, a powerful, successful competitive strategy employed by one rival greatly intensifies the competitive pressure on other rivals. Second, the frequency and vigor with which rivals use any and all competitive pressures associated with rivalry are cutthroat, fierce, strong, moderate, or weak, rivalry can be characterized as cutthroat or brutal when competitors engage in protracted to profitability. Rivalry can be considered fierce

to strong when competitors are initiating frequent moves and countermoves in a battle for market share so vigorous that profit margins are being squeezed. Rivalry can be characterized as moderate when sellers are active in using the various weapons of competition at their command yet are still usually able to earn acceptable profits. Rivalry is weak when most companies in the industry are relatively well satisfied with their sales growth and market shares, rarely weaken concerted attempts to steal customers away from one another, and have comparatively attractive earnings and returns on investment.

2. The Potential Entry of New Competitors

New entrants to market bring new production capacity, the desire to establish a secure place in the market, and some times substantial resources with which to compete. Just how serious the competitive threat of entry is in a particular market depends on two classes of factors; barriers to entry and the expected reaction of incumbent firms to new entry. A barrier to entry exists whenever it is hard for a new comer to break in to the market or economic factors put a potential entrant at a disadvantage relative to its competitors.

There are several types of entry barriers.

- ✓ **Economies of scale**- scale economies deter entry because they force potential competitors either to enter on large scale (a costly and perhaps risky move) or to accept a cost disadvantage and consequently lower profitability. Trying to over come the disadvantages of small size by entering on a large scale at the outset can result in long- term overcapacity problems for the new entrant (until sales volume builds up) and it can so threaten the market shares of existing firms that they retaliate aggressively (with price cuts, increased advertising and sales promotion, and similar blocking actions) to maintain their positions, Either way, a potential entrant is discouraged by the prospect of lower profits. Entrants may encounter scale- related barriers not just in production but in advertising, marketing and distribution, financing after – scale customer service, raw materials purchasing and R&D as well.
- ✓ **Cost and resource disadvantages independent of size**- Existing firms may have cost and resources advantages not available to potential entrants. These advantages can include partnerships with the best and cheapest suppliers of raw materials and components,

possession of patents and proprietary technology, existing plants built and equipped years earlier at lower costs, favorable locations, and lower borrowing costs.

- ✓ **Learning and experience curve effects**- when lower unit costs are partly of mostly a result of experience in producing the product and other learning curve benefits, new entrants face a potentially significant cost disadvantage competing against existing firms with more accumulated know how.
- ✓ **Inability to match the technology and specialized know how of firms already in the industry-** Successful entry may require technological capability not readily available to a newcomer or skills and know- how not easily learned by a newcomer. Key patents can effectively bar entry, as can lack of technically skilled personnel and an inability to execute complicated manufacturing techniques. Existing firms often carefully guard the know- how that gives them an edge in technology and man factoring capability. Unless new entrants can gain access to such proprietary knowledge, they can not compete on a level playing field.
- ✓ **Brand preferences and customer and customer loyalty**- Buyers are often attached to established brands. Japanese consumers, for example are fiercely loyal to Japanese brands of motor vehicles, electronics products, cameras, and film. European consumers have traditionally been loyal to European brands of major household appliance. High brand loyal means that a potential entrant must commit to building a network of distributors and dealers, and then be prepared to spend enough money on advertising and sales promotion to overcome customer loyalties and build its own clientele. Establishing brand recognition and building customer loyalty can be a slow and costly process. In addition, if it is difficult or costly for a customer to switch to a new brand a new entrant must persuade buyers that its brand is worth the switching costs. To overcome the switching cost barrier, new entrants may have to offer buyers a discounted the switching cost barrier, new entrants may have to offer buyers a discounted price or an extra margin of quality or service. All this can mean lower expected profit margins for new entrants something that increases the risk to start-up companies dependent on sizable, early profits to support their new investments.-
- ✓ **Capital requirements**- The larger the total dollar investment needed to enter the market successfully, the more limited the pool of potential entrants. The most obvious capital

requirements are associated with manufacturing plants and equipment, working capital to finance inventories and customer credit, introductory advertising and sales promotion to establish a clientele, and cash reserves to cover start, up losses.

- ✓ **Access to distribution channels-** In the case of consumer goods, a potential entrant may face the barrier of gaining adequate access to consumers. Wholesale distributors may be reluctant to take on a product that lacks buyer recognition. A network of retail dealers may have to be set up from scratch. Retailers have to be convinced to give a new brand ample display space and an adequate trial period. The more existing producers tie up present distribution channels, the tougher entry will be. To overcome this barrier, potential entrants may have to "buy" distribution access by offering better margins to dealers and distributors or by giving advertising allowance and other promotional incentives. As a consequence a potential entrant's profits may be squeezed unless and until its product gains enough acceptance that distributors and retailers want to carry it.
- ✓ **Regulatory policies-** Government agencies can limit or even bar entry by requiring licenses and permits. Regulated industries like cable TV, telecommunications electric and gas utilities radio and television broadcasting, liquor retailing and railroads entail government controlled entry. In international markets, host governments commonly limit foreign entry and must approve all foreign investment applications. Stringent government mandated safety regulations and environmental pollution standards are entry barriers because they raise entry costs.
- ✓ **Tariffs and international trade restrictions**- National governments commonly use tariffs and trade restrictions (antidumping rules local content requirements, and quotas) to raise entry barriers for foreign firms and protect domestic producers from competition. In 1996, due to tariffs imposed by the South Korean government, a ford Taurus cost South Korean car buyers over $40,000. The government of India has required that 90 percent of the parts and components used in Indian truck assembly plants be made in India. And to protect European chip makers form low- cost Asian competition.

Whether an industry's entry barriers ought to be considered high or low depends on the resources and competencies possessed by the pool of potential entrants. Entry barriers can be formidable for start- up enterprises trying to compete against well- established companies. But interested

outsiders may given their resources, competencies, and brand name recognition, see the industry's entry barriers as relatively easy to hurdle. Likewise, entry barriers may be low for current industry participants that are looking to enter areas of the overall market where they do not yet have a presence. A company already will establish in one market segment or geographic area may possess the resources competencies, and competitive capabilities to hurdle the barriers of entering a different market segment or new geographic area. In evaluating the potential threat of entry, management must look at (1) how formidable the entry barriers are for each type of potential entrant start up enterprises, candidate companies in other industries and current industry participants looking to expand their market reach and net to firms outside the industry motivating potential entrants. High profits act as a magnet to firms outside the industry motivating potential entrants to commit the resources needed to hurdle entry barriers.

Even if a potential entrant has or can acquire the needed competencies and resources to attempt entry, it still faces the issue of how existing firms will react. Will incumbent firms offer only passive resistance, or will they aggressively defend their market positions using price cuts, increased advertising product improvements, and whatever else they can to give a new entrant as well as other rivals) a hard time' A potential entrant can have second thoughts when financially strong incumbent firms send clear signals that they will stoutly defend their market positions against newcomers. A potential entrant may also turn away when incumbent firms can leverage distributors and customers to retain their business.

The best test of whether potential entry is a strong or weak competitive force in the marketplace is to ask if the industry's growth and profit prospects are attractive enough to induce additional entry. When the answer is no potential entry is a weak competitive force. When the answer is yes and there are entry candidates with sufficient expertise and resources, then potential entry adds significantly to completive pressures in the marketplace. The stronger the threats of entry, the more that incumbent firms are driven to fortify their positions against newcomers, endeavoring not only to protect their market share but also to make entry more costly or difficult.

One additional point: the threat of entry changes as the industry's prospects grow brighter or dimmer and as entry barriers rise or fall. For example, the expiration of a key patent can greatly increase the threat of entry. A technological discovery can create an economy- or- scale

advantage where none existed before or, alternatively make it easier for newcomers to gain a market foothold the internet, for example, is making it much easier for new e-commerce retailers to compete against some of the strongest and best known retail chains. New actions by incumbent firms or greatly bolster their e-commerce capabilities, increase advertising, strengthen distributor- dealer relations, step up R&D or improve product quality can raise the roadblocks to entry. In international markets, entry barriers for foreign based firms fall as tariffs are lowered as host governments open up their domestic markets to outsiders as domestic wholesalers and dealers seek out lower cost foreign- made goods, and as domestic buyers become more willing to purchase foreign brands.

3. Competitive pressures from substitute products

Firms in one industry are quite often in close competition with firms in another industry because their respective products are good substitutes. The producers of eyeglasses compete with the makers of contact lenses and with eye specialists who perform laser surgery to correct vision problems. The sugar industry competes with companies that produce artificial sweeteners and high- fructose corn syrup. Cotton and wool producers are in head- on competition with the makers of polyester fabrics. Companies providing electric power are in competition with companies providing natural gas for such purposes as cooking, space heating, and water heating. Aspirin manufacturers compete against the makers of acetaminophen, ibuprofen, and other pain relievers. Newspapers are in competition with television in providing late- breaking news and with internet sources in providing sports results, stock quotes, and job opportunities, E- mail is a substitute for the overnight document delivery services of Fed Ex. Airborne Express and the U.S Postal Service Just how strong the competitive pressures are from substitute products depends on three factor: (1) whether attractively priced substitutes are available (2) whether buyers view the substitutes as being satisfactory in terms of quality performance and other relevant attributes and (3) whether buyers can switch to substitutes easily.

The presence of readily available and attractively priced substitutes creates competitive pressure by placing on the prices an industry can charge for its product with out giving customers an incentive to switch to substitutes and risking sales erosion. This price ceiling at the same time put a lid on the profits that industry members can earn unless they find w ay sot cut costs. When

substitutes are cheaper than an industry's product, industry members come under heavy competitive pressure to reduce their prices and find ways to absorb the price costs with cost reductions.

The availability of substitutes inevitably invites customers to compare quality features, performance ease of use, and other attributes as well as price. For example skill boat manufactures are experiencing strong competition form personal water skill craft because water sports enthusiasts are finding that personal water skis have exciting per for manse features that make them satisfying substitutes. The users of glass bottles and jars constantly weigh the performance trade offs with plastic containers, paper cartons, and metal cans. Competition form substitute products pushes industry participants to heighten efforts to convince customers their product has attributes that are superior to those of substitutes.

Another determinant of the strength of competition from substitutes is how difficult or costly it is for the industry's customers to switch to a substitute. Typical switching costs include extra price premiums, the costs of additional equipment, the time and costs in testing the quality and reliability of the substitute the psychic costs of severing old supplier relationship and establishing new ones, payments for technical help in making the changeover, and employee retraining costs. If switching costs are high sellers of substitutes must offer a major cost or performance benefit in order to entice the industry's customers away. When switching costs are low, it is much easier for sellers of substitutes to convince buyers to change over to their products.

As a rule then the lower the price for substitutes the higher their quality and performance, and the lower the user's switching costs, the more intense the competitive pressures posed by substitute products. Good indicators of the competitive strength of substitute products are the rate at which their sales and profits are growing the market inroads they are making and their plans for expanding production capacity.

4. Supplier bargaining power can create competitive pressures

Competitive pressures stemming from supplier bargaining power and supplier seller collaboration whether supplier seller relationships represent a weak or strong competitive force

depends on (1) whether suppliers can exercise sufficient bargaining power to influence the terms and conditions of supply in their favor and (2) the extent of supplier- seller collaboration in the industry.

How suppler bargaining power can create competitive pressures

Suppliers have little or no bargaining power or leverage over rivals whenever the items they provide are commodities available on the open market from numerous suppliers with ample capability to fill orders. In such cases it is relatively simple for rivals to obtain whatever is needed form order. In such cases, it is relatively simple for rivals to obtain whatever is needed form any of several capable suppliers perhaps dividing their purchases among two or more suppliers to promote lively competition for orders. Commodity product suppliers have market power only when supplies become quite tight and users are so anxious to secure that they need that they agree to terms more favorable to suppliers.

Suppliers are likewise relegated to a weak bargaining position whenever there are good substitutes for the item they provide and buyers find it neither costly nor difficult to switch their purchases of alternative items. For example, soft- drink bottlers can counter the bargaining power of aluminum can suppliers on price or delivery by promoting greater use of plastic containers and introducing more attractive plastic container designs.

Suppliers also tend to have less leverage to bargain over price and other terms of sale when the company they are supplying is a major customer. In such cases, the well being of suppliers is closely tied to the well- being of their major customers. Suppliers then have a big incentive to protect and enhance their customer's competitiveness via reasonable prices, exceptional quality and ongoing advances in the technology of the items supplied.

In contrast, companies may be have little bargaining power with major suppliers consider Intel's position as the world's dominant supplier of microprocessors for PCS of a PC, as much as 20 percent in the case of chips for high performance PCs. It thus matters a great deal to PC makers (and to PC buyers) whether Intel's price for its latest microprocessor chip is $ 600 or 300 and whether a chip of comparable quality and performance is available form Advanced Micro

Devices (AMD), Intel's leading rival. When suppliers provide an item that accounts for a sizable fraction of the costs of an industry's product is crucial to the industry's production process or significantly affects the quality of the industry's product suppliers have considerable influence on the competitive process. This is particularly true when a few large companies control most of the available supplies and have pricing leverage (as in microprocessors for PCs). Likewise a supplier (or group of suppliers) possesses more bargaining leverage the more difficult or costly it is for users to switch to alternate suppliers. Big suppliers with good reputation and growing demand for their output are harder to wring concessions from than struggling suppliers striving to broaden their customer base or more fully utilize their production capacity.

Suppliers are also more powerful if then they can supply a component more cheaply than industry members can make themselves. For instance most producers of outdoor power equipment (lawn mowers, rotary tiller show blowers, and so on) find it cheaper to source the small engines they need from outside manufacturers rather than make their own because the quantity they need from outside manufacturers rather than make their own because the quantity they need is too little to justify the investment master the process, and capture scale economies. Specialists in small engine manufacture , by supplying many kinds of engines to the whole power equipment industry, obtain a big enough sales volume to fully realize scale economies, become proficient in all the manufacturing techniques and keep costs well below what power equipment firms could realize making the item in – house. Small- engine suppliers, then are in a position to price the item below that it would cost the user to self-manufacture but far enough above their own costs to generate an attractive profit margin. In such situations, the bargaining position of suppliers is strong until the volume of parts a user needs becomes large enough for the user to justify backward integration in to self-manufacture of the component. Then the balance of power shifts from suppliers to users. The more credible the threat of such backward integration in to the suppliers' business becomes, the more leverage users have in negotiating favorable terms with suppliers.

Another instance in which the relationship between industry members and suppliers is a notable competitive force is when suppliers for one reason or another do not have the capability or the incentive to provide items of high or consistent quality. For example, if a manufacturer's

suppliers provide components that have a relatively high defect rate or that fail prematurely, they can so increase the warranty and defective goods costs of the manufacturer that its profits, reputation, and competitive position are seriously impaired.

How collaborative partnerships between sellers and suppliers can create competitive pressures. In more and more industries rival sellers are electing to form long- term strategic partnerships and close working relationships with select suppliers in order to 91) promote just in time deliveries and reduced inventory and logistics costs 92) speed the availability of next generation components (3) enhance the quality of the parts and components begin supplied and reduce defect rates and (4) reduce the supplier's costs and pave the way for lower prices on the items supplied. Such benefits can translate in to competitive advantage for industry members who do the best job of managing supply chain relationships and form effective collaborative partnerships with suppliers.

Dell computer has used strategic partnering with key suppliers as a major element in its strategy to be the world's low- cost supplier of branded PCs servers and work stations. Because Dell has managed its supply chain relationships in ways that contribute to a low- cost/ high quality competitive edge over rivals in components supply dell has pur enormous competitive pressure on its PC rivals to try to imitate its supply chain management practices or else run the risk of being at a serious competitive disadvantage. Effective supply chain partnerships on the part of one or more industry rivals can thus become a major source of competitive pressure for other rivals.

5. Competitive pressures stemming from buyer bargaining power

Whether seller buyer relationship represents a weak or strong competitive force depends on (on whether buyers have sufficient bargaining power to influence the terms and conditions of sale in their favor and (2) the extent and competitive importance of seller buyer strategic partnerships in the industry.

How buyer bargaining power can create competitive pressure

Just as with suppliers the leverage that buyers have in negotiating favorable terms can range from strong to weak. Buyers have substantial bargaining leverage in a number of situations. The most obvious is when buyers are large and purchase a sizable percentage of the industry's output. Typically, purchasing in large quantities gives a buyer enough leverage to obtain price concessions and other favorable terms.

Large retail chains have considerable negotiating leverage in purchasing products from manufacturers because of manufacturers' need for broad retail exposure and favorable shelf space for their products. Retailers may stock one or even several brands but rarely all available brands, so competition among rival manufacturers for the business of popular or high volume retailers gives such retailers significant bargaining leverage. In the united states and Britain super market chains have sufficient leverage to require food products manufactures to make lump sum payments to gain shelf space for new products.

Motor vehicle manufacturers have significant bargaining power in negotiating to buy original equipment tires not only because they buy in large quantities but also because tire makes believe they gain an advantage in supplying replacement tires to vehicle owners if their tire brands is original equipment on the vehicle. "Prestige" buyers have a degree of clout in negotiating with sellers because a seller's reputation is enhanced by having prestige buyers on its customer list.

Even if buyers do not purchase in large quantities or offer a seller important market exposure or prestige, they may still have some degree of bargaining leverage in the following circumstances:

- ✓ If buyers' costs of switching to competing brands or substitutes are relatively low- Buyers who have the flexibility to fill their needs by switching brands or sourcing from several sellers often have negotiating room with sellers. When the products of rival sellers are virtually identical, it is relatively easy for buyers to switch from seller to seller at little or no cost and anxious sellers may be willing to make concessions to win a buyer's business. However, if the products of rival sellers are strongly differentiated, buyers may be less able to switch without incurring sizable changeover costs; an alert

seller may conclude, often correctly, that the customer is locked in to using its product and therefore may be inclined to make any substantive concession.

- ✓ If the number of buyers is small or if a customer is particularly important to a seller- The smaller the number of buyers, the less easy it is for sellers to find alternative when a customer is lost. The prospect of losing a customer not easily replaced often make a seller more willing to grant concessions of one kind or another.
- ✓ If buyers are well- informed about sellers' products, prices and costs. The more information buyers have the better bargaining position they are in. The mushrooming availability of information on the internet is giving added bargaining power to individuals. It is relatively easy for buyers to sue the internet to compare prices and features of motor vehicles, obtain mortgages and loans, and purchase big ticket items such as digital cameras. Bargain-hunting individuals can shop around for the best deal on the internet and use that information to negotiate with sellers.
- ✓ If buyers pose a credible threat of integrating backward in to the business of sellers companies like Anheuser- Busch, Coors, and Heinz have integrated backward in to metal can manufacturing to gain bargaining power in obtaining the balance of their can requirements form otherwise powerful metal can manufactures. Retailers gain bargaining power by stocking and promoting their own private label brands alongside manufacturers' name brands. Wal-Mart, for example , has elected to compete against Procter& gamble, its biggest supplier by introducing its own brand of laundry detergent called Sam's American Choice which is priced about 25 to 30 percent lower than P&G's Tide.
- ✓ If buyers have discretion in whether and when they purchase the product. If consumers are unhappy with the sticker prices of new motor vehicles, they can delay purchase or buy a used vehicle instead. If business customers are not happy with the prices or security features of electronic bill payment software systems, they can either delay purchase until next- generation products become available or at tempt to develop their own software in house. If college students believe that the prices of new textbooks are to high they can purchase used copies.

Buyers typically have weak bargaining power when they buy infrequently or in small quantities and when they face high costs to switch brands. High switching costs can keep a buyer locked in to the present brand. For example, companies that have bought Compaq or Hewlett, Packard engineering and graphics work stations that use Microsoft's windows operating systems are not strong candidates to switch to Sun Microsystems' workstation models that run on UNIX operating system. Switching from windows to UNIX entails considerable time and relearning on the part of users and can also entail having to abandon all the windows- based engineering and graphics application software that the user has accumulated over the years and replace it with soft ware applications written for a UNIX- based operating system.

