***Chapter – One***

***Introduction***

* 1. **Defining Strategic Management**

The top management of an organization is concerned with selection of a course of action from among different alternatives to meet the organizational objectives. The process by which objectives are formulated and achieved is known as a ***strategic management*** and strategy acts as the means to achieve the objective.

**Strategy** is the grand design or an overall ‘plan’ which an organization chooses in order to move or react towards the set of objectives by using its resource. It is the pathway along which the organizations move towards its objectives.

***Strategic management*** is the art and science of formulating, implementing and evaluating cross functional decisions that will enable an organization to achieve its objectives. It is the process of specifying the organization’s objectives, developing policies, and plan to achieve these objectives, and allocating resources to implement the policies and plans