A final point to keep in mind is that not all buyers of an industry's product have equal degree of bargaining power with sellers and some may be less sensitive than others to price, quality or service differences among competing sellers. For example, independent tire retailers have less bargaining power in purchasing tires than do Honda, Ford, and Daimler Chrysler (which buy in much large quantities), and they are also less quality sensitive. Motor vehicle manufacturers are very particular about tire quality and tire performance because of the effects on vehicle performance, and they drive a hard bargain with tire manufacturers on both price and quality.

How collaborative partnerships between sellers and buyers can create competitive pressures?

Partnerships between sellers and buyers are an increasingly important element of the competitive picture in business- to-business relationships as opposed to business- to- consumer relationships. Many sellers that provide items to business customers have found it in their mutual interest to collaborate closely on such matters as just-in0 time deliveries, order processing, electronic invoice payments and online sharing of sales at the cash register. Wal-Mart, for example, provides the manufacturers with whom it does business (like Procter& Gamble) with daily sales data from each of its stores so that they can replenish inventory stocks on time. Dell computer has partnered with its largest customers to create online systems for over 50,000 corporate customers, providing their employees with information on approved product configurations, global pricing, paperless purchase orders, real- time order tracking, invoicing purchasing history, and other efficiency tools. Dell also loads a customer's software at the factory and installs asset tags so that customer setup time on the PCs it orders is minimal and helps customers migrate

their PC systems to next generation hardware and software. Dell's partnership with its customers have put significant competitive pressure on other PC makers to develop packages of offerings to corporate customers that will compare favorably with compare favorably with what dell offers.

Strategic implications of the five competitive forces

The special contribution of the five-force model is the through ness with it exposes what competition is like in a given market- the strength of each of the five competitive forces, the nature of the competitive pressures comprising each force, and the overall structure of competition. As a rule, the stronger the collective impact to competitive forces the lower the combined profitability of participant firms. The most brutally competitive situation occurs when the five forces create market conditions tough enough to impose prolonged subpart profitability or even losses on most or all firms. The competitive structure of an industry is clearly" unattractive" from a profit- making standpoint if rivalry among sellers is very strong, low entry barriers are allowing new rivals to gain a market foothold, competition from substitutes is strong, and both suppliers and customers are able to exercise considerable baring leverage. These conditions are approximated in tire manufacturing and apparel, where profit margins have historically been thin.

In contrast, when competitive force is not collectively structure of the industry is "favorable" or "attractive" from the standpoint of earning superior profits. The "ideal" competitive environment is one in which both suppliers and customers are in weak bargaining positions, there are no good substitutes, enter barriers are relatively high, and revelry among present sellers is only moderate. However even when some of the five competitive forces are strong, an industry can be competitively attractive to those firms whose market position and strategy provide a good enough defense against competitive pressures to preserve their ability to earn above- average profits.

To contend successfully, managers must craft strategies that shield the firm as much as possible from the five competitive forces and that help make the rules, put added pressure on rivals, and per haps even define the business model for the industry. Managers can not expect to develop winning competitive strategies without firs identifying what competitive pressures exist, gauging

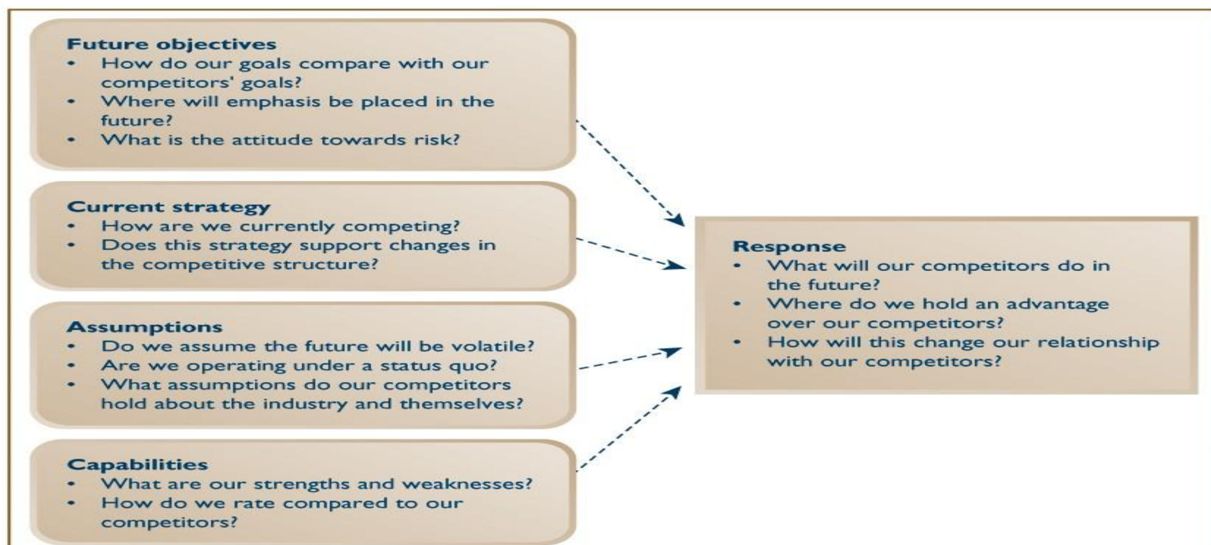
the relative strength of each, and gaining a deep understanding of the industry's whole competitive structure. The five forces model is a powerful tool for giving strategy makers the competitive insights they need to build a successful enterprise ideally one that enjoys a sustainable competitive advantage.

3.3 Competitor analysis

Analysis of competitors is focused on predicting the dynamics of competitors' actions, responses & intentions

Competitor intelligence: The ethical gathering of needed information and data that provides insight into the competitor's:

- **Future objectives**
  - What drives the competitor?
- **Current strategy**
  - What the competitor is doing and can do
- **Assumptions**
  - What the competitor believes about its own firm and the industry
- **Capabilities**
  - Competitor firm's capabilities, strengths and weaknesses



DISCUSSION QUESTIONS

1. Why is it important for any organization (firms, nonprofits, etc.) to study and understand its external environment?
2. What are the differences between the general environment and the industry environment? Why are these differences important?
3. What is the external environmental analysis process? What does the firm want to learn when using this process?
4. What are the six segments of the general environment? Explain the differences among them.
5. Discuss how a development in a corporation's natural and societal environments can affect the corporation through its task environment
6. According to Porter, what determines the level of competitive intensity in an industry?
7. According to Porter's discussion of industry analysis, is Pepsi Cola a substitute for Coca-Cola?
8. How can a decision maker identify strategic factors in a corporation's external international environment?
9. Compare and contrast trend extrapolation with the writing of scenarios as forecasting techniques.
10. How do the five competitive forces in Porter's model affect the average profitability of the industry? For example, in what way might weak forces increase industry profits, and in what way do strong forces reduce industry profits? Identify an industry in which many of the competitors seem to be having financial performance problems. Which of the five forces seems to be strongest?
11. What is a strategic group? How can studying such groups be useful in industry analysis?
12. How do mobility barriers affect the structure of an industry? How do they help us explain firm differences in performance?
13. What is the importance of collecting and interpreting data and information about competitors? What practices should a firm use to gather competitor intelligence and why?

CHAPTER FOUR

INTERNAL ENVIRONMENTAL ANALYSIS

Learning Objectives:

- *Explain the need for firms to study and understand their internal environment.*
- *Define value and discuss its importance.*
- *Describe the differences between tangible and intangible resources.*
- *Define capabilities and discuss how they are developed.*
- *Describe four criteria used to determine whether resources and capabilities are core competencies.*
- *Explain how value chain analysis is used to identify and evaluate resources and capabilities.*
- *Define outsourcing and discuss the reasons for its use.*
- *Discuss the importance of identifying internal strengths and weakness*

4.1 Introduction

Examining the external environment firm's will be able to identify *What They Might Do* by carefully analyzing opportunities and threats. Meanwhile, examining the internal environment assist firm's to determine *What They Can Do* by exploring their resources, capabilities and competencies. As a result firm's must much between *What They Might Do and What They Can Do*. Therefore, the opportunities identified could be exploited if there are resources, capabilities, & core competencies.

Analysis of the firm's internal environment finds evaluators thinking of their firm as a bundle of heterogeneous resources and capabilities that can be used to create an exclusive market position. This perspective suggests that individual firms possess at least some resources and capabilities that other companies do not—at least not in the same combination. Resources are the source of capabilities, some of which lead to the development of a firm's core competencies or its competitive advantages. Understanding how to leverage the firm's unique bundle of resources and capabilities is a key outcome decision makers seek when analyzing the internal environment.

This figure illustrates the relationships among resources, capabilities, and core competencies and shows how firms use them to create strategic competitiveness. Before examining these topics in depth, we describe value and how firms use their resources, capabilities, and core competencies to create it.

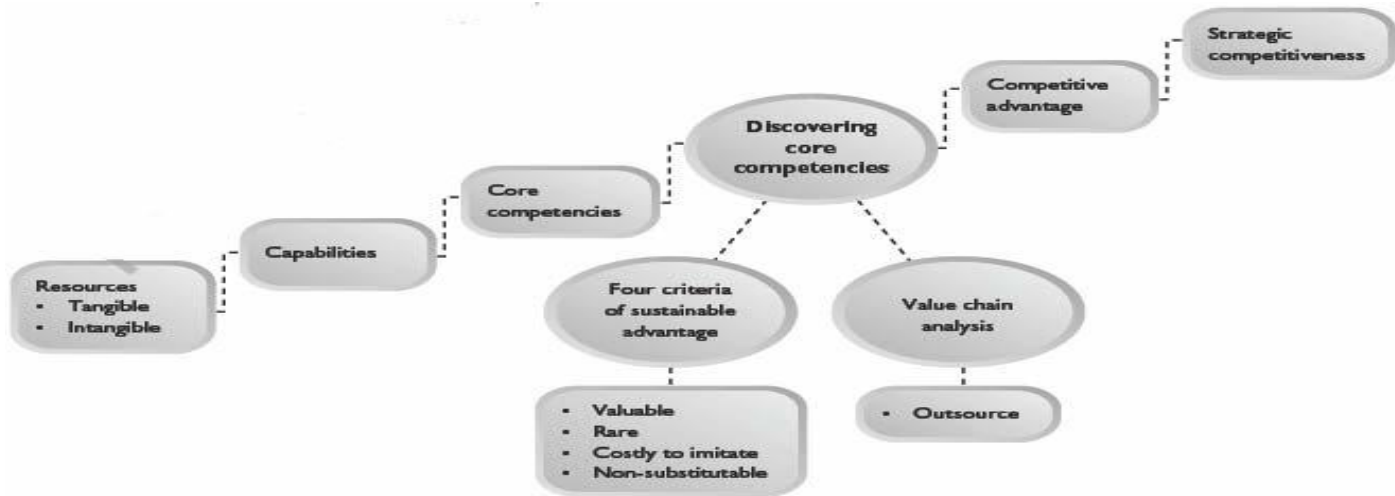


Figure 4.1 Components of Internal Analysis Leading to Competitive Advantage and Strategic Competitiveness

Creating Value

By exploiting their core competencies or competitive advantages to at least meet if not exceed the demanding standards of global competition, firms create value for customers. *Value is measured by a product's performance, characteristics and by its attributes for which customers are willing to pay.* Evidence suggests that increasingly, customers perceive higher value in global rather than domestic-only brands. Firms create value by innovatively bundling and leveraging their resources and capabilities.

Firms unable to creatively bundle and leverage their resources and capabilities in ways that create value for customers suffer performance declines.

During the last several decades, the strategic management process was concerned largely with understanding the characteristics of the industry in which the firm competed and, in light of those characteristics, determining how the firm should position it relative to competitors. This emphasis on industry characteristics and competitive strategy may have underestimated the role of the firm's resources and capabilities in developing competitive advantage. In fact, core competencies, in combination with product-market positions, are the firm's most important sources of competitive advantage. The core competencies of a firm, in addition to its analysis of its general, industry, and competitor environments, should drive its selection of strategies. By emphasizing core competencies when formulating strategies, companies learn to compete on the

basis of firm-specific differences, but they must be very aware of how things are changing in the external environment as well.

4.2 Organizational Appraisal

The appraisal of the external environment of a firm helps it to think of what it might choose to do. The appraisal of the internal environment, on the other hand, enables a firm to decide about what it can do.

We shall build a foundation for understanding the internal environment through an explanation of its dynamic. This has been done by referring to the resource-based view of strategy. The resources, behavior, strengths and weaknesses, synergy, and competencies constitute the internal environment, and we shall deal briefly with each of these aspects initially. All these together determine the organizational capability that leads to strategic advantage.

Organizational capability could be understood in terms of the strengths and weaknesses existing in the different functional areas of an organization. We shall consider six such areas: finance, marketing, operations, personnel, information management and general management. For each of these, we shall mention the important factors influencing them and clarify the nature of the various functional capability factors through illustrations.

The various considerations involved in organizational appraisal are discussed next. We deal with the factors that affect appraisal, the approaches adopted for appraisal, and the sources of information used to perform organizational appraisal.

With regard to the methods and techniques used for organizational appraisal, we consider a range of factors grouped under the three headings of internal analysis, comparative analysis, and comprehensive analysis. The application of these methods results in highlighting the strengths and weaknesses that exist in different functional areas.

The results of organizational appraisal are structured through the preparation of an organizational capability profile and a strategic advantage profile. We end this chapter with an explanation of

these two types of profiles: *Components of internal environment* and *Organizational capability factors*

4.2.1. Components of Internal Environment

Recall that we focused on the external environment in the previous chapter and that could lead us to think that the external part of the environment solely dictates what an organization should do regarding its strategy. But this is just one side of the coin. The other side is that the internal environment provides an organization with the capability to capitalize on the opportunities or protect itself from the threats that are present in the external environment. Ultimately it is the fit that takes place between the external and the internal environment that enable an organization to formulate its strategy.

We attempt to understand the internal environment of an organization in term of behaviour. The interplay of these different resources along with the prevalent behaviour produces synergy or dysnergy within an organization, which leads to the development of strengths or weaknesses over a period of time. Some of these strengths makes an organization special competent in a particular area of its activity causing it to develop competencies. Organizational capability rests on an organization's capacity and ability to use its competencies to excel in a particular field.
The resources, behaviour, strengths and weaknesses, synergistic effects and competencies of an organization determine the nature of its internal environment.

1. Organizational Resources

The dynamics of the internal environment of an organization can be best understood in the context of the resource-based view of strategy. According to Barney (1991), who is credited with developing this view of strategy as a theory, a firm is bundles of resources-tangible and intangible-that include all assets, capabilities, organizational processes, information, knowledge, and so on. These resources could be classified as physical, human, and organizational resources. The physical resources are the technology, plant and equipment, geographic location access to raw materials, among others. The human resources are training, experience, judgment, intelligence, relationships, and so on, present in an organization. The organizational resources are

the formal systems and structures as well as informal relations among groups. Elsewhere, Barney has said that the resources of an organization can ultimately lead to a strategic advantage for it if the posses four characteristics, that is, if these resources are valuable, rare, costly to imitate, and non-substitutable.

The cost and availability of resources are the most important factors on which the success of an organization depends. If an organization is favorably placed with respect to the cost and availability of a particular type of resource, it possesses an enduring strength which may be used as a strategic weapon by it against its competitors. Conversely, the high cost and scarce availability of resource are handicaps which cause a persistent strategic weakness in an organization.

Broad in scope, resources cover a spectrum of individual, social, and organizational phenomena. Typically, resources alone do not yield a competitive advantage. In fact, a competitive advantage is created through the unique bundling of several resources. *For example, Amazon.com has combined service and distribution resources to develop its competitive advantages*. The firm started as an online bookseller, directly shipping orders to customers. It quickly grew large and established a distribution network through which it could ship "millions of different items to millions of different customers." Compared to Amazon's use of combined resources, traditional bricks-and mortar companies, such as Toys 'R' Us and Borders, found it hard to establish an effective online presence. These difficulties led them to develop partnerships with Amazon.

Some of a firm's resources are tangible while others are intangible. Tangible resources are assets that can be seen and quantified. Production equipment, manufacturing plants, and formal reporting structures are examples of tangible resources. Intangible resources include assets that typically are rooted deeply in the firm's history and have accumulated over time. Because they are embedded in unique patterns of routines, intangible resources are relatively difficult for competitors to analyze and imitate. Knowledge, trust between managers and employees, ideas, the capacity for innovation, managerial capabilities, organizational routines (the unique ways people work together), scientific capabilities, and the firm's reputation for its goods or services and how it interacts with people (such as employees, customers, and suppliers) are all examples

of intangible resources. The four types of tangible resources are financial, organizational, physical, and technological and the three types of intangible resources are human, innovation, and reputational (see Table below).

Type of Resources	Description	
TANGIBLE	Financial Resource	i. The firm's borrowing capacity i. The firm's ability to generate internal funds
	Organizational Resource	i. The firm's formal reporting structure and its formal planning, controlling, and coordinating system
	Physical Resource	/. Sophistication and location of firm's plant and equipment /. Access to Raw material
	Technological Resources	. Stock of technology, such as patents, trade- marks, copyrights, and trade secrets
INTANGIBLE RESOURCES	**Human Resources**	. Knowledge, Trust, Managerial capabilities, Organizational routines
	Innovation Resources	i. Ideas Scientific capabilities and capacity to innovate
	Reputational Resources	. Reputation with customers . Brand name i. Perceptions of product quality, durability, and reliability i. Reputation with suppliers For efficient, effective, supportive, and mutually beneficial interactions and relationships.

Tangible Resources: - As tangible resources, a firm's borrowing capacity and the status of its plant and equipment are visible. The value of many tangible resources can be established through financial statements, but these statements do not account for the value of all of a firm's assets, because they disregard some intangible resources. As such, each of the firm's sources of competitive advantage typically is not fully reflected on corporate financial statements. The

value of tangible resources is also constrained because they are difficult to leverage—it is hard to derive additional business or value from a tangible resource.

For example, an airplane is a tangible resource or asset, but: "You can't use the same airplane on five different routes at the same time. You can't put the same crew on five different routes at the same time. And the same goes for the financial investment you've made in the airplane."

Intangible Resources: - As suggested above, compared to tangible resources, intangible resources are a superior and more potent source of core competencies. In fact, in the global economy, "the success of a corporation lies more in its intellectual and systems capabilities than in its physical assets. Moreover, the capacity to manage human intellect—and to convert it into useful products and services—is fast becoming the critical executive skill of the age."

Even though it is hard to measure the value of intangible assets such as knowledge, there is some evidence that the value of intangible assets is growing relative to that of tangible assets. Because intangible resources are less visible and more difficult for competitors to understand, purchase, imitate, or substitute for, firms prefer to rely on them rather than on tangible resources as the foundation for their capabilities and core competencies. In fact, the more unobservable (that is, intangible) a resource is, the more sustainable will be the competitive advantage that is based on it.

2. Organizational Capability

Organizational capability is the inherent capacity or potential of an organization to use its strengths and overcome its weaknesses in order to exploit opportunities and face threats in its external environment. It is also viewed as a skill for coordinating resources and putting them to productive use. Without capability, resources, even though valuable and unique, may be worthless. Since organizational capability is the capacity or potential of an organization, it means that it is a measurable attribute. A since it can be measured; it follows that organizational capability can be compared. Yet it is very difficult to measure organizational capability as it is, in the ultimate analysis, a subjective attribute. As an attribute, it is the sum total of resources and behavior, strengths and weaknesses, synergistic effects occurring in and the competencies of any organization.

Strategists are primarily interested in organizational capability because of two reasons. Firstly, they wish to know what capacity exists within the organization to exploit opportunities or face threats in its environments. Secondly, they are interested in knowing what potentials should be developed within the organization so that opportunities could be exploited and threats should be faced in future.

Strategic Advantage

Strategic advantages are the outcome of organizational capabilities. They are the result of organizational activities leading to rewards in terms of financial parameters, such as, profit or shareholder value, and/or non-financial parameters, such as, market share or reputation. In contrast, strategic disadvantages are penalties in the form of financial loss or damage to market share. Clearly, such advantages or disadvantages are the outcome of the presence or absence of organizational capabilities. Strategic advantages are measurable in absolute terms using the parameters in which they are expressed. So, profitability could be used to measure strategic advantage-the higher the profitability the better the strategic advantage. They are comparable in terms of the historical performance of an organization or its current performance with respect to its competitors.

Competitive advantage is a special case of strategic advantage where there are one or more identified rivals against whom rewards or penalties could be measured. So, outperforming rivals in profitability or market standing could be a competitive advantage for an organization. Competitive advantage is relative rather than absolute, and it is to be measured and compared with respect to other rivals in an industry.

Organizational Capability Factors

Capabilities are most often developed in specific functional areas, such as, marketing or operations, or in a part of a functional area, such as, distribution or R & D. It is also feasible to measure and compare capabilities in functional areas. Thus, a company could be considered as inherently strong in marketing owing to a competence in distribution skills. Or a company could be competitive in operations owing to a superior R&D infrastructure.

Organizational capability factors (or, simply, capability factors) are the strategic strengths and weaknesses existing in different functional areas within an organization which are of crucial

importance to strategy formulation and implementation. Other terms synonymous with organizational capability factors are: strategic factors strategic advantage factors, corporate competence factors, and so on.

Different types of capability factors exist within the internal environment of an organization. For the purpose of explanation, authors divide them into different functional areas. In this module, we have followed an approach of dividing an organization into six largely-accepted and commonly-understood functional areas. These are finance, marketing, operations, personnel, information, and general management areas.

A) Financial Capability

Financial capability factors relate to the availability, usage, and management of funds, and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the financial capability of any organization are as follows:

1. ***Factors related to sources of funds.*** Capital structure, procurement of capital controllership, financing pattern, working capital availability, borrowings, capital and credit availability, reserves and surplus, and relationship with lenders, bank and financial institutions.
2. ***Factors related to the usage of funds.*** Capital investment, fixed asset acquisition, current assets, loans and advance, dividend distribution, and relationship with shareholders.
3. ***Factors related to the management of funds.*** Financial, accounting, and budgeting systems: management control systems; state of financial health, cash, inflation, credit, return and risk management; cost reduction and control; and tax planning and advantages.

B) Marketing Capability

Marketing capability factors relate to the pricing, promotion, and distribution of products or services, and all the allied aspects that have a bearing on an organization's capacity and ability to implement its strategies.

Some of the important factors which influence the marketing capability of an organization are as follows:

1. ***Product related factors.*** Variety, differentiation, mix quality, positioning, packaging and others.
2. ***Price-related factors.*** Pricing objectives, policies, changes, protection, advantages, among others.
3. ***Place-related factors.*** Distribution, transportation and logistics, marketing channels, marketing intermediaries, and so on.
4. ***Promotion-related factors.*** Promotional tools, sales promotion, advertising, public relations, and so on.
5. ***Integrative and systemic factors.*** Marketing mix, market standing, company image, marketing organization, marketing system, marketing management information system, and so on.

C) Operations Capability

Operations capability factors related to the production of products or services, the use of material resources, and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the operations capability of an organization are as follows:

1. ***Factors related to the production system.*** Capacity, location, layout, product or service design, work systems, degree of automation, extent of vertical integration, and others.
2. ***Factors related to the operations and control system.*** Aggregate production planning, material supply; inventory, cost and quality control; maintenance systems and procedures, and so on.
3. ***Factors related to the R & D system.*** Personnel, facilities, product development, patent rights, level of technology used, technical collaboration and support, land so on.

D) Personnel or human Resource Capability

Personnel capability factors related to the existence and use of human resources and skills, and all allied aspects that have a bearing on an organization's capacity and ability to implement its strategies. Some of the important factors which influence the personnel capability of an organization are as follows:

1. ***Factors related to the personnel system.*** System for manpower planning, selection, development compensation, communication, and appraisal; position of the personnel department within the organization; procedures and standards, and so on.
2. ***Factors related to organizational and employees' characteristics.*** Corporate image, quality of mangers, staff and workers; perception about and image of the organization as an employer; availability of development opportunities for employees; working conditions; and so on.
3. ***Factors related to industrial relations.*** Union-management relationship, collective bargaining, safety, welfare and security; employee satisfaction and moral; among others.

E) Information Management Capability

Information management capability factors relate to the design and management of the flow of information from outside into, and within, an organization for the purpose of decision-making and all allied aspects that have a bearing on an organization's capacity and ability to implements is strategies. Some of the important factors which influence the information capability of an organization are as follows:

1. ***Factors related to acquisition and retention of information.*** Sources, quantity, quality, and timelines of information, retention capacity, and security of information.
2. ***Factors related to the processing and synthesis of information.*** Database management, computer systems, software capability, and ability to synthesize information.
3. ***Factors related to the retrieval and usage of information.*** Availability and appropriateness of information formats, and capacity to assimilate and use information.
4. ***Factors related to transmission and dissemination.*** Speed, scope width, and depth of coverage of information, and willingness to accept information.
5. ***Integrative, systemic and supportive factors.*** Availability of IT infrastructure, its relevance and compatibility to organizational needs, upgradation of facilities, willingness to invest in state-of-the-are systems, availability of compute professionals, and top management support.

F) General Management Capability

General management capability relates to the integration, coordination, and direction of the functional capabilities towards common goals, and all the allied aspects that have a bearing on an organization's capacity and ability to implement its strategies.

Some of the important factors which influence the general management capability of an organization are as follows:

1. ***Factors related to the general management system.*** Strategic management system, processes related to setting strategic intent, strategy formulation and implementation machinery, strategy evaluation system, management information system, corporate planning system, rewards and incentives system for top managers, and so on.
2. ***Factors related to general managers.*** Orientation, risk-propensity, values, norms, personal goals, competence, capacity for work, track record, balance of functional experience, and so forth.
3. ***Factors related to external relationships.*** Influence on and rapport with the government, regulatory agencies and financial institutions; public relations; sense of social responsibility, philanthropy, public image as corporate citizen, and so on.
4. ***Factors related to organizational climate.*** Organizational culture, use of power, political processes, balance of vested interests; introduction, acceptance and management of change; nature of organizational structure and controls, and so on.

3. Organizational Competencies

On the basis of its resources and behaviour, an organization develops certain strengths and weaknesses which when combined lead to synergistic effects. Such effects manifest themselves in terms of organizational competencies. Competencies are special qualities possessed by an organization that make them withstand pressures of competition in the marketplace. In other words, the net results of the strategic advantages and disadvantages that exist for an organization determine its ability to compete with its rivals. Other terms frequently used as being synonymous to competencies are ***unique resources***, ***core capabilities***, ***invisible assets***, ***embedded knowledge***, and so on.

When an organization develops its competencies over a period of time and hones them into a fine art of competing with its rivals it tends to use these competencies exceedingly well. The capability to use the competencies exceedingly well turns them into core competencies.

When a specific ability is possessed by a particular organization exclusively, or in a relatively large measure, it is called a distinctive competence.

Many organizations achieve strategic success by building distinctive competencies around the Critical Success Factors/CSFs. Recall the CSFs are those factors which are crucial for organizational success a few examples of distinctive competencies are given below.

- Superior product quality in a particular attributes, say, a two-wheeler, which is more fuel-efficient than its competitor products.
- Creation of a market niche by supplying highly-specialized products to a particular market segment.
- Differential advantages based on the superior R & D skills of an organization not possessed by its competitors.
- An organization's access to a low-cost financial source like equity shareholders, not available to its competitors.

A distinctive competence is "any advantage a company has over its competitors because it can do something which they cannot or it can do something better than they can". It is not necessary, of course, for all organizations to possess a distinctive competence. Neither do all the organizations, which possess certain distinctive competencies, use them for strategic purposes. Nevertheless, the concept of distinctive competence is useful for the purpose of strategy formulation. The importance of distinctive competence in strategy formulation rests with "the unique capability it gives an organization in capitalizing upon a particular opportunity; the competitive edge it may give a firm in the market place, and the potential for building a distinctive competence and making it the cornerstone of strategy".

Core competencies are the competencies that a firm has, which may not be necessarily unique. It shows the main resource strength of the firm. On the other hand distinctive competencies have

greater potential to lead a firm to strategic advantage. Distinctive or core competencies can easily lead to strategic advantage when they have the following characteristics.

1. **Value**--the resource allows the firm to conceive of and implement strategies that effectively deal with opportunities and threats.
2. **Rarity**--the resource is generally unavailable to large numbers of current or potential competitors.
3. **Not imitable**--the resource cannot be easily obtained by competitors.
4. **Non-substitutability**--there are no strategically equivalent valuable resources available to competitors. Resources are substitutes when they can each individually be used to implement the same strategies.

When the four criteria are met, resources & capabilities become core competencies. Core competencies are resources & capabilities that serve as a source of competitive advantage for a firm over its rivals. Core competencies are largely knowledge-based.

The table below shows various outcomes from combinations of the criteria for sustainable competitive advantage.

Is the resource/ Capability Valuable?	***Is the resource/ Capability Rare?***	***Is the resource/ Capability Costly to imitate?***	***Is the resource/ Capability Nonsubstitutable?***	***Competitive Consequence***	***Performance Implication***
No	No	No	No	Competitive disadvantage	Below average Return
Yes	No	No	Yes/No	Competitive parity	Average Return
Yes	Yes	No	Yes/No	Temporary Competitive advantage	above average return to Average return
Yes	Yes	Yes	Yes	Sustainable competitive advantage	Above average return

4.3 Methods and Techniques Used for Organizational Appraisal

The methods and techniques used for organizational appraisal can be identical to those used for the performance evaluation of an organization. But there is an important difference between performance evaluation and organization appraisal. In evaluating performance the emphasis is on assessing the current behaviour of the organization with respect to its efficiency and effectiveness, and such an assessment is generally of a short-term nature whereas organizational appraisal's emphasis is not just on current behavior only but also on what the organization needs to do in order to gain the capability to compete in the market, take advantages of the available opportunities, and overcome the threats operating in its relevant environment.

Keeping in view the differences between performance evaluation and organizational appraisal, the methods and techniques used could be classified broadly in three parts as below.

1. Internal analysis

- a. Value chain analysis
- b. Quantitative analysis
  - i) Financial analysis
  - ii) Non-financial quantitative analysis
- c. Qualitative analysis

2. Comparative analysis

- a. Historical analysis
- b. Industry norms
- c. Benchmarking

3. Comprehensive analysis

- a. Balanced scorecard
- b. Key factor rating

However, our discussion in this module will focus on ***three commonly used techniques of appraisal***: Value chain analysis, Benchmarking and Key factor rating

1. Value Chain Analysis

This is a method for assessing the strengths and weaknesses of an organization on the basis of an understanding of the series of activities it performs. Porter (1985) is credited with the introduction to the framework called value chain. A value chain is a set of interlinked value-creating activities performed by an organization. These activities may begin with the

procurement of basis raw materials, go through its processing in various states, and continue right up to the end products finally marketed to the ultimate consumer.

Porter divided the value chain of a manufacturing organization into primary and support activities. Primary activities are directly related to the flow of the product to the customer and include five sub-activities: ***inbound logistics*** (receiving, storing, etc.), ***operations*** (or transformation of raw materials to finished products), ***outbound logistics*** (order processing, physical distribution, etc.), ***marketing & sales*** and ***Service***. Support activities are provided to sustain the primary activities. These consist of the firm ***infrastructure*** (including finance accounting, general management, etc.), ***human resource management***, ***technology development***, and ***procurement***.

Exhibit 4.1 Porter's Generic Value Chain

Primary activities				
Inbound Logistics	***Operations***	***Outbound logistics***	***Marketing And sales***	***Service***
Warehousing	Manufacturing	Warehousing		
Materials handling	Packaging	Transportation		
Inventory control	Assembly	Order processing		
Scheduling	Maintenance	Scheduling		
Supported by				
Procurement	Human resources development	Technology Development	Infrastructure	
Purchasing	Recruiting	Equipping	Organizational	
Physical	Rewarding	Assimilation	Design	
resources	Developing		Staff functions	
	Retrenchment			

Exhibit 4.1 provides a simplified depiction of the value chain. As you may observe, it is a representation of the interrelated chain of activities that are required to be undertaken to bring the finished product to the doorstep of the customer. The profit margin that an organization earns depends on how effectively the value chain has been managed. The value chain provides a systematic view of the examination of all the activities performed by an organization and how these activities interact and are interrelated.

2. Benchmarking

A benchmark is a reference point for the purpose of measuring. The process of benchmarking is aimed at finding the best practices within and out side the industry to which an organization belongs. The purpose of benchmarking is to find the best performers in an area so that one could match one's own performance with them and even surpass them. The American Productivity and quality Centre (APQC) gives an interesting interpretation of the term benchmarking by saying that it is "the practice of being humble enough to admit that someone else is better at something, and being wise enough to learn how to match and even surpass them at it".

When one is interested in finding out what is to be compared then there are three types of benchmarking: ***performance***, ***process***, and ***strategic benchmarking***. Performance benchmarking is to compare one's own performance with that of some other organization for the purpose of determining how good one's own organization is. Process benchmarking is to compare the methods and practices for performing processes; while strategic benchmarking is to compare the long-term, significant decisions and actions undertaken by other organizations to achieve their objectives.

When one is interested in finding out against whom to compare oneself then there could a different classification of four types of benchmarking. Internal benchmarking is a comparison between units or departments of the same organization. Competitive benchmarking is a direct comparison of one's own performance against the best competitors. Functional benchmarking is a comparison of processes of functions against non-competitive organizations within the same sector or technological area. Generic benchmarking is a comparison of one's own processes against the best practices anywhere in any type of organization.

A firm could attempt benchmarking at several levels using all the different types of benchmarking. The main purpose should be to find out the best practices so that one could conform to it. But before one does this, benchmarking is enough to show where a firm excels or lags behind. This is helpful in assessing the strengths and weaknesses of an organization and determining its capability.

3. Key Factors Rating

A comprehensive method, which can be used in association with financial analysis, is that of key factor rating. Many systems have been evolved by consultants to assess organizational strengths and weaknesses. Essentially, these systems are based on rating, depending on a number of key factors, each of which is analyzed on the basis of a series of thoughtful and penetrating questions. A detailed study of the areas covered by these questions leads to a reliable appraisal of an organization.

Preparing the Organizational Capability Profile

The organizational capability profile (OCP) is drawn in the form of a chart as depicted in Exhibit 4.2, which shows a summarized OCP. The strategists are required to systematically assess the various functional areas and subjectively assign values to the different functional capability factors and sub-factors along a scale ranging from the values of -5 to +5. A detailed OCP may run into several pages where each of the sub-factors constituting the different functional capability factors can be assessed. In this manner, a summarized OCP, as shown in Exhibit 3.6, may be prepared.

Exhibit 4.2: Summarized Form of Organizational Capability Profile

	Capability factors		
	Weakness	**Normal**	**Strength**
	-5	**0**	**+5**
1. Financial capability factors			
a) Sources of funds			
b) Usage of funds			
c) Management of funds			
2. Marketing capability factors			
a) Product-related			
b) Price-related			

c) Promotion-related
d) Integrative and systematic

3. Operations capability factors
   a) Production system
   b) Operations and control system
   c) R & D system
4. Personnel capability factors
   a) Personnel system
   b) Organizational and employee characteristics
   c) Industrial relations
5. Information management capability factors
   a) Acquisition and retention of information
   b) Processing and synthesis of information
   c) Retrieval and usage of information
   d) Transmission and dissemination of information
   e) Integrative, systemic, and supportive
6. General management capability factors
   a) General management system
   b) External relations
   c) Organizational climate

After the completion of the chart, the strategists are in a position to assess the relative strengths and weaknesses of an organization in each of the six functional areas and identify the gaps that need to be filled or the opportunities that could be used. The preparation of an OCP provides a convenient method to determine the relative priorities of an organization vis-à-vis its competitors, its vulnerability to outside influences, the factors that support or pose a threat to its existence, and its overall capability to compete in a given industry.

4.4 Competencies, Strength, Weakness and Strategic Decisions

At the conclusion of the internal analysis, firms must identify their strengths and weaknesses in resources, capabilities, and core competencies. For example, if they have weak capabilities or do not have core competencies in areas required to achieve a competitive advantage, they must acquire those resources and build the capabilities and competencies needed. Alternatively, they could decide to outsource a function or activity where they are weak in order to improve the value that they provide to customers.

Therefore, firms need to have the appropriate resources and capabilities to develop the desired strategy and create value for customers and shareholders as well. Having many resources does not necessarily lead to success. Firms must have the right ones and the capabilities needed to produce

superior value to customers. Undoubtedly, having the appropriate and strong capabilities required for achieving a competitive advantage is a primary responsibility of top-level managers. These important leaders must focus on both the firm' s strengths and weaknesses.

Tools such as outsourcing help the firm focus on its core competencies as the source of its competitive advantages. However, evidence shows that the value-creating ability of core competencies should never be taken for granted. Moreover, the ability of a core competence to be a permanent competitive advantage can't be assumed. The reason for these cautions is that all core competencies have the potential to become core rigidities. As Leslie Wexner, CEO of Limited Brands, says: "Success doesn't beget success. Success begets failure because the more that you know a thing works, the less likely you are to think that it won't work. When you've had a long string of victories, it' s harder to foresee your own vulnerabilities. "Thus, a core competence is usually a strength because it is the source of competitive advantage. If emphasized when it is no longer competitively relevant, it can become a weakness, a seed of organizational inertia.

Events occurring in the firm' s external environment create conditions through which core competencies can become core rigidities, generate inertia, and stifle innovation. "Often the flip side, the dark side, of core capabilities is revealed due to external events when new competitors figure out a better way to serve the firm' s customers, when new technologies emerge, or when political or social events shift the ground underneath. " However, in the final analysis, changes in the external environment do not cause core competencies to become core rigidities; rather, strategic bias and inflexibility on the part of managers are the cause.

DISCUSSION QUESTION

1. Why is it important for a firm to study and understand its internal environment?
2. Why is it important to study the internal resources, capabilities, and activities of firms? What insights can be gained?
3. What is value? Why is it critical for the firm to create value? How does it do so?
4. What are the differences between tangible and intangible resources? Why is it important for decision makers to understand these differences? Are tangible resources linked more closely to the creation of competitive advantages than are intangible resources, or is the reverse true? Why?
5. What are capabilities? What must firms do to create capabilities?

6. What are the four criteria used to determine which of a firm' s capabilities are core competencies? Why is it important for these criteria to be used?
7. What is value chain analysis? What does the firm gain when it successfully uses this tool?
8. What is outsourcing? Why do firms outsource? Will outsourcing's importance grow in the 21st century? If so, why?
9. How do firms identify internal strengths and weaknesses? Why is it vital that firms base their strategy on such strengths and weaknesses?
10. The resource-based view of the firm identifies four criteria that managers can use to evaluate whether particular resources and capabilities are core competencies and can, therefore, provide a basis for sustainable competitive advantage. Are these measures independent or interdependent? Explain. If (some of) the measures are interdependent, what implications does that fact have for managers wanting to create and sustain a competitive advantage
11. Conduct a value chain analysis for any Hotel around your locality. What are its primary activities? What are its support activities? Identify the activities that add the most value for the customer. Why? Which activities help the Hotel to contain cost? Why?
12. In what ways can a corporation's structure and culture be internal strengths or weaknesses?
13. How might a firm's management decide whether it should continue to invest in current known technology or in new, but untested technology? What factors might encourage or discourage such a shift

CHAPTER FIVE

STRATEGY LEVELS: ANALYSIS AND CHOICE

Learning Objectives

- *Define corporate-level strategy and discuss its purpose.*
- *Describe the three grand strategies and their respective sub-strategies*
- *Describe the conditions required for each strategy*
- *Understand and explain the main techniques of corporate portfolio analysis*
- *Describe different levels of diversification with different corporate-level strategies.*
- *Define business-level strategy.*
- *Discuss the relationship between customers and business-level strategies in terms of who, what, and how.*
- *Explain the differences among business-level strategies.*
- *Use the five forces of competition model to explain how above-average returns can be earned through each business-level strategy.*
- *Describe the risks of using each of the business-level strategies*

5.1 What Is Corporate Strategy

Strategy formulation centers around the key questions of where and how to compete. Business Strategy concerns the question of how to compete in a single product market. As firms grow, they are frequently expanding their business activities through seeking new markets both by offering new products and services and by competing in different geographies. When this happens, managers must formulate a corporate strategy. To gain and sustain competitive advantage, therefore, any corporate strategy must align with and strengthen a firm's business strategy, whether it is a differentiation, cost-leadership, or both.

Corporate strategy comprises the decisions that senior management makes and the goal-directed actions it takes in the quest for competitive advantage in several industries and markets simultaneously. It provides answers to the key question of where to compete. Corporate strategy determines the boundaries of the firm along three dimensions: vertical integration (along the

industry value chain), diversification (of products and services), and geographic scope (regional, national, or global markets).

Corporate strategy, therefore, includes decisions regarding the flow of financial and other resources to and from a company's product lines and business units. Through a series of coordinating devices, a company transfers skills and capabilities developed in one unit to other units that need such resources. In this way, it attempts to obtain synergy among numerous product lines and business units so that the corporate whole is greater than the sum of its individual business unit parts. All corporations, from the smallest company offering one product in only one industry to the largest conglomerate operating in many industries with many products, must at one time or another consider one or more of these issues.

5.2 STRATEGY LEVELS

5.2.1 CORPORATE LEVEL STRATEGY

A corporate-level strategy is an action taken to gain a competitive advantage through the selection & management of a ***mix of businesses*** competing in several industries or product markets.

A corporate-level strategy is concerned with **two** key questions: *What business should the firm be in? How should the corporate office manage its group of businesses?*

Corporate strategies are often called grand/master strategies. Grand strategy is an overall framework for action developed at the corporate level. It is most commonly used when corporation competes in a single market or in a few highly related markets. There are three basic grand strategies that companies choose to pursue: growth, stability, and retrenchment/defensive.

The table 5.1 below shows each of the grand strategies in relation to the **SWOT** analysis.

	Opportunity	**Threat**
Strength	Growth Strategy	Stability Strategy
Weakness	Stability Strategy	Defensive Strategy

These grand strategies (major Corporate Strategies) can be: Growth strategy, Stability strategy, Defensive strategy.

1. Corporate Growth Strategy

Organizations pursuing a growth strategy can be described as follows:

- They do not necessarily grow faster than the economy as a whole but do grow faster than the markets in which their products are sold.
- They tend to have larger-than-average profit margins.
- They attempt to postpone or even eliminate the danger of price competition in their industry.
- They regularly develop new products, new markets, new processes, and new uses for old products.
- Instead of adapting to changes in the outside world, they tend to adapt the outside world to themselves by creating something or a demand for something that did not exist before.

Organizations pursuing growth strategies, however, are not confined to growth industries. They can be found in industries with relatively fixed markets and established product lines.

Several different generic strategies fall in the growth category. The most frequently encountered and clearly identifiable of the growth strategies are discussed in the following sections.

I. Concentration Strategy

A concentration strategy focuses on a single product/service or on a small number of closely related products/services and involves increasing sales, profits or market share faster than it has increased in the past. Concentration strategy will be appropriate when the company concentrates on the current business. The firm directs its resources to the profitable growth of a single product, in a single market, with a single technology. Several factors might influence an organization to pursue a concentration strategy. Some of these include:

- Lack of a full product line in the relevant market (product line gap)
- Absent or inadequate distribution system to or within the relevant market (distribution gap)
- Less than full usage in the market (usage gap)
- Competitors sales(competitors gap)

Some of the actions available to an organization in filling these gaps include the following:

- Filling out the existing product line (e.g., new sizes, options, styles or colors could be offered).
- Developing new products in the existing product line

- Expanding distribution into new geographical areas either nationally or internationally
- Expanding the number of distribution outlets in a geographical area
- Encouraging nonusers to use the product and light users to use it more frequently through the use of advertising, promotions and special pricing campaigns
- Penetrating competitors' positions through pricing strategies, product differentiation and advertising.

Basically, there are three general approaches to pursuing a concentration strategy: Market development, Product development and horizontal integration.

A. **Market Development:** is selling present products in new markets – additional regional, national & international expansions and attracting other market segments through:
   - Developing product versions to appeal to other segments
   - Entering other channels of distribution
   - Advertising in other media

B. **Product Development:** is developing new products for present markets. This involves: Developing new product features:
   - Modifying (change color, form, shape, etc.)
   - Magnify & minify
   - Rearrange (layout, patterns, etc.)
   - Developing additional models & sizes (product proliferation)

Thus, it involves substantial modification of existing products or creation of new but related items that can be marketed to current customers through established channels. The idea is to attract satisfied customers to new products as a result of their positive experience with company's initial offering. The product development strategy is often adopted either to prolong the life cycle of current products or to take advantage of favorable reputation & brand name.

C. Horizontal integration:

Horizontal integration occurs when an organization adds one or more businesses that produce similar products or services and that are operating at the same stage in the product marketing

chain. Almost all Horizontal integration is accomplished by buying another organization in the same business. One concern with employing horizontal integration is that such a strategy eliminates the competition that has existed between the two organizations and may result in legal ramification.

Advantages of concentration strategy:

- ✓ *The organization has much of the knowledge and many of the resources necessary to compete in the market place.*
- ✓ *It allows the organization to focus its attention on doing a small number of things extremely well.*

The major drawback to a concentration strategies are:

- ✓ *It places all or most of the organization's resources in the same basket.* If the market for the organizations product/service declines, than the organization is in trouble.
- ✓ *The increasing instability of consumer preference, the growing intensity and sophistication of the competition, technological changes, and changes in government policy pose a risk.*

Regardless of the risk associated with a concentration strategy, many organizations have been very successful in pursuing a concentration strategy.

II. Vertical Integration

Vertical integration is a growth strategy that involves extending an organization's present business in two possible directions.

- **Forward integration** moves the organization into distributing its own product and services.
- **Backward integration** moves an organization into supplying some or all of the products or services used in producing its present products or services.

Several factors, including the following may cause an organization to pursue either forward or backward Vertical integration:

- ✓ Backward integration gives an organization more control over the cost, availability and quality of the raw material it uses.
- ✓ When suppliers of an organization products or services have large profit margins, the organization can convert a cost-center into a profit-center by integrating backwards.

- ✓ Forward integration gives an organization control over sales and distribution channels, which can help in eliminating inventory buildups and production slowdowns.
- ✓ When the distributors of an organization's products or services have large markups, the organization may increase its own profits by integrating forward.
- ✓ Some organizations use either forward or backward integration in hopes of benefiting from the economics of scale available from the creation of nationwide sales and marketing organizations and the constructions of larger manufacturing plants. These economies of scale may result in lower overall cost and thus increased profits.
- ✓ Some organizations use either forward or backward integration to increase their size and power in a particular market or industry in order to gain some degree of monopolistic control.

Vertical integration is a reasonable and rational strategy in certain situations. However, organizations should adopt a vertical integration strategy with caution, because integrated organizations have become associated with mature and less profitable industries. At the same time, escape from these industries is particularly difficult for a large, vertically integrated organization.

III. Diversification

Diversification occurs when an organization moves into areas that are clearly differentiated from its current businesses. Why Diversification Strategy?

- ✓ To spread the risk so the organization is not totally subject to the whims of any one given product or industry. For example, both Philip Morris and R. J. Reynolds have diversified significantly since the time when cigarettes were first linked to cancer.
- ✓ Management may believe the move represent an unusually attractive opportunities, especially when compared with other possible growth strategies.
- ✓ The new area may be especially interesting or challenging to management.
- ✓ To balance out seasonal and cyclical fluctuations in product demand.

Most diversification strategies can be classified as either concentric diversification or conglomerate diversification:

A. Concentric Diversification

The basic difference between a concentric diversification strategy and a concentration strategy is that a concentric diversification strategy involves expansion of the current business. Concentric

diversification involves adding products or services that lies within the organizations know-how and experience in terms of technology employed, distribution system, or customer base.

A concentric diversification strategy can have several advantages. The most obvious is that it allows the organization to build on its expertise in a related area. It can also have the advantage of spreading the organizations risks.

B. Conglomerate Diversification

Conglomerate diversification is a growth strategy that involves adding new products or services that are significantly different from the organizations present products or services. Conglomerate diversification can be pursued internally or externally. Most frequently, however, it is achieved through mergers, acquisitions, or joint ventures.

The reasons for following such a strategy is:

- Supporting some strategic business units (SBUs) with the cash flow from other SBUs
- Using the profits of one SBU to cover expenses in another SBU without paying taxes on the profits from the first SBU
- Encouraging growth for its own sake and to satisfy the ambitions of management or the owners
- Taking advantage of unusually attractive growth opportunities.
- Distributing risk by serving several different markets.
- Improving the overall profitability and flexibility of the organization by moving into industries that have better economic characteristics.
- Gaining better access to capital markets and better stability and growth in earnings.
- Reaping the benefits of synergy. Synergy results from a Conglomerate merger when the combined organization is more profitable than the two organizations operating independently.

2. Corporate Stability Strategy

It is also called neutral strategy: occurs when an organization is satisfied with its current situation & wants to maintain the status quo. Reasons for using stability strategy:

- The company is doing well “if it works, don’t fix it”
- The management wants to avoid additional hassles associated with growth

- Resources has been exhausted because of earlier growth strategies
- The organization continues to serve its customers with basically the same product/services.
- Management may not wish to take the risk of greatly modifying its present strategy.

Generally, organizations that pursue a stable growth strategy concentrate on one product/service. They grow by maintaining their share of the steadily increasing market, by slowly increasing their share of the market, by adding new products/services (but only after extensive marketing research), or by expanding their market coverage geographically. Many organizations in the public utility, transportation, and insurance industries follow a stable growth strategy. In fact, for many industries and for many organizations, stable growth is the most logical and appropriate strategy.

Some of the more popular of these strategies are: the pause/proceed with caution, no change, and profit strategies.

I. Pause/Proceed with Caution Strategy

A pause/proceed with caution strategy is, in effect, a timeout – an opportunity to rest before continuing a growth or retrenchment strategy. It is a very deliberate attempt to make only incremental improvements until a particular environmental situation changes. It is typically conceived as a temporary strategy to be used until the environment becomes more hospitable or to enable a company to consolidate its resources after prolonged rapid growth.

II. No Change Strategy

A no change strategy is a decision to do nothing new – a choice to continue current operations and policies for the foreseeable future. Rarely articulated as a definite strategy, a no change strategy's success depends on a lack of significant change in a corporation's situation. The relative stability created by the firm's modest competitive position in an industry facing little or no growth encourages the company to continue on its current course, making only small adjustments for inflation in its sales and profit objectives.

III. Profit Strategy

A profit strategy is a decision to do nothing new in a worsening situation but instead to act as though the company's problems are only temporary. The profit strategy is an attempt to

artificially support profits when a company's sales are declining by reducing investment and short-term discretionary expenditures. Rather than announcing the company's poor position to shareholders and the investment community at large, top management may be tempted to follow this very seductive strategy, blaming the company's problems.

3. Corporate Retrenchment/ Defensive Strategy

A company may pursue retrenchment strategies when it has a weak competitive position in some or all of its product lines resulting in poor performance-sales are down and profits are becoming losses. These strategies impose a great deal of pressure to improve performance. In an attempt to eliminate the weaknesses that are dragging the company down, management may follow one of several retrenchment strategies ranging from turn around or becoming a captive company to selling out, bankruptcy, or liquidation.

Reasons for retrenchment strategy: When;

- ✓ The company faced financial problems – certain parts of the organization are doing poorly.
- ✓ The company forecasts hard times ahead related to:
    - Challenges from new competitors & products
    - Changes in government regulations
- ✓ Owners are tired of the business or have to have an opportunity to profit substantially by selling

Could be classified into **decline** & **closure** strategies.

I. Decline Strategy

Decline strategy includes Retrenchment, Harvesting, Turn Around & Divestiture.

A. **Retrenchment;** strategy will be used when the company wants to reduce its operations – primarily, by reducing product lines. The main purpose of retrenchment is economizing through cutting production costs.

B. **Harvesting;** occurs when future growth appears doubtful or not cost effective – the main reason could be because of new competition or changes in consumer preferences. In this case the firm limits additional investment & expenses but maximizes short-term profit & cash flow through maintaining market share over the short-run. Conditions for harvesting strategy:

- The business is not a major contributor of sales, stability, or prestige to the organization.
- The management may use the freed-up resources for other attractive uses.

C. **Turn Around;** strategy is designed to reverse a negative trend & get the organization back on the track or profitability – a temporary measure until things improve. Major actions that should be taken are:

- Reducing the size of operations; Eliminating low-margin products, Selling machineries, Laying off employees
- Cutting back employee compensation or benefits
- Replacing higher-paid employees with lower-paid employees
- Leasing rather than buying equipment
- Cutting back marketing expenses

D. **Divestiture;** strategy occurs when an organization sells or divests itself of a business or part of a business – previous diversification is not successful (weak growth prospects & poor profitability). Moreover, when the firm is highly indebted – it might prefer to survive by selling some of its businesses by raising sufficient capital to: Increase the performance of the remaining businesses and Settle its debt – liquidity.

II. Closure strategy: Closure strategy consists of liquidation & filing of bankruptcy

A. **Liquidation;** occurs when an entire company is either sold or dissolved either by choice or force. When by choice, it can be because the owners are tired of the business or near retirement; the organization's future prospect is not good and sell at this time. When by force, the decision often occurs because of a deteriorated financial condition:

   a. Such circumstances leave the seller in a weak bargaining position
   b. It is the last resort measure & generally is forced by financial institutions

B. **Filing for bankruptcy;** it allows a company to protect itself from creditors & from enforcement.

Corporate Portfolio Analysis

The corporate or business portfolio is the collection of businesses and products that make up the company. The best business portfolio is one that fits the company's strengths and helps exploit the most attractive opportunities.

The company must:

- Analyze its current business portfolio and decide which businesses should receive more or less investment, and
- Develop growth strategies for adding new products and businesses to the portfolio, whilst at the same time deciding when products and businesses should no longer be retained.

Methods of Portfolio Planning

The two best-known portfolio-planning methods are from the Boston Consulting Group and by General Electric/Shell. In each method, the first step is to identify the various Strategic Business Units ("SBU's") in a company portfolio. An SBU is a unit of the company that has a separate mission and objectives and that can be planned independently from the other businesses. An SBU can be a company division, a product line or even individual brands - it all depends on how the company is organized.

1. The Boston Consulting Group Matrix

Using the BCG Box (an example is illustrated above) a company classifies all its SBU's according to two dimensions:

On the horizontal axis: relative market share this serves as a measure of SBU strength in the market. On the vertical axis: market growth rate this provides a measure of market attractiveness

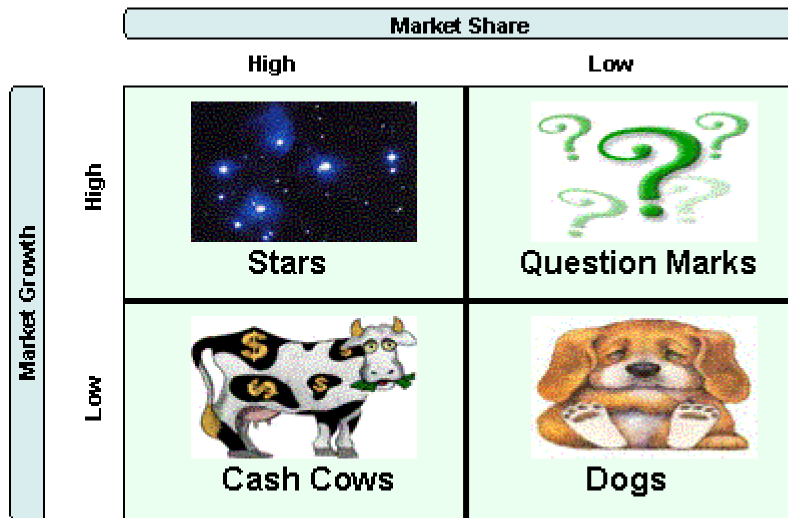


Figure 4.1: The Boston Consulting Group Box ("BCG Box")

By dividing the matrix into four areas, four types of SBU can be distinguished:

Stars

Stars are high growth businesses or products competing in markets where they are relatively strong compared with the competition. Often they need heavy investment to sustain their growth. Eventually their growth will slow and, assuming they maintain their relative market share, will become cash cows.

Cash Cows

Cash cows are low-growth businesses or products with a relatively high market share. These are mature, successful businesses with relatively little need for investment. They need to be managed for continued profit - so that they continue to generate the strong cash flows that the company needs for its Stars.

Question marks

Question marks are businesses or products with low market share but which operate in higher growth markets. This suggests that they have potential, but may require substantial investment in order to grow market share at the expense of more powerful competitors. Management have to think hard about "question marks" - which ones should they invest in? Which ones should they allow to fail or shrink?

Dogs

Unsurprisingly, the term "dogs" refers to businesses or products that have low relative share in unattractive, low-growth markets. Dogs may generate enough cash to break-even, but they are rarely, if ever, worth investing in.

Using the BCG Box to determine strategy

Once a company has classified its SBU's, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU's sales), a large dog and two, smaller stars and question marks.

Conventional strategic thinking suggests there are four possible strategies for each SBU:

- ***Build Share***: here the company can invest to increase market share (for example turning a "question mark" into a star)
- ***Hold***: here the company invests just enough to keep the SBU in its present position
- ***Harvest:*** here the company reduces the amount of investment in order to maximise the short-term cash flows and profits from the SBU. This may have the effect of turning Stars into Cash Cows.
- ***Divest:*** the company can divest the SBU by phasing it out or selling it - in order to use the resources elsewhere (e.g. investing in the more promising "question marks").

2. The McKinsey / General Electric Matrix

The McKinsey/GE Matrix overcomes a number of the disadvantages of the BCG Box. Firstly, market attractiveness replaces market growth as the dimension of industry attractiveness, and includes a broader range of factors other than just the market growth rate. Secondly, competitive strength replaces market share as the dimension by which the competitive position of each SBU is assessed.

The diagram below illustrates some of the possible elements that determine market attractiveness and competitive strength by applying the McKinsey/GE Matrix to the UK retailing market.

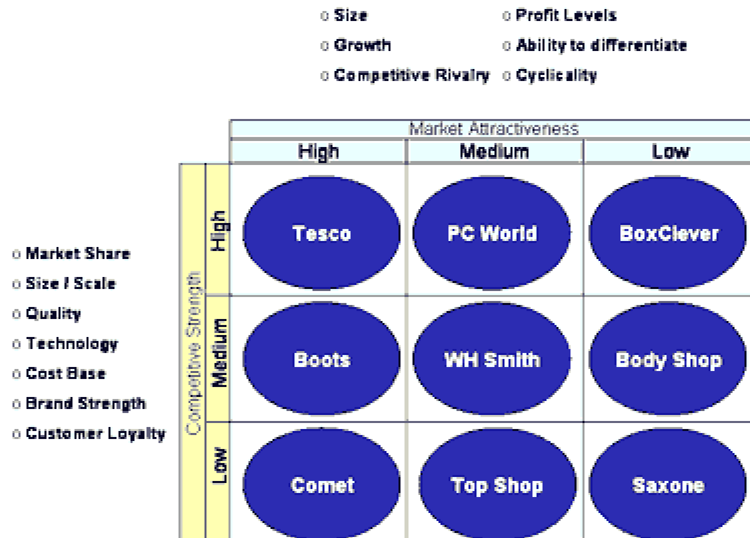


Figure 4.2: The Mckinsey Matrix

Whilst any assessment of market attractiveness is necessarily subjective, there are several factors that can help determine attractiveness. These are listed below:

- Market Size
- Market growth
- Market profitability
- Pricing trends
- Competitive intensity / rivalry
- Overall risk of returns in the industry
- Opportunity to differentiate products and services
- Segmentation
- Distribution structure (e.g. retail, direct, wholesale

Factors that Affect Competitive Strength

Factors to consider include:

- Strength of assets and competencies
- Relative brand strength
- Market share
- Customer loyalty
- Relative cost position (cost structure compared with competitors)
- Distribution strength
- Record of technological or other innovation
- Access to financial and other investment resources

5.1.2 BUSINESS-LEVEL STRATEGY

Strategy is an integrated & coordinated set of commitments & actions designed to exploit core competencies & gain competitive advantage.

Business-level strategy is a strategy designed to gain competitive advantage by exploiting core competencies in specific product market for the purpose of providing value to customers.

Business-level strategy is designed to answer the question, "How do we compete in our business or industry?" Typically, business-level strategy is concerned with a single product line or strategic business unit. Business-level strategy arises from the analysis of:

- The competitive environment of the industry,
- The needs of customers, and
- The resources and core competences of the business.

Business-level strategy is a deliberate choice about how a firm will perform the value chain's primary & support activities in ways that create unique value. Reflects where & how the firm has an advantage over its rivals. It is intended to create differences between the firm's positions relative those of its rivals.

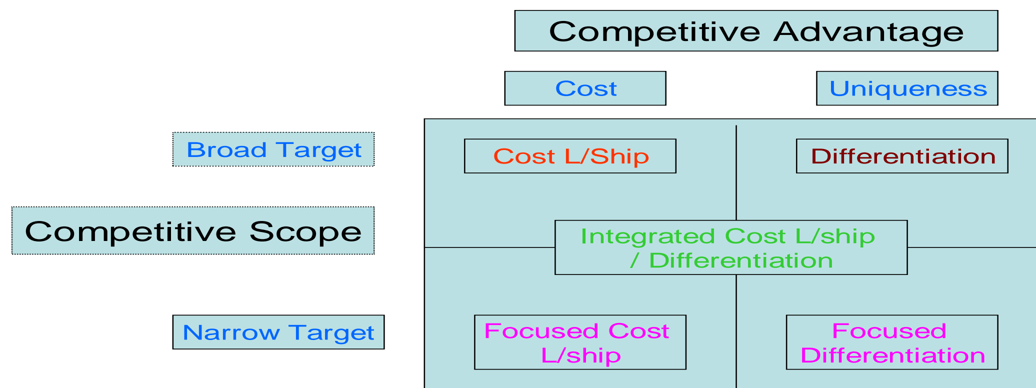
Thus, the essence of a firm's business-level strategy is choosing to perform activities differently than rivals – to achieve lowest cost or Perform different (valuable) activities – being able to differentiate.

The two basic types of competitive advantage a firm can possess are low cost or differentiation. They are important to cope with the five forces based on an industry structure. The two basic types of competitive advantage combined with the competitive scope leads to three generic strategies for achieving above-average performance. The three generic strategies are cost leadership, differentiation & focus. The focus strategy has two variants: cost focus & differentiation focus. Thus, a focus strategy is an integrated set of actions designed to produce & deliver goods/services that serve the needs of a particular competitive segment.

- ✓ **Competitive scope;** refers to either broad target or narrow target
    - *Broad target* – refers to a wide array of customers, i.e., all potential customers)
    - *Narrow target* – a specific market segment, i.e., particular customers
- ✓ **Competitive Advantage;** refers to either cost or uniqueness
    - *Cost* – refers to lowest cost with standardized products & services

- *Uniqueness* – refers to high quality (differentiated) products & services

Business-level strategies are called "generic strategies". These are: *Cost leadership, Differentiation, Focused cost leadership, Focused differentiation, integrated cost leadership & differentiation.*



- *Cost leadership*: lowest cost to produce acceptable features to all customers.
- *Differentiation*: differentiated features rather than low cost for customers who **value** differentiation
- *Focused cost leadership*: refers to targeting those specific customers with low cost
- *Focused differentiation*: refers to targeting those specific customers with a differentiated product (e.g., Rolls Royce motor cars, Ferrari sport cars, Italian shoes from natural materials & man work ship)
- *Integrated cost leadership & differentiation*: according to porter, this strategy was referred initially as "stuck in the middle" - Meaning, neither the lowest cost nor a differentiated firm.

None of the five business-level strategies is inherently or universally superior to others. The effectiveness of each strategy is contingent both on the opportunities & threats in a firm's external environment & on the possibilities provided by the firm's unique resources & capabilities i.e. core competencies. It is critical, therefore, for the firm to select an appropriate strategy in light of its external conditions & competencies. Thus, if a firm is to attain a

competitive advantage, it must make a choice about the type of competitive advantage it seeks to attain & the scope within which it will attain it.

I. Cost Leadership Strategy

A cost leadership strategy is an integrated set of actions designed to produce or deliver goods or services at the lowest cost relative to competitors, with features that are acceptable to customers and relatively standardised products. Cost saving actions required by this strategy:

- Tightly controlling production & overhead costs
- Simplifying production processes & building efficient manufacturing facilities
- Minimising costs of sales, R&D & service
- Monitoring costs of activities provided by outsiders

Cost-Leadership and the Industry

Potential entrants - Firm can frighten off potential new entrants due to:

- Their need to enter on a large scale in order to be cost competitive
- The time it takes to move down the learning curve

Bargaining power of suppliers & buyers –

Can mitigate suppliers' power by:

- Being able to absorb cost increases due to low cost position
- Being able to make very large purchases, reducing chance of suppliers using power

Can mitigate buyers' power by:

- Driving prices far below competitors and causing them to exit, thus shifting the power of the buyers back to the firm

Product substitutes & rivalry among existing competitors

Cost leader is well positioned to:

- Make investments to be first to create substitutes
- Buy patents developed by potential substitutes
- Lower prices in order to maintain value position

Due to cost leader's advantageous position:

- Rivals hesitate to compete on basis of price
- Lack of price competition leads to greater profits

Competitive risks of the cost-leadership strategy

- Processes used to produce & distribute goods or services may become obsolete due to competitors' innovations.
- Focus on cost reductions may occur at expense of customers' perceptions of differentiation encouraging them to purchase competitors' products & services
- Competitors, using their own core competencies, may learn to successfully imitate the cost leader's strategy

II. Differentiation Strategy

A differentiation strategy is an integrated set of actions designed to produce goods or services that customers perceive as being different in ways that are important to them. The firm produces non-standardized products for customers who value differentiated features more than they value low cost. The ability to sell goods or services at a price that substantially exceeds the cost of creating its differentiated features allows the firm to outperform rivals & earn above-average returns.

Differentiation and the Industry

Potential entrants - Can defend against new entrants because:

- Entrants' new products must surpass proven products
- Entrants' new products must be at least equal to performance of proven products, but offered at lower prices

Bargaining power of suppliers & buyers

Can mitigate suppliers' power by:

- Absorbing price increases due to higher margins
- Passing along higher supplier prices because buyers are loyal to differentiated brand

Can mitigate buyers' power by:

- Well differentiated products reducing customer sensitivity to price increases

Product substitutes - Well positioned relative to substitutes because:

- Brand loyalty to a differentiated product tends to reduce customers' testing of new products or switching brands

Rivalry among existing competitors - Well positioned relative to competitors because:

- Brand loyalty to a differentiated product tends to offset price competition

Competitive risks of the differentiation strategy

- The price differential between the differentiator's product and the cost leader's product becomes too large
- Differentiation ceases to provide value for which customers are willing to pay
- Experience narrows customers' perceptions of the value of a product's differentiated features
- Counterfeit goods replicate differentiated features of the firm's products at significantly reduced prices.

III. Focus Strategy

A focus strategy is an integrated set of actions designed to produce or deliver goods or services that serve the needs of a particular competitive segment. Examples of specific market segments that can be targeted by a focus strategy:

- Particular buyer group (e.g. youths or senior citizens)
- Different segment of a product line (e.g. professional craftsmen versus do-it-yourselves)
- Different geographic markets

Focused strategies can be: Focused cost leadership strategy and Focused differentiation strategy

To implement a focus strategy, the firm must be able to complete various primary and support value chain activities in a competitively superior manner, in order to develop & sustain a competitive advantage and earn above-average returns.

Competitor firms may overlook small niches. The firm lacks resources needed to compete in the broader market, but serves a narrow segment more effectively than industry-wide competitors.

Competitive risks of focus strategies:

- The focuser firm may be 'out focused' by its competitors
- A firm competing on an industry-wide basis decides to pursue the niche market of the focuser firm
- Customer preferences in the niche market may change to more closely resemble those of the broader market

VI. Integrated Cost Leadership / Differentiation Strategy

A firm that successfully uses the integrated cost leadership / differentiation strategy should be in a better position to:

- Adapt quickly to environmental changes
- Learn new skills and technologies more quickly
- Effectively leverage its core competencies while competing against its rivals

A commitment to strategic flexibility is necessary for successful use of this strategy.

Competitive risks of the integrated cost leadership/differentiation strategy

- Often involves compromises - Becoming neither the lowest cost nor most differentiated firm
- Becoming 'stuck in the middle - Lacking the strong commitment and expertise that accompanies firms following either a cost leadership or a differentiation strategy, Earning below-average returns and Competing at a disadvantage

The integrated strategy is an appropriate choice for firms possessing the core competencies to produce somewhat differentiated products at relatively low prices.

Generic Strategies and Industry Forces;

Industry Force	**Cost Leadership**	**Differentiation**	**Focus**
Entry Barriers	Ability to cut price in retaliation deters potential entrants.	Customer loyalty can discourage potential entrants.	Focusing develops core competencies that can act as an entry barrier.
Buyer Power	Ability to offer lower price to powerful buyers.	Large buyers have less power to negotiate because of few close alternatives.	Large buyers have less power to negotiate because of few alternatives.
Supplier Power	Better insulated from powerful suppliers.	Better able to pass on supplier price increases to customers.	Suppliers have power because of low volumes, but a differentiation-focused firm is better able to pass on supplier price increases.

Threat of Substitutes	Can use low price to defend against substitutes.	Customer's become attached to differentiating attributes, reducing threat of substitutes.	Specialized products & core competency protect against substitutes.
Rivalry	Better able to compete on price.	Brand loyalty to keep customers from rivals.	Rivals cannot meet differentiation-focused customer needs.

5.1.3 FUNCTIONAL STRATEGY

Functional strategy is the approach a functional area takes to achieve corporate and business unit objectives and strategies by maximizing resource productivity. It is concerned with developing and nurturing a distinctive competence to provide a company or business unit with a competitive advantage. Just as a multidivisional corporation has several business units, each with its own business strategy, each business unit has its own set of departments, each with its own functional strategy.

The orientation of a functional strategy is dictated by its parent business unit's strategy. For example, a business unit following a competitive strategy of differentiation through high quality needs a manufacturing functional strategy that emphasizes expensive quality assurance processes over cheaper, high-volume production; a human resource functional strategy that emphasizes the hiring and training of a highly skilled, but costly, workforce; and a marketing functional strategy that emphasizes distribution channel "pull," using advertising to increase consumer demand, over "push," using promotional allowances to retailers. If a business unit were to follow a low-cost competitive strategy, however, a different set of functional strategies would be needed to support the business strategy.

Just as competitive strategies may need to vary from one region of the world to another, functional strategies may need to vary from region to region. When Mr.Donut expanded into

Japan, for example, it had to market donuts not as breakfast, but as snack food. Because the Japanese had no breakfast coffee-and-donut custom, they preferred to eat the donuts in the afternoon or evening. Mr.Donut restaurants were thus located near railroad stations and supermarkets. All signs were in English to appeal to the Western interests of the Japanese.

Marketing Strategy

Marketing strategy deals with pricing, selling, and distributing a product. Using a market Development strategy, a company or business unit can (1) capture a larger share of an existing market for current products through market saturation and market penetration or (2) develop new uses and/or markets for current products. Consumer product giants such as P&G, Colgate Palmolive, and Unilever are experts at using advertising and promotion to implement a market saturation/penetration strategy to gain the dominant market share in a product category.

Financial Strategy

Financial strategy examines the financial implications of corporate and business-level strategic options and identifies the best financial course of action. It can also provide competitive advantage through a lower cost of funds and a flexible ability to raise capital to support a business strategy. Financial strategy usually attempts to maximize the financial value of a firm.

Research And Development (R&D) Strategy

R&D strategy deals with product and process innovation and improvement. It also deals with the appropriate mix of different types of R&D (basic, product, or process) and with the question of how new technology should be accessed—through internal development, external acquisition, or strategic alliances.

Operations Strategy

Operations strategy determines how and where a product or service is to be manufactured, the level of vertical integration in the production process, the deployment of physical resources, and relationships with suppliers. It should also deal with the optimum level of technology the firm should use in its operations processes. See the Global Issue feature to see how differences in national conditions can lead to differences in product design and manufacturing facilities from one country to another.

Purchasing Strategy

Purchasing strategy deals with obtaining the raw materials, parts, and supplies needed to perform the operations function. Purchasing strategy is important because materials and components purchased from suppliers comprise 50% of total manufacturing costs of manufacturing companies in the United Kingdom, United States, Australia, Belgium, and Finland.

The basic purchasing choices are multiple, sole, and parallel sourcing. Under multiple sourcing, the purchasing company orders a particular part from several vendors. Multiple sourcing has traditionally been considered superior to other purchasing approaches because (1) it forces suppliers to compete for the business of an important buyer, thus reducing purchasing costs, and (2) if one supplier cannot deliver, another usually can, thus guaranteeing that parts and supplies are always on hand when needed. Multiple sourcing has been one way for a purchasing firm to control the relationship with its suppliers. So long as suppliers can provide evidence that they can meet the product specifications, they are kept on the purchaser's list of acceptable vendors for specific parts and supplies. Unfortunately, the common practice of accepting the lowest bid often compromises quality.

Logistics Strategy

Logistics strategy deals with the flow of products into and out of the manufacturing process. Three trends related to this strategy are evident: centralization, outsourcing, and the use of the Internet. To gain logistical synergies across business units, corporations began centralizing logistics in the headquarters group. This centralized logistics group usually contains specialists with expertise in different transportation modes such as rail or trucking. They work to aggregate shipping volumes across the entire corporation to gain better contracts with shippers. Companies such as Georgia-Pacific, Marriott, and Union Carbide view the logistics function as an important way to differentiate themselves from the competition, to add value, and to reduce costs.

Human Resource Management (HRM) Strategy

HRM strategy, among other things, addresses the issue of whether a company or business unit should hire a large number of low-skilled employees who receive low pay, perform repetitive jobs, and are most likely quit after a short time (the McDonald's restaurant strategy) or hire skilled employees who receive relatively high pay and are cross-trained to participate in self managing work teams. As work increases in complexity, the more suited it is for teams, especially in the case of innovative product development efforts. Multinational corporations are

increasingly using self-managing work teams in their foreign affiliates as well as in home country operations. Research indicates that the use of work teams leads to increased quality and productivity as well as to higher employee satisfaction and commitment.

Information Technology Strategy

Corporations are increasingly using information technology strategy to provide business units with competitive advantage. When FedEx first provided its customers with Power Ship computer software to store addresses, print shipping labels, and track package location, its sales jumped significantly.

DISCUSSION QUESTION

1. What is corporate-level strategy and why is it important?
2. What are the different levels of diversification firms can pursue by using different corporate-level strategies?
3. How does horizontal growth differ from vertical growth as a corporate strategy? From concentric diversification?
4. What are the tradeoffs between an internal and an external growth strategy? Which approach is best as an international entry strategy?
5. Is stability really a strategy or just a term for no strategy?
6. Compare and contrast SWOT analysis with portfolio analysis.
7. How is corporate parenting different from portfolio analysis? How is it alike? Is it a useful concept in a global industry?
8. What are three reasons causing firms to diversify their operations?
9. What is a business-level strategy?
10. What is the relationship between a firm' s customers and its business-level strategy in terms of who, what, and how? Why is this relationship important?
11. What are the differences among the cost leadership, differentiation, focused cost leadership, focused differentiation, and integrated cost leadership/differentiation business-level strategies?
12. How can each one of the business-level strategies be used to position the firm relative to the five forces of competition in a way that helps the firm earn above-average returns?
13. What are the specific risks associated with using each business level strategy?

14. Are functional strategies interdependent, or can they be formulated independently of other functions?

CHAPTER SIX

STRATEGY IMPLEMENTATION

Learning Objectives

- *Discuss the functional structures used to implement business-level strategies.*
- *Define organizational structure and controls and discuss the difference between strategic and financial controls.*
- *Describe the relationship between strategy and structure.*
- *Discuss the organizational structures used to implement three international strategies.*
- *Define strategic networks and discuss how strategic center firms implement such networks at the business, corporate and international levels.*

6.1 Introduction

Once managers have decided on a strategy, the emphasis turns to converting it into actions and good results. Strategy implementation has been defined in many ways. Traditionally the focus has been on organizational structure and systems. Others have stressed the communicational and cultural aspects in strategy implementation. However, scholars and managers alike agree on some central ideas:

- First, successful strategy implementation depends in part on the organization's structure.
- Second, strategy must be institutionalized, or incorporated into a system of values, norms, and roles that will help shape employee behavior, making it easier to reach strategic goals.
- Third, strategy must be operationalized, or translated into specific policies, procedures, and rules that will guide planning and decision-making by managers and employees.

Factors Causing Unsuccessful Implementation of Strategy

Before going into the details of how a chosen strategy is implemented, it is desirable to identify the factors, which cause unsuccessful implementation of strategy so that managers can take adequate safeguard against these factors. These factors are :-

i. *Unsatisfactory coupling of strategy and operational actions.*

Unsatisfactory coupling of the strategy to the actions necessary to implement it, both within the organization and in the external decision situations with which it is concerned may cause unsuccessful implementation of the strategy. This type of difficulty can result from a number of

causes and conditions. For example, unsatisfactory coupling of the new strategy may be due ***to the lack of explicit decoupling from previous strategy*** and commitment within the organization itself. This decoupling may be caused, in turn, by the existence of a sizable group of people within the organization who are convinced that the new strategy is not practical and that the previous ways and activities are best.

ii. Insufficient Attention

Another major factor causing unsuccessful implementation of the strategy is insufficient attention to the negotiation of outcomes in the external decision situations. It is a tendency to assume, once the strategy is formulated, that all that is necessary for the success of the organization is the aggressive pursuit of the strategy.

iii. Defective Strategy

Sometimes, there may be strategy, which cannot be implemented within the context of present and future organizational resources. Perhaps, every one of us may be aware about ***'who will bell the cat'***

6.2 Activating Strategy

Activation is the process of stimulating an activity -so that it is undertaken effectively. Activation of strategy is required because only a very small group of people is involved in strategy formulation while its implementation involves a large number of people in the organization. So long as a strategy is not activated, it remains in the mind of strategists. Activation of a strategy or set of strategies requires the performance of following activities:

1. Institutionalization of strategy,
2. Formulation of derivative-plans and programs,
3. Translation of general objectives into specific objectives, and
4. Resource mobilization and allocation.

1. Institutionalization of Strategy

The first basic role of the strategist in strategy implementation is the institutionalization of the strategy. Since strategy does not become either acceptable or effective by virtue of being well designed and clearly announced, the successful implementation of strategy requires that the leader act as its promoter and defender. Therefore, there is an urgent need for the institutionalization of the strategy because without it, the strategy is subject to being

undermined. Institutionalization of strategy involves two elements: *Communication of strategy t*o organizational members and *getting acceptance of strategy* by these members.

2. Formulation of Derivative Plans and Programs

Once the strategy is institutionalized through its communication and acceptance, the organization may proceed to formulate action plans and programs. Since these plans and programs are derived from a strategic choice (strategic plan), these are known as derivative plans and programs.

Action Plans - Action plans target at the most effective utilization of resources in an organization so that objectives are achieved. These action plans may be of several types like plan for procuring a new plant, developing a new product, and so .on.

Programs - A program is a single-use plan that covers relatively a large set of activities and specifies major steps, their order and timing, and responsibility for each step. There may be several programs in an organization; some of them being major, others being minor. These programs are generally supported by necessary capital and operating budgets.

3. Translating General Objectives into Specific Objectives

Organizational objectives are of general and broad nature. They provide direction for action on continuous basis. However, these objectives are too general and, sometimes, intangible to be transformed into action. In order to make these operative, managers determine specific objectives within the framework of general objectives, which the organization and its various units will seek to achieve within a specific period.

Translation of general objectives into specific and operative objectives must fulfill two criteria.

- Translation of general objectives into specific objectives should be tangible and meaningful.
- Specific objectives should contribute to the achievement of general objectives.

4. Resource mobilization and allocation

For implementing a strategy, an organization should have commensurate resources and these resources should be committed and allocated to various units and functions where these have optimum use. These resources are the means by which an organization produces goods and services of value through conversion process. The success of the organization depends on the quality of its resources and their utilization. Therefore, the organization should feel concerned about how to mobilize resources and allocate these to various units and subunits.

6.3 Implementation of Strategy

'It's been rather easy for us to decide where we wanted to go. The hard part is to get the organization to act on the new priorities.'(Floyd and Woolridge, 1992)

Implementation is taking the actions necessary to accomplish the goals, strategies, and objectives. It requires action planning, senior leadership involvement, commitment to the plan, resourcing (people, time, and money), and involvement from the entire organization. The strategic planning process that was used to create the plan is inverted in the implementation phase. Completion of the objectives impacts completion of the strategies, then the goals, and leads toward accomplishing the vision. To implement the strategic plan successfully, it is necessary for the organization to have a formal implementation plan with actions assigned to either teams or individuals who are responsible for their accomplishment. Following are actions that are keys for successfully implementing the strategic plan and actions that guarantee failure.

<u>Keys to Success</u>

- Assign roles and responsibilities
- Involve senior leaders
- Define an infrastructure
- Link goal groups
- Phase integration of implementation actions with workload
- Involve everyone within the Organization Allocate resources for implementation
- Manage the change process Evaluate results
- Share lessons learned;
- acknowledge successes through

<u>Facts of Failure</u>

- ✓ No accountability
- ✓ Disengagement from process
- ✓ Unmanaged activity
- ✓ Fragmented accomplishment of objectives leads to sub optimization
- ✓ Force people to choose between implementation and daily work; too many teams
- ✓ No alignment of strategies
- ✓ Focus only on short term need for resources
- ✓ Ignore or avoid change

- ✓ No measurement system
- ✓ Hide mistakes/lay blame;

1. Structural Implementation

Structural implementation of strategy involves designing of organization structure and interlinking various units and subunits of the organization created as a result of the organization structure. Organization structure is the pattern in which the various parts of the organization are interrelated or interconnected. Thus, it involves such issues as to how the work of the organization will be divided and assigned among various positions, groups, departments, divisions, etc. and the coordination, necessary to accomplish organizational objectives: will be achieved. Thus, there are two aspects of organizational design: differentiation and integration.

- *Differentiation* refers to 'the differences in cognitive and emotional orientations among managers in different functional departments'.
- *Integration refers* to 'the quality of the state of collaboration that are required to achieve unity of efforts in the organization. Therefore, the organization must emphasize on both the aspects: it must design organization structure and provide systems for interaction and coordination among organization's parts and members.

Achieving a fit b/n strategy & structure is a complex process that involves how activities will be grouped & groups will be coordinated. This refers to the need for identifying the appropriate types of organizational structure, linking organizational units, & decision making (centralization vs. decentralization)

Organizational structure facilitates the implementation of the strategy. Although there are many types of structures, three basic types identified: Simple, functional & multi-divisional.

A. Simple Structure

an organizational form in which the owner-manager makes all decisions directly & monitors all activities – employees serve as an extension of the manager's supervisory authority.

Features:

- Little specialization of tasks
- Few rules & limited formalization
- Communication is frequent & direct

- Offering products in a single geographic market
- New products tend to be introduced to the market quickly – competitive advantage

This type of organizational structure is frequently used by firms implementing either the focused cost leadership or focused differentiation strategy. Simple structure is more appropriate for small firms: restaurants, repair businesses, & other specialized enterprises. As firms grow, they implement functional structure to coordinate more complex organizational functions.

B. Functional Structure

Is an organizational form where dominant organizational areas such as human resource, production, accounting & finance, marketing, R&D, & engineering are separately organized. A functional structure consists of a chief executive officer & limited corporate staff.

Features:

- Facilitates specialization, knowledge sharing & idea development
- Facilitates career paths & professional development in specialized areas
- However, differences in orientation impede communication & coordination

Integrating the decisions & actions of functional areas for the benefit of the entire organization rests on the CEO. This structure is used by large firms: To implement one of the business-level strategies However, with low levels of product diversification.

C. Multi-divisional Structure

This is composed of operating divisions, each representing a separate business or profit center.

Features:

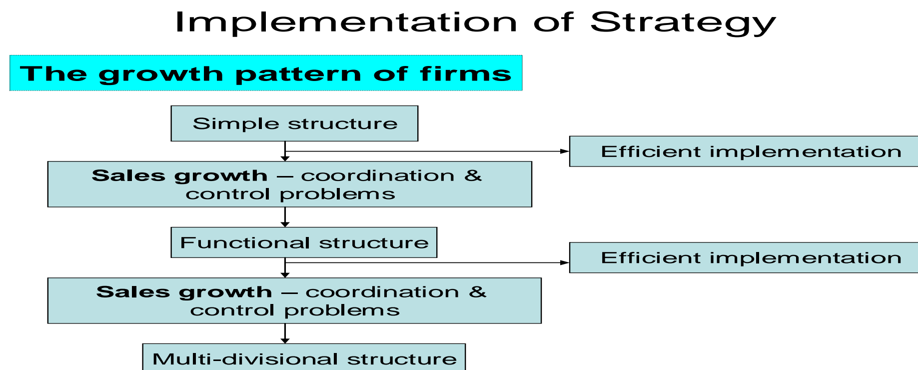
- Separate divisions are distinct businesses
- Self-contained & have their own functional hierarchy
- Each division makes its own business-level strategic decisions

Thus, corporate-level managers are responsible for: Determining the company's overall long-term strategic direction and exercising overall financial control of semi-autonomous divisions.

Implications:

- Enables to monitor accurately – simplifies the problem of control
- Facilities comparisons b/n divisions – improves the resource allocation process
- Stimulates managers of poor performing divisions

- The cost leadership strategy requires a centralized functional structure – emphasizing manufacturing efficiency & process engineering
- The differentiation strategy requires a decentralized functional structure – implementation decision (specially marketing)
- Focus strategy requires a simple structure until firms begin to compete in multiple markets
- or sells multiple products



2. Functional Implementation

Functional implementation deals with the development of policies and plans in different areas of functions, which an organization undertakes. Every business organization is built around two basic functions: production and marketing; to be in business, every organization has to produce goods or services and sell these to the customers. The resources that are used to perform and pay for these two basic functions constitute two other significant functions-finance and personne1. Thus, an organization has to formulate policies and plans in these functions to implement its strategy successfully.

3. Behavioural Implementation

Behavioural Implementation deals with strategic leadership, organizational culture and values.

I. Strategic Leadership

Strategic leadership is the process of transforming an organization with the help of its people so - as to put it in a unique position. Thus, two aspects are involved in strategic leadership. First, it transforms the organization which involves changing all faces such as size, management practices, culture and values, and people in such a way that the organization becomes unique. Second, strategic leadership process emphasizes people because they are the source for

transforming various physical and financial resources of the organization into outputs that are meaningful to the society. Thus, strategic leadership
proceeds as follows:

- Strategic leadership deals with vision-keeping the mission in sight-and with effectiveness and results.
- Strategic leadership emphasizes transformational aspect.
- Strategic leadership inspires and motivates people to work together with a common vision and purpose.
- Strategic leadership has external focus rather internal focus.

II. Organizational Culture

Organizational culture is another element which affects strategy implementation as it provides a framework within, which the behaviour of the members takes place. Though there are differing views on what constitute an organizational culture, generally, it is defined as a set of assumptions the members of an organization share in common. For example, organizational culture has been defined as follows: "Organizational culture is the set of assumptions. beliefs, values and norms that are shared by an organization's members. Thus, there are two types of elements, which define the culture of an organization: abstract elements and material elements. Abstract - elements are internally oriented and include values, beliefs, attitudes, and feelings. Material elements are externally focused and include building, personnel dresses, products, etc.

III. Values

Values of individuals, particularly those of key strategists, have major impact on strategy of the, organization. While terminal values shape organizational strategies, instrumental values indicate how these strategies are to be implemented. Depending on the dominance of terminal values in strategists, these are means for organizational transformation.

6.4 The Seven-S Model

Based on discussions with consultants, academics, and business leaders, the consulting firm of McKinsey & Co. has proposed the Seven-S Model for successful strategy implementation. The model starts on the premise that an organization is not just structure, but consists of seven elements:

Those seven elements are distinguished in so called ***hard S's and soft S's***.

- The 3Ss across the top of the model are described as 'Hard Ss', which are feasible and easy to identify. They can be found in strategy statements, corporate plans, organizational charts and other documentations.
- The four soft S's however, are hardly feasible. They are difficult to describe since capabilities, values and elements of corporate culture are continuously developing and changing. They are highly determined by the people at work in the organization. Therefore it is much more difficult to planor to influence the characteristics of the soft elements. Although the soft factors are below the surface, they can have a great impact of the hard Structures, Strategies and Systems of the organization.

Description	
The Hard S's	
Strategy	Actions a company plans in response to or anticipation of changes in its external environment.
Structure	Basis for specialization and co-ordination influenced primarily by strategy and by organization size and diversity.
System	Formal and informal procedures that support the strategy and structure. (Systems are more powerful than they are given credit)
The Soft S's	
Style/Culture	The culture of the organization, consisting of two components: *Organizational Culture:* the dominant values and beliefs, and norms, which develop over time and become relatively enduring features of organizational life. *Management Style:* more a matter of what managers do than what they say; How do a company's managers spend their time? What are they focusing attention on? Symbolism – the creation and maintenance (or sometimes deconstruction) of meaning is a fundamental responsibility of managers.
Staff	The people/human resource management – processes used to develop managers, socialization processes, ways of shaping basic values of management cadre, ways of introducing young recruits to the company, ways of helping to manage the careers of employees. c
Skill	The distinctive competences – what the company does best, ways of expanding or shifting competences.

Shared Values/Subordinate goals	Guiding concepts, fundamental ideas around which a business is built – must be simple, usually stated at abstract level, have great meaning inside the organization even though outsiders may not see or understand them.

The 7-S Model is a valuable tool to initiate change processes and to give them direction. A helpful application is to determine the current state of each element and to compare this with the ideal state. Based in this it is possible to develop action plans to achieve the intended state.

6.5 Balanced Scorecard (BSC) Model

According to the balanced scorecard organizations are viewed from four perspectives:

- *The Financial Perspective*
- *The Customer Perspective*
- *The Business Process Perspective*
- *The learning & Growth Perspective*

To develop metrics, collect data & analyze it relative to each of these perspectives

- **Financial perspective** - measures reflecting financial performance, for example number of debtors, cash flow or return on investment. The financial performance of an organization is fundamental to its success.
- **Customer Perspective** - measures having a direct impact on customers, for example time taken to process a phone call, results of customer surveys, number of complaints or competitive rankings (an increasing realization of the importance of **customer focus** & **customer satisfaction** in any business)
- **Business Process Perspective** - measures reflecting the performance of key business processes, for example the time spent prospecting, number of units that required rework or process cost (whether its **products** & **services** conform to **customer requirements**)
- **Learning and growth perspective** - measures describing the company's learning curve - for example, number of employee suggestions or total hours spent on staff training (ease of **communication** & **knowledgable** employees)

DISCUSSION QUESTION

1. How should a corporation attempt to achieve synergy among functions and business units?
2. How should an owner-manager prepare a company for its movement from Stage I to Stage II?
3. How can a corporation keep from sliding into the Decline stage of the organizational life cycle?
4. Is reengineering just another management fad, or does it offers something of lasting value?
5. How is the cellular/modular structure different from the network structure?
6. Why is it important for an organization to have alignment between its strategy and structure?
7. Briefly explain the concept of seven S's model and its importance in implementing strategy
8. Briefly discuss the four perspectives balanced scorecard in organizations.

CHAPTER SEVEN
STRATEGY EVALUATION AND CONTROL

Learning objectives

- *Understand the basic evaluation and control process*
- *Apply the benchmarking process to a function or an activity*
- *Understand the impact of problems with measuring performance*
- *Develop appropriate control systems to support specific strategic*

7.1 Strategy Evaluation

In general, evaluation refers to measuring & controlling the organization's progress with respect to its strategy & when discrepancies exist, taking corrective action.

Corrective action may require adjusting performance objectives because of:

- Changes in circumstances
- Shifting contingency plan
- Fine-tuning strategies

However, the system must encourage efficient operations that are consistent with the plan while allowing the flexibility to adapt the changing conditions.

The major issues which make evaluation difficult

- Each business strategy is unique-neither strategy is "wrong" nor "right" in any absolute sense
- Strategy is centrally concerned with the selection of goals and objectives rather than trying to achieve goals and evaluate them.
- Formal systems of strategic review, while appealing in principal, can create explosive conflict situations.

Principles of Strategy Evaluation

- ***Consistency***: The strategy must not present mutually inconsistent goals and policies.
- ***Consonance***: The strategy must represent an adaptive response to the external environment and to the critical changes occurring within it.
- ***Advantage***: The strategy. must provide for the creation and/or maintenance of a competitive advantage in the selected area of activity.

- ***Feasibility***: The strategy must neither overtax available resources nor create unsolvable sub problems.
    - A strategy that fails to meet one or more of these criteria fails to perform at least one of the key functions that are necessary for the survival of the business.
    - Experience within a particular industry or other setting will permit the analyst to sharpen these criteria and add others that are appropriate to the situation at hand.

There are two types of evaluation systems: process evaluation & outcome evaluation.

1. Process evaluation

Emphasizes on **uncovering** the deficiencies in an ongoing program

- Monitoring the **progress** of an organization against the **strategic plan** while it is under implementation
- Helps to know whether the organization is moving toward the strategic goals

Four phases of process evaluation (Cox III et al, 1994):

- ✓ Problem identification
- ✓ Solution development
- ✓ Implementation of the solution
- ✓ Feedback evaluation

2. Outcome evaluation

Could be undertaken at the end of the entire strategic management process with the aim of determining what has been **accomplished**. The outcome from such an evaluation:

- How much of the stated goal was accomplished?
- What other effects, that were not otherwise anticipated, resulted from this program?
- What databases are available on which to start the strategic management process again?

The outcome evaluation closes the loop of the strategic management process & returns managers to the first phase of formulating a **vision** & **mission** for a new process.

7.2 Strategy Control

The purpose of control could be to determine whether:

- Selected strategies implemented successfully
- The resources are used widely
- Set objectives are achieved, etc.

There are several methods of control: strategic, financial, management, operational, performance, etc. Steps in controlling & evaluation process:

- Setting standards for performance
- Measure actual performance
- Compare actual performance with the standard
- Analyze the reasons for significant deviations, if any
- Take corrective action when performance does not fall within acceptable range

Thus, corrective actions refer to revising standards, objectives, structure, & activities, etc.

Control systems

Components of management control systems include budgets, statistical reports, policies/procedures, & performance appraisal.

Thus, the progress toward desired ends must be periodically monitored & evaluated in order to take corrective action timely.

In general, control is necessary for goal achievement.

Types of control system

1. Strategic control: Entails corporate-level managers to evaluate the performance of division managers & their units using long-term & strategically relevant criteria. The effective use of strategic control:

- Requires deep understanding of business unit's operations & markets
- Demands rich exchanges of information b/n corporate & divisional managers – *openness must be encouraged*
- Demands high levels of cognitive diversity by corporate managers – *behavioral in nature*
- Requires detecting of any problem or potential problem areas & making necessary adjustments

However, as diversification increases, strategic control can be **strained** – this results in reducing the firm's level of diversification

2. Financial control: Entails objective criteria (e.g. return on investment) that corporate-level managers use to evaluate both individual business units & the managers responsible for their performance.

- Requires each division's performance to be largely independent – the units are oriented towards financial outcomes.

- Therefore, the effectiveness of financial control is based on SBUs independence.
- Financial data are the most commonly used warning signals: profit, sales, ROI, ROE, cost figures, etc.
- Substantial discrepancies in any of the figures indicate something unanticipated is happening.
- There are also non-financial controls that are used as early warning signals to potential problems
    - Productivity measures
    - Quality measures
    - Personnel related measures
    - Feedback from customers

Types of strategy & organizational control:

- Large diversified firms using a cost leadership strategy emphasize financial controls
- Companies using differentiation strategy emphasize strategic controls

Concepts and Roles of Strategic Evaluation and Control

- Strategic evaluation and control is related to ensuring whether it is achieving its objectives
- Glueck and Jauch have defined strategic evaluation as follows: *"Evaluation of strategy is that phase of the strategic management process in which the top managers determine whether their strategic choice as implemented is meeting the objectives of the enterprise.*
- There are two aspects in this phase of strategic management: evaluation and control
    - ✓ Evaluation emphasizes measurement of results
    - ✓ Control emphasizes on taking necessary actions
- Both are intertwined.

Role of Strategic Evaluation and Control

- When strategic evaluation and control is undertaken properly, it contributes in three specific areas:
- The linkage of *Strategic Planning, Control To Performance And Reward*

Participants in Strategic Evaluation and Control

All those persons who participate in strategy formulation and implementation should also participate in strategic evaluation except those who act in advisory capacity

- ✓ Board of directors,
- ✓ chief executive,
- ✓ other managers,
- ✓ corporate planning staff, consultants as advisors

Barriers in Strategic Evaluation and Control

In strategic evaluation and control there are barriers and problems around two factors:

1. Motivational Problems

Often two problems are involved in motivation to evaluate the strategy:

- Psychological problem and
- Lack of direct relationship between performance and rewards.

A) Psychological Barriers

- Top management hardly appreciates any mistake it may commit at the level of strategy formulation.
- Even if something goes wrong at the level of strategy formulation, it may put the blame on the operating management on strategy implementation.
- Managers are seldom motivated to evaluate their strategies because of the psychological barriers of accepting their mistakes
- This happens more in the case of retrenchment strategy, particularly divestment strategy where a particular business has failed because of strategic mistake and in order to save the organization from further damage, the business has to be sold.

B) Lack of Direct Relationship between Performance and Rewards

- This results from ' the lack of direct relationship between performance achievement and incentives.
- Thus, what is required for motivating the top and lower level managers to evaluate their performance and strategy is the right type of motivational climate in the organization.

2. Operational Problems

- Even if managers agree to evaluate the strategy, the problem of strategic evaluation is not over because strategic evaluation is a nebulous process; many factors are not as clear as the managers would like these to be.
- These factors are in the areas of determination of
  - ✓ Evaluative Criteria,
  - ✓ Performance Measurement,
  - ✓ Measurement Of Organizational Progress,
  - ✓ Feedback for Future Actions,
  - ✓ Linking Performance and Rewards.

DISCUSION QUESTIONS

1. Discuss the importance of evaluating strategy
2. Briefly explain principles of strategy evaluation
3. Discuss in detail the difference between process evaluation and outcome evaluation
4. What is the purpose of control in strategic management?
5. Discuss types of controls system.
6. What are barriers to strategic evaluation and control?

CASES TO BE ANALYSED

1. Does Facebook Have a Strategy?

Facebook was founded in a dorm room at Harvard in 2004 by 19-year-old Mark Zuckerberg and three college pals. What began as a hobby to let college students socialize online is now the world's largest social networking site, with more than 1.1 billion users and over $5 billion in revenues (in 2012). As of summer 2013, Facebook is the most popular website globally, even more popular than Google. Zuckerberg sees online social networking as the "most powerful and transformative social change" in recent history, and the biggest invention since Gutenberg's printing press. Indeed, it's made him the world's youngest billionaire.

Before Facebook became a global phenomenon, it had to overcome the first-mover advantage held by Myspace. Launched in 2003, Myspace was an early leader in social networking. Its success attracted the attention of News Corp. and other media outlets.

News Corp. acquired Myspace for $580 million in 2005. As a subsidiary of a publicly owned company, Myspace's revenues and profitability became more pressing issues after the acquisition. Myspace's business model shifted from accumulating more users to growing revenues and profits by focusing on a few ad-heavy markets such as the U.S., UK, Germany, France, and Japan. Myspace was hit hard by the global economic downturn that began in 2008. A year later, it laid off 45 percent of its staff.

Facebook, on the other hand, remained a private company until May 2012. Among other investors, Microsoft purchased a $240 million equity stake in 2007, and a Russian investment group added $200 million in 2009. Facebook's managers had less pressure to produce bottom-line results than did Myspace. This allowed the company to pursue a different business model: more users first, profits later. While Myspace concentrated on a few developed markets, Facebook pursued a truly global strategy. More than 70 percent of its users are outside the United States. In 2008, Facebook displaced Myspace as the most popular social networking site. Facebook's new challengers in the social media space include Google, LinkedIn, Pinterest, and Twitter.

Facebook's business model is based on three pillars:

1. *News Feed.* Launched in September 2006, this quickly became a core feature of Facebook. It is at the heart of a user's homepage and provides regular updates of friends' posts, photos,

events, group memberships, and other subjects. The priority of items displayed in the News Feed is based on a complex algorithm.

2. *Timeline.* This is an updated version of the profile pages and was launched in September 2011. It allows each user to paint a complete life story on his or her profile. Users can select what information is shared and with whom they share it.

3. *Graph Search.* Zuckerberg calls the network of connections between people the “social graph.” Graph Search is an attempt to map the global social graph in the form of a massive database. Introduced in January 2013, it is a search bar that hovers at the top of Facebook’s web page, acting as a title for the content of that page and allowing a user to query the portion of the social graph that is connected to and filled in by the user.

In May 2012 Facebook went public with an initial share price of $38, making the company worth more than $100 billion. Just a year later, in the summer of 2013, Facebook was valued at around $60 billion. In an interview, Mark Zuckerberg conceded, “The performance of the stock has obviously been disappointing.

Discussion Questions

1. Why is Facebook the number-one social media company, and not Myspace which enjoyed a first mover advantage?
2. Given the characteristic of good and bad strategy, do you think Facebook has a good strategy? Why or why not?
3. The first step in creating a good strategy is to diagnose the competitive challenge. What do you believe is Facebook’s number-one competitive challenge?
4. What top-three recommendations would you give Mr. Zuckerberg? Why? Support your arguments.

2. The Wonder from Sweden: Is IKEA's Success Sustainable?

The world's most successful global retailer**,** in terms of profitability, is not Walmart or the French grocery chain Carrefour, but IKEA—a privately owned home-furnishings company with origins in Sweden. In 2012, IKEA had more than 330 stores worldwide in 38 countries, employed some 140,000 people, and earned revenues of 33 billion euros. IKEA's revenues by geographic region are 70 percent from Europe, with the rest from North America (16 percent), Asia and Australia (8 percent), and Russia (6 percent) (Exhibit MC5.1). Although IKEA's largest market is in Germany (14 percent of total sales), its fastest-growing markets are the United States, China, and Russia. Known today for its iconic blue-and-yellow big box retail stores, focusing on flat-pack furniture boxes combined with a large DIY component, IKEA started as a small retail outlet in 1943 by then-17-year-old Ingvar Kamprad.

Though IKEA has become a global phenomenon, it was initially slow to internationalize. It took 20 years before the company expanded beyond Sweden to its neighboring country of Norway. After honing and refining its core competencies of designing modern functional home furnishings at low prices and offering a unique retail experience in its home market, IKEA followed an *international strategy,* expanding first to Europe, and then beyond. Using an international strategy allowed IKEA to sell the same types of home furnishings across the globe with little adaptation (although it does make some allowances for country preferences). Because IKEA focuses on low cost, it shifted more recently from an international strategy to a global-standardization strategy, in which it attempts to achieve economies of scale through effectively managing a global supply chain. Although Asia accounts currently for only 8 percent of its sales, IKEA sources 32 percent of its inputs (mostly timber) from this region. To drive costs down further, IKEA has begun to implement production techniques from auto and electronics industries, in which cutting-edge technologies are employed to address complexity while achieving flexibility and low cost.

Despite its success, IKEA faces significant challenges going forward. Opening new stores is critical to drive future growth. Finding new sources of supply to support more store openings, however, is a challenge. Although demand for IKEA's low-cost home furnishings increased during the global financial crisis as more customers became price conscious, IKEA's annual store growth has slowed to less than five new stores a year. This is because its supply chain has become a bottleneck. IKEA has difficulty finding suppliers that are a strategic fit with its highly

efficient operations. Related to this issue is the fact that wood remains one of IKEA's main input factors, and the world's consumers are becoming more sensitive to the issue of deforestation and its possible link to global warming. In the near future, IKEA must find low-cost replacement materials for wood. In addition, powerful competitors have taken notice of IKEA's success. Although IKEA is growing in North America, it holds less than 5 percent of the home furnishings market. In some European markets, IKEA holds 30 percent market share. To keep IKEA at bay in the U.S., Target has recently recruited top designers and launched a wide range of low-priced furnishings. Kmart, likewise, has enrolled Martha Stewart to help with the design of its offerings of home furnishings.

Besides these external challenges, IKEA also faces significant internal ones. Since the company's founding in 1943, no strategic decisions have been made without Mr. Kamprad's involvement and explicit approval. In 2013, Mr. Kamprad (now in his late 80s) announced he is stepping down from chairing Inter IKEA, the foundation that owns the company. Many observers compare Mr. Kamprad's influence on IKEA's culture and organization to that of the legendary Sam Walton at Walmart. Mr. Kamprad's three sons will take on stronger leadership roles at IKEA, with one of them now chairing Inter IKEA.

Moreover, IKEA is privately held (through a complicated network of foundations and holding companies in the Netherlands, Lichtenstein, and Luxembourg). This arrangement provides benefits in terms of reducing tax exposure, but also creates constraints in accessing large sums of capital needed for rapid global expansion. IKEA will need to address these challenges in order to live up to its strategic intent of doubling its number of yearly openings in an attempt to capture a larger slice of fast-growing markets such as the U.S., China, and Russia.

Discussion Questions

1. List IKEA's external and internal challenges. Looking at IKEA's challenges, which ones do you think pose the greatest threat? Why? How would you address the challenges?
2. Walmart entered a period of difficulties after Sam Walton stepped down. Do you anticipate IKEA having the same leadership transition challenges? Why or why not?
3. What can IKEA do to continue to drive growth globally, especially given its strategic intent to double annual store openings?

4. Assume you are hired to consult IKEA on the topic of *corporate social responsibility*. Which areas would you recommend the company be most sensitive to, and how should these be addressed?

3. Starbucks: Re-creating Its Uniqueness

Inspired by italian coffee bars, Starbucks' CEO Howard Schultz set out to provide a completely new consumer experience. The trademark of any Starbucks coffee house is its ambience—where music and comfortable chairs and sofas encourage customers to sit and enjoy their beverages. While hanging out at Starbucks, they can use the complimentary wireless hotspot or just visit with friends.

The barista seems to speak a foreign language as she rattles off the offerings: Caffé Misto, Caramel Macchiato, Cinnamon Dolce Latte, Espresso Con Panna, and Starbucks' Mint Mocha Chip Frappuccino are among some 30 different coffee blends. Dazzled and enchanted, customers pay $4 or more for a Venti-sized drink. Starbucks has been so successful in creating its ambience that customers keep coming back for more.

Starbucks' core competency is to create a unique consumer experience the world over. That is what customers are paying for, not the cup of coffee or tea. The consumer experience Starbucks created was a valuable, rare, and costly-to-imitate intangible resource. This allowed the company to gain a competitive advantage.

While core competencies are often built through learning from experience, these competencies can a trophy through forgetting. This is what happened to Starbucks. Between 2004 and 2008, Starbucks expanded operations rapidly by doubling the number of stores from 8,500 to almost 17,000 stores. It also branched out into ice cream, desserts, sandwiches, books, music, and other retail merchandise, straying from its core business. Trying to keep up with its explosive growth in both the number of stores and product offerings, Starbucks began to forget what made it unique. It lost the appeal that made it special, and its unique culture became diluted. For example, baristas used to grind beans throughout the day whenever a new pot of coffee had to be brewed (which was at least every eight minutes). The grinding sounds and fresh coffee aroma were trademarks of Starbucks stores. Instead, to accommodate its fast growth, many baristas began to grind all of the day's coffee beans in the morning and store them for the rest of the day. To make matters worse, in 2008 the global financial crisis hit. The first items consumers go without during recession are luxury items such as a $4 coffee at Starbucks.

Coming out of an eight-year retirement, Howard Schultz again took the reins as CEO and president in January 2008, attempting to re-create what had made Starbucks special. In 2009, Starbucks introduced Via, its new instant coffee, a move that some worried might further dilute the brand. In the fall of 2010, Schultz rolled out a new guideline: Baristas would no longer multitask, making multiple drinks at the same time, but would instead focus on no more than two drinks at a time, starting a second one while finishing the first. The goal was to bring back the customer experience that built the Starbucks brand. By the summer of 2013, Starbucks operated some 21,000 stores in over 60 countries, bringing in $14 billion in annual revenues.

Discussion Questions

1. What resources and capabilities formed the basis of the uniqueness of Starbucks in the first place? Why was it so successful?
2. To be a source of competitive advantage over time, core competencies need to be honed and upgraded continuously.
    a) Why and how did Starbucks lose its uniqueness?
    b) How is Starbucks re-creating its uniqueness?
    c) Do you think it will be successful over time? Why or why not?
3. What recommendations would you give Howard Schultz to sustain a competitive advantage over time? Support your arguments.

4. LVMH in China: Building Its Empire of Desire

In July 2012**,** Louis Vuitton, the flagship brand of France's Moët Hennessy Louis Vuitton S.A., better known as LVMH, opened its 16 th global "Maison" at Shanghai's Plaza 66, a mega luxury mall. The Shanghai Maison houses the entire range of Louis Vuitton collections, from high-fashion clothing and leather goods, to jewelry, watches, cosmetics, and wines and spirits. The grand opening of the Shanghai Maison also coincided with the 20 th anniversary of the brand's presence in China; Louis Vuitton had opened its first store in the country in 1992, in Beijing's Peninsula Hotel.

LVMH's sales in Asia accounted for one third of its total revenue by the end of the first quarter of 2013.Those results made Asia the largest region for LVMH in terms of revenues. Focusing on countries rather than regions, China is the world's biggest luxury market, having achieved an average annual growth rate of 27 percent from 2008 to 2012. Louis Vuitton loves China, and the

Chinese love Louis Vuitton. In a recent Chinese luxury consumer survey published by the Hurun Research Institute, Louis Vuitton topped the list as the number-one and number-two preferred luxury brand by Chinese men and women, respectively. Although the brand's heritage and craftsmanship are attractive characteristics to Chinese consumers, they are not solely responsible for opening the wallets of affluent Chinese. Louis Vuitton's steep prices and glamorous prestige are reflected onto its customers, and Chinese luxury customers value being recognized as wealthy elites with high social status. To stay apart from (or atop) the crowd is what Chinese customers crave in a densely populated and formerly egalitarian (communist) society. The brand's image reinforcement is so powerful that even many in China's middle class aspire to become owners of Louis Vuitton goods. On average, Chinese Louis Vuitton customers are younger than their Western counterparts. Moreover, they spend a significantly higher amount of their disposable income on LVMH's luxury status symbols.

With an eager consumer base and a lack of local competitors, there is probably no stronger tail wind an international brand could hope for in China. LVMH's years of heavy marketing to raise consumer brand recognition have paid off: Goods fly off the shelves, and every single store LVMH has opened in China is profitable.

LVMH managed its growth well. Since its formation in 1987, it has become the world's largest luxury conglomerate, owning more than 60 brands and 3,200 stores worldwide. 2 It has a remarkable track record in Asia: 85 percent of Japanese women own a Louis Vuitton product, for example. With an early entry into China, LVMH was also able to take advantage of the country's increasing growth to become the largest luxury market worldwide. Not only did LVMH capture the luxury lovers in Beijing and Shanghai, but it also opened stores in second-tier provincial capitals and wealthier third-tier cities in the west, where rapid growth was expected.

After nearly a decade of successful expansion, LVMH recently turned more cautious, though. LVMH's concern in China is to "avoid becoming too common place." Although the newly rich in second- and third-tier cities still crave luxury goods, consumer tastes in Beijing and Shanghai may be maturing. Chinese in the major cities have become well-traveled global consumers and are shying away from "logo-heavy" mega brands. Increasingly, they are more sophisticated consumers, embracing uniqueness and understatement in luxury items.

To respond to changing consumer tastes, LVMH stopped opening new stores in China and launched the Shanghai Maison with invitation-only floors. It also offers custom made-to-order bags using exotic animal skins, to project exclusivity for the very top-end customers.

It began to focus on leather products with high value added rather than the entry-level-priced canvas logo style. In addition, LVMH has promoted a set of "logo-free" handbags targeted exclusively at high-end Chinese customers.

But LVMH's decision to limit store growth may have another reason: The Chinese are more often choosing to buy abroad. The main reasons Chinese consumers cite for shopping overseas are lower prices (due to China's high luxury taxes), better selection, and greater "showoff" value. It is quite common to find busloads of Chinese tourists lining up outside Louis Vuitton's boutique on Avenue des Champs- Elysées in Paris to purchase merchandise.

Although such purchases in the Paris store have created growth for LVMH Europe, they also pose challenges such as managing inventory and providing adequate service. Before a recent holiday season, for example, Louis Vuitton had to put in drastic measures to slow sales. In its flagship Paris store, LVMH limited the total number of leather products available for purchase for each customer and reduced store hours. In addition, Louis Vuitton's European stores have hired Mandarin-speaking staff who are trained to better meet Chinese needs and better handle the spikes of tour-bus traffic. Meanwhile, LVMH aims to strengthen its relationship with Chinese customers at home by providing premium services and enhancing their shopping experience. As long as the price difference exists, however, stores abroad will continue to be Chinese customers' preferred shopping destinations.

Like all other luxury brands, LVMH has to constantly fight against the counterfeiting of its products, especially the Louis Vuitton brand. China's dominance in manufacturing and its general lack of enforcement of intellectual property laws have made it the location for the manufacture of more than 80 percent of the estimated $300 billion counterfeit industry. To keep some control over its products, LVMH manufactures its leather goods in company owned factories in France, Switzerland, Germany, Italy, Spain, and the United States. Since the early 2000s, LVMH's Chinese anti-counterfeiting team, together with its global specialists and investigators, has raised public awareness of counterfeits and stemmed the flow of the counterfeits from China to the developed world. It also brought legal actions against pirates who made fake goods, as well as landlords who provided operation locations for the pirates. LVMH

has achieved much anti-counterfeiting success in China, including winning several recent cases in Chinese courts. But as long as the popularity of its Louis Vuitton bag lasts, the anti counterfeiting battle goes on, further contributing to a potential loss of exclusivity.

Discussion Questions

1. Why is LVMH so successful in China?
2. Louis Vuitton is LVMH's flagship brand. Much of Louis Vuitton's appeal is that it bestows exclusivity on its owners. In the last few years, however, the Louis Vuitton logo has been applied to handbags and accessories at an unprecedented rate. Discuss the challenges to the value of the brand as LVMH responds by introducing more luxury handbags and accessories without displaying the logo.
3. LVMH is also confronting the problem of proliferation of the LV logo through excessive counterfeiting activity. How can LVMH use its strengths to overcome threats from counterfeiters?
4. How does LVMH encourage Chinese customers to purchase LVMH products in China rather than abroad? Do you think these strategic initiatives will be successful? Why or why not? What other ideas do you think LVMH should pursue to encourage Chinese customers to purchase LVMH products in China?
5. Other luxury brands such as Chanel, Burberry, and Gucci are building a presence in the large luxury goods market in China. What actions might LVMH take to sustain its strong position in the market?

5. The Rise and fall of Circuit City: From Good to Great to Gone

In the 1990s**,** Circuit City was the largest and most successful consumer-electronics retailer in the United States. Indeed, Circuit City was so successful it was included as one of only 11 companies featured in Jim Collins' bestseller *Good to Great.* To qualify for this august group of high performers, a company had to attain "extraordinary results, averaging cumulative stock returns 6.9 times the general market in the 15 years following their transition points." Indeed, Circuit City was *the best-performing* company on Collins' good-to-great list, outperforming the stock market 18.5 times during the 1982–1997 periods.

How did Circuit City become so successful? The company was able to build and refine a set of core competencies that enabled it to create a higher economic value than its competitors. In

particular, Circuit City created world-class competencies in efficient and effective logistics expertise. It deployed sophisticated point-of-sale and inventory-tracking technology, supported by IT investments that enabled the firm to connect the flow of information among geographically dispersed stores. This expertise in turn allowed detailed tracking of customer preferences and enabled Circuit City to respond quickly to changing trends. The company also relied on highly motivated, well trained sales personnel to provide superior service and thus build and maintain customer loyalty. These core competencies enabled Circuit City to implement a "4S business model"—service, selection, savings, and satisfaction—that it applied to big-ticket consumer electronics with an unmatched degree of consistency throughout the United States.

Perhaps even more important during the company's high-performance run, many capable competitors were unable to replicate Circuit City's core competencies. Further underscoring Circuit City's superior performance is the fact, as Jim Collins described it, that "if you had to choose between $1 invested in Circuit City or $1 invested in General Electric on the day that the legendary Jack Welch took over GE in 1981 and held [that investment] to January 1, 2000, you would have been better off with Circuit City—by [a factor of] six times." In the fall of 2008, however, Circuit City filed for bankruptcy. So what happened?

Circuit City's core competencies lost value because the firm neglected to upgrade and protect them. As a consequence, it was outflanked by Best Buy and online retailers such as Amazon. Moreover, Circuit City's top management team was also distracted by pursuing noncore activities such as the creation of CarMax, a retail chain for used cars, a foray into providing an alternative to video rentals through its proprietary DivX DVD player, and an attempted merger with Blockbuster (which filed for bankruptcy in 2010).

Perhaps the biggest blunder that Circuit City's top management team committed was to lay off 3,000 of the firm's highest-paid sales personnel. The layoff was done to become more cost-competitive with Best Buy and, in particular, the growing online retailers. The problem was that the highest-paid salespeople were also the most experienced and loyal ones, better able to provide superior customer service. It appears that lying off key human capital—given their valuable, rare, and difficult-to-imitate nature—was a supreme strategic mistake! Not only did Circuit City destroy part of its core competency, it also allowed its main competitor—Best Buy—to recruit Circuit City's top salespeople. With that transfer of personnel to Best Buy went the transfer of important tacit knowledge underlying some of Circuit City's core competencies,

which in turn not only eroded Circuit City's advantage but also allowed Best Buy to upgrade its core competencies. In particular, Best Buy went on to develop its innovative "customer-centricity" model, based on a set of skills that allowed its store employees to identify and more effectively serve specific customer segments. Highlighting the dynamic nature of the competitive process, however, Best Buy now faces its own challenges competing with online retailers such as Amazon.

Employees at Circuit City stores and even at the headquarters in Richmond, Virginia, were shocked and devastated when the firm actually ceased operations in March 2009. More than a year after the closing, former headquarters workers noted that the firm had a good, hard-working, and family-friendly atmosphere. They believed to the end that, in the worst case, another firm would buy Circuit City and perhaps business.

Discussion Questions

1. Why was Circuit City so successful as to be featured in *Good to Great?* What was its strategic position during its successful period? How did it contribute to competitive advantage?
2. Why did Circuit City lose its competitive advantage? What was Circuit City's strategic position during the time of its competitive disadvantage?
3. What could Circuit City's management have done differently?
4. What is the future of Best Buy as the leader in big box electronics retailing as it faces tough competition with Amazon and other online retailers? What core competencies in big-box retailing are critical not only to survive but also to gain and sustain a competitive advantage?

6. China's Li Ning Challenges Nike and adidas

Almost everyone in China knows Li Ning Company Ltd. The eponymous sportswear company was founded in 1990 by former star gymnast Li Ning, who won six medals (including three golds) at the 1984 Los Angeles Olympics. Riding on the fame of its founder, Li Ning quickly became the largest and best-known Chinese sportswear company. In parallel with China's incredible economic rise, Li Ning did exceptionally well.

The company decided that the 2008 Olympics in Beijing would mark the beginning of overtaking the world leaders in sports shoes and apparel, Nike and adidas. This would happen

first in the Chinese market and then globally. To symbolize the company rise, its founder Li Ning, still a popular folk hero, was chosen to light the Olympic flame during the Beijing opening ceremonies. With its home turf advantage, everything seemed to be going in Li Ning's favor. In March 2013, however, Li Ning shocked the business world by announcing a worse-than-expected annual loss of $315 million. This was Li Ning's first ever loss since going public in 2004. Just two years earlier in 2010, Li Ning reported an all-time-high revenue of $1.5 billion, with $182.3 million in net income. What happened?

Li Ning's strategic intent had been from the very beginning to overtake Nike and adidas. The Beijing Olympics were to be the turning point in this "epic battle" for market dominance. In anticipation of the enormous business opportunities that would come with the 2008 Beijing Olympics, Li Ning pushed its penetration into China's second- and third-tier cities via aggressive channel expansion through its distributors, adding almost 1,000 stores a year. In 2008 and 2009 alone, more than 80 percent of the new stores were opened in China's second and third-tier cities.

China's rapid urbanization and the post-Olympics effects echoed Li Ning's vision: from 2005 to 2010, Li Ning tripled its revenue and seemed to be overtaking adidas to become number two in the Chinese market, just behind Nike. Fueled by seemingly unstoppable success, Li Ning began to expand in Southeast Asia. In a brazen move, Li Ning even opened a specialty store across the Pacific in Portland, Oregon, the hometown of Nike.

Li Ning soon found that its local Chinese competitors were pursuing a similar expansion strategy. To make matters worse, even Nike and adidas joined the fray to compete aggressively in second- and third-tier cities. This was a departure from the usual business model where the two world leaders would focus on high-end markets such as Shanghai and Beijing. As the post-Olympic shopping enthusiasm gradually faded, competition further intensified. Realizing that the expansion-fueled growth was not sustainable, Li Ning began fine-tuning its business model: consolidating distributors, upgrading product offerings, and focusing on serving higher-end markets and younger consumers. Li Ning even changed its logo and slogan to promote the new image. Almost overnight, Li Ning's brand marketing campaign swept China's airwaves, towns, and cities.

Despite its best marketing efforts, Li Ning's inventory kept piling up. Against the backdrop of declining sales, Li Ning's cash flow soon drained. Given its financial squeeze, Li Ning had to

raise funds from a private equity group and the Government of Singapore Investment Corporation. This led to a shake-up of Li Ning's board of directors, which subsequently put a new top management team in place. The top priority of the new management was to tackle Li Ning's inventory problems. Its management took several drastic steps to revive the sales channel by freeing up distributors' cash flows for introducing new products. Distributors were further consolidated and Li Ning added more factory outlets and discount stores to speed up inventory clearance. All stores underwent careful performance evaluation. Eventually, Li Ning closed 1,821 underperforming stores.

In addition, Li Ning started implementing a transformation plan to gradually shift away from the distributor- driven business model to a market-oriented one. In the past, Li Ning's distributors made orders based on their own judgment of retail demand six months ahead at quarterly trade fairs, and so Li Ning would arrange production, deliveries, and marketing campaigns. Under the new plan, Li Ning introduced "A+" Stock Keeping Units (SKUs), as well as customer group–specific SKUs, helping distributors make sound ordering decisions. Once these SKUs hit the stores, Li Ning would collect and monitor real-time sales data and make inventory adjustments accordingly. Li Ning launched fast-response products that could easily be ordered in between trade fairs in response to changes in market trends. It also redesigned product lines and changed pricing based on the needs of its target customers, which had not been clearly defined before.

The new management team at Li Ning believed that there was a big market between the higher-end Nike and adidas, on the one hand, and most of the low-end local brands, on the other. New products with a wider price range would be launched to capture the consumer in the "middle." Li Ning's transformation is nonetheless costly: revenue in 2012 declined by a whopping 25 percent to $1 billion (versus $26 billion for Nike and $20 billion for adidas). Li Ning's market share ranking in China has dropped to number four from number three (now held by a local competitor, Anta). To avoid bankruptcy, Li Ning had to ask for another round of liquidity injection by its recent backers.

Li Ning's problem of overexpansion is not unique. Slowing sales and high inventories have burdened other sportswear brands in China, including Nike and adidas. The two global brands have gained back their market shares, presumably at Li Ning's expense. Nike and adidas were faster in responding to changes in the market environment. They also further differentiated

themselves from the pack through continued innovation and sophisticated marketing. For example, adidas introduced fashionable sportswear such as high-heeled sports shoes in China.
The only sportswear brand in China to post positive growth in 2012 was adidas, and it seems best positioned to gain from the country's $24 billion sportswear business, which is estimated to grow at 15 to 20 percent for the next three years. In contrast, Li Ning is in deep downsizing mode: stores, distributors, and business segments are all up to be cut in 2013. Its proud Portland venture and other overseas stores are long gone, and the company is now refocusing on the Chinese market only.

Discussion Questions

1. At the close of the case, why was Li Ning experiencing a competitive disadvantage?
2. What are the strategic positions of Nike, adidas, and Li Ning? Do you see a link between strategic position and firm performance? If so, what explains that link?
3. Why is it so difficult for Li Ning to challenge Nike and adidas even in China? Would you expect that the Chinese consumer would be more loyal to a Chinese brand? What moves could the company make that would build customer loyalty? What recommendations would you give Li Ning to achieve a successful turnaround? Explain.

7. Is Porsche Killing the Golden Goose?

When porsche revealed its 911 sports car design in 1962, it caused a worldwide sensation. Ever since, Porsche has been one of the world's finest performance car manufacturers. The Porsche 911 is a legendary sports car icon. Although focusing on a niche market with a small output every year, Porsche was extremely profitable. Even today, it still enjoys the largest profit margins among all major auto manufacturers, thanks to the hefty premium it can command for its cars.
More than 50 years after its birth, the 911 remains the heart and soul of Porsche. However, it is no longer the company's best-selling model. The number-one spot has been taken by the Cayenne, a five-seat sports utility vehicle (SUV) launched by Porsche in 2002. Porsche views the Cayenne as a way to reduce the company's dependence on the traditional sports models and to provide for future growth in sales and profits. The Cayenne may be the most successful model launch of Porsche since the 911: Porsche sold the 200,000th Cayenne unit only six years after its debut at the Paris Motor Show. In 2012, the Cayenne's worldwide sales reached a record 77,822

units, accounting for more than half of the company's overall sales volume. The popularity of Cayenne is seen across regions, especially in the U.S. and China, the two largest markets of Porsche overall. In fact, China has become the largest market for Cayenne, and the model will continue to be the strategic sales focus of Porsche in that country.

The Cayenne has made Porsche more appealing to people who are not sports-car drivers but are happy to own the sportiest SUV on the market. While the model expansion may upset the purists, Porsche did not stop there. In 2005, Porsche announced its plan to build a new model line Panamera, a premium-category four seat sports sedan, to extend its customer base. The line was launched on time in 2009 and like Cayenne; it outsold the 911 in the subsequent years. As of 2012, Cayenne and Panamera together accounted for 73 percent of Porsche's total sales volumes.

In the years leading up to the global financial crisis in 2008–2009, Porsche was attempting a hostile takeover of the much larger Volkswagen (VW). Part of the competition was motivated by a bitter family feud resulting from estranged members of the Porsche family holding leading executive positions in both companies. As the global financial crisis took hold, Porsche collapsed under a heavy debt burden caused by the hostile VW takeover attempt. VW turned the tables and took over Porsche in 2012. Now Porsche is clearly gunning for economies of scale as it ramps up unit sales, and VW overall is aiming to overtake GM and Toyota as the world leader in unit sales.

Porsche developed its own growth blueprint, termed "Strategy 2018," as part of Volkswagen group's grand vision: Porsche plans to increase unit sales to 200,000 per year by 2018, up from 30,000 units in 2002. To achieve this goal, Porsche needs to inspire more buyers. It continues to push overseas sales of the Cayenne and the Panamera models, setting up more dealerships where growth is the strongest. To address potential customers' concern over the 911's drivability as an everyday vehicle, Porsche launched an advertising campaign titled "Engineered for Magic." Every day, in the U.S., featuring actual Porsche owners using their sports cars for daily activities, from commuting to work, to picking up their kids and running errands. In 2012, Porsche revealed the name of its fifth model line, Macan—a compact SUV to be launched in 2014. The company is also considering the development of a smaller version of the Panamera.

The essence of a Porsche—a high-performance sports car—seems now to take a back seat. Although the company has built "experience centers" in China and the U.S. to cultivate sports-car enthusiasts, Porsche only sold 26,203 units of the 911 in 2012, or 18 percent of Porsche's

total sales volumes. Porsche's expansion success so far largely relies on its reputation as an iconic sports-car maker. At the same time, many of today's Cayenne buyers, such as soccer parents in the U.S. or Chinese business people that like a chauffeur, have no idea about Porsche's true identity as a high-performance sports and race car manufacturer.

Discussion Questions

1. For many decades, Porsche pursued a focused differentiation strategy. Using a clear strategic profile as a focused differentiator, Porsche was very successful and very profitable. More recently, the Porsche brand is repositioning itself from focused differentiation to broad differentiation by changing its competitive scope.

   a. What are the risks inherent in such strategic positioning? What are the benefits?

   b. Do you think Porsche will be successful in carving out a new strategic position as a broad differentiator? Why or why not?

2. Volkswagen ranks with GM and Toyota as one of the top-three carmakers in the world today in terms of sales volume (in units). It uses its Volkswagen brand, as well as its entire portfolio of other brands, including the luxury marques of Porsche, Audi, Bentley, Bugatti, and Lamborghini, and at the lower end, the Seat, Skoda, and Scania.

   a. What type of diversification is Volkswagen pursuing?

   b. What are the advantages and disadvantages in VW's corporate strategy?

3. In the recent past, both GM and Toyota ran into problems as they chased the goal of becoming the world's leader in terms of unit sales. GM achieved this goal but lost billions in the process and ended up in bankruptcy (in 2008). If you were asked to advise VW,

   a. what drawback would you point that may need to be considered when attempting to be the world leader in unit output?

   b. How might VW avoid those pitfalls?

8. The Rise of Samsung Electronics

In 2012, samsung**,** with $248 billion in revenues, was one of the largest conglomerates globally and the largest *chaebol (*a South Korean multinational business conglomerate) in South Korea. A rough comparison would be the U.S. conglomerate General Electric, which had $147 billion in

revenues in the same year. Established in 1938 by Lee Byung-chul as a trading company selling noodles and dried seafood, Samsung has since diversified into various industries, such as electronics, chemicals, ship building, financial services, and construction. In particular, Samsung is widely diversified with 83 standalone subsidiaries. The conglomerate accounts for a fifth of all South Korean exports. In 1987, Lee Kun-hee, the youngest son of the founder, took over as chairman of the conglomerate after the death of Lee Byung-chul. By that time, Samsung had become an industry leader in many
of its markets.

Samsung Electronics, the flagship subsidiary of Samsung (and best known in the U.S. for its Galaxy line of smart phones and tablets), was initially set up in 1969 to produce home appliances. In 1988, Lee Kun-hee merged Samsung Electronics with Samsung Semiconductors to integrate manufacturing. By 1992, it had become the worldwide market leader in DRAM (dynamic random access memory). Samsung Electronics, however, aspired to be more than a leading supplier and OEM (original equipment manufacturer). Its strategic intent was to be the leader in branded consumer electronics.

Samsung's image, however, was overshadowed by Sony and Motorola, the undisputed world leaders in consumer electronics and mobile phones during this time. In 1988, Samsung Electronics launched its first mobile phone in the South Korean market. It flopped because of the phone's poor quality. In the early 1990s, Samsung Electronics' market share in mobile phones in South Korea was a mere 10 percent compared to Motorola's 60 percent.

The pivotal moment in redefining Samsung Electronics' strategic focus came in early 1995. Samsung's chairman, Mr. Lee, sent out mobile phones as New Year's gifts to hundreds of key business partners. A public embarrassment occurred when Mr. Lee later learned that the phones he had send out as personal gifts didn't work properly. Mr. Lee ordered drastic changes. In front of Samsung's Gami factory with 2,000 employees watching, Mr. Lee set fire to a pile of 150,000 mobile phones to show his disappointment and determination alike. Many Samsung employees credit this day as the beginning of a successful turnaround.

Samsung Electronics increased spending significantly on R&D as well as on marketing and design. Meanwhile, Mr. Lee was undertaking a complete overhaul of the conglomerate's structure in order to change Samsung's culture. To a culture that deeply values seniority, Mr. Lee introduced merit-based pay and promotion. Mr. Lee (who holds an MBA degree from George

Washington University) hired Western managers and designers into leading positions and sent home-grown talent to learn the best business practices of other firms around the globe. Mr. Lee also set up the Global Strategic Group to assist non-Korean MBAs and PhDs with a smooth transition into their positions in a largely homogenous cadre of employees.

Mr. Lee appointed a new CEO for Samsung Electronics in 1996, Yun Jong-Yong. Mr. Yun aggressively trimmed costs and sold off unproductive assets during the Asian Financial Crisis in 1997, making the company leaner and more agile. Subsequently, through improved operational efficiency and an integrated manufacturing process, Samsung Electronics shortened the time needed to respond quickly to changes in market trends. It chose to be a fast follower, investing only after a new product category had proven market traction. Once such categories were identified, however, Samsung vastly outspent competitors in order to develop leading electronics products. For example, the company started making batteries for digital gadgets in 2000. Ten years later, it became the world's largest producer of this critical component. In 2001, Samsung started to invest in flat-panel televisions. Just four years later, Samsung was the world's leader in flat panel TVs. In 2002, Samsung Electronics bet on flash memory, the technology that runs Apple's iPads and iPhones. Providing not only batteries but also flash memory, Samsung is Apple's largest supplier today.

Samsung Electronics applied the same "follow first, innovate second" rule to smart phones. Being a key component vendor to other leading technology companies including Apple, Samsung was able to see easily what directions other companies were taking. It made a range of smart phones tailored to customers in different price categories. Within two short years, it had overtaken Motorola, HTC, BlackBerry, and eventually even Apple to become the number-one vendor of smart phones in the world and the largest technology company by revenues globally.

Although Samsung has gained a temporary competitive advantage, sustaining it will be even more difficult for a number of reasons. First, Samsung's competitive advantage was built in large part by following its "follow first, innovate second" rule. To keep its number-one spot in the world's technology industry may be a challenge for a company that intends to be a follower rather than a leader. Second, Chinese technology companies such as Lenovo and Huawei are also looking to join the battlefield in smart phones. Third, Apple and Samsung have been locked in ongoing court battles about who infringed the copyrights of whom and in what type of smart

phone models. Samsung has already lost a high-profile case against Apple in a California court, where damages were reduced later to some $500 million.

To provide new avenues for future revenue growth, chairman Lee laid out five new business areas in which Samsung plans to invest some $20 billion by2020. The five areas include (in order of size of investment): LED lighting, solar panels, e-vehicle batteries, biotech drugs, and medical devices.

Succession planning is another challenge Samsung is facing. The family of the late founder, Lee Byung-Chul, still controls a majority of the shares. At 71, Lee Kun-hee has long-groomed his eldest son Jay Y. Lee (43) to be his successor as chairman of Samsung. It remains to be seen whether the younger Mr. Lee, as grandson of the founder, can maintain Samsung's momentum.

Discussion Questions

1. Describe Samsung as a conglomerate.
   a. What type of diversification does Samsung pursue?
   b. Identify possible factors such as core competencies, economies of scale, and economies of scope that might underlie its success as a diversified conglomerate (chaebol).
   c. Which do you consider its key success factors?

2. How did Mr. Lee turn Samsung Electronics from a sleeping and bureaucratic company into a world leader?

3. What type of global strategy is Samsung Electronics pursuing?

4. What can Samsung Electronics do to sustain its competitive advantage in smart phones? Should Samsung change its "follow first, innovate second" approach as it seeks to build a competitive position in new product areas other than smart phones?

9. Amazon

Amazon.Com Continues to diversify at a relentless pace. Besides offering same-day delivery of groceries in some metropolitan areas and testing drones for even faster distribution, Amazon now plans to capture a large piece of the over $10 billion college bookstore market. In a pilot project, Amazon initiated a student-centered program at three large universities: Purdue University, the University of California, Davis, and the University of Massachusetts Amherst. The goal of

Amazon Campus is co-branded university-specific websites that offer textbooks, paraphernalia such as the ubiquitous logo sweaters and baseball hats, as well as ramen noodles!

As part of this new campus initiative, Amazon offers its Prime membership to students at a 50 percent discount ($49 a year) and guarantees unlimited next-day delivery of any goods ordered online, besides all the other Prime membership benefits (free streaming of media content, loaning one e-book a month for free, discounts on hardware, etc.). To accomplish next-day delivery, Amazon is building fashionable delivery centers on campus, university co-branded such as “amazon@purdue.” Once a package arrives, students receive a text message and can then retrieve it via code-activated lockers or from Amazon employees directly. The on-campus delivery facilities also serve as student return centers.

Amazon’s new campus initiative allows it to bind a younger generation of shoppers ever closer into its web of products, services, and content. Next-day delivery makes students less likely to shop at traditional campus bookstores. Amazon also has a history of selling textbooks at a discount in comparison to old-line campus bookstores.

All course materials automatically qualify for next-day delivery and do not require a Prime membership. The Amazon Campus initiative is predicted to save students $200 to $400 a year on textbooks and other supplies.

Questions

1. Amazon.com continues to spend billions on seemingly unrelated diversification efforts. Do you believe these efforts contribute to Amazon gaining and sustaining a competitive advantage? Why or why not?
2. Amazon.com is now over 20 years old and makes some $100 billion in annual revenues. As an investor, would it concern you that Amazon.com has yet to deliver any profits? Why or why not? How much longer do you think investors will be patient with Jeff Bezos as he continues to pursue billion-dollar diversification initiatives?
3. One of the most profitable business endeavors that Amazon pursues is its cloud service offering, AWS. In 2014, AWS revenues were an estimated $6 billion, but bringing in $1 billion in profits. What is Amazon’s core business? Is AWS related to Amazon’s core business? Why or why not? Some investors are pressuring Jeff Bezos to spin out AWS as a standalone company. Do you agree with this corporate strategy recommendation? Why

or why not? Hint: Do you believe AWS would be more valuable within Amazon or as a standalone company?

10. Apple

Although many observers are convinced that Apple purchased Beats Electronics for the coolness of its brand and to gain a stronger position in the music industry, others are suggesting that what Apple is really buying are the talents that Beats co-founder Jimmy Iovine and Dr. Dre bring to the table. Since the death of Steve Jobs, Apple's visionary leader, the company has been lacking the kind of inspired personality it needs to remain a cultural icon. The critics argue that what Apple really needs is someone with a creative vision combined with a wide-reaching industry network and the ability to close a deal, especially in music where the personalities of its celebrities are known to be idiosyncratic. In music jargon, Apple is in need of a "front man." With the acquisition of Beats, it got two of the greatest creative talents in the music industry, with a long successful track record and deep and far-reaching networks.

Indeed, Iovine is of the opinion that Beats had always belonged with Apple. Iovine and Dr. Dre set out to model Beats Electronics after Apple's unique ability to marry culture and technology. Intriguingly, both Iovine and Dr. Dre are taking on senior positions at Apple. This indicates how much Apple's culture has changed under CEO Cook, because Iovine and Dr. Dre were not the first cool superstars from flashy industries he brought to Apple. In 2013, Apple hired former Burberry CEO Angela Ahrendts to head its retail operations. Bringing in superstars from the flashy industries of music or fashion to Apple, let alone into senior executive roles, would have been unthinkable under Jobs. Under his top-down leadership, only Apple products introduced to the public by himself in well-rehearsed theatrical launches were allowed to shine.

Questions

1. The Case argues that Beats Electronics' core competency lies in its marketing savvy and in Dr. Dre's coolness factor. Do you agree with this assessment? Why or why not?
2. If you believe that Apple bought Beats Electronics to bring Jimmy Iovine and Dr. Dre into Apple, what are the potential downsides of this multibillion-dollar "acqui-hire" (an acquisition to hire key personnel)?
3. If Beats Electronics' core competencies are indeed intangibles, such as coolness and marketing savvy, do you think these competencies will remain as valuable under Apple's ownership? Why or why not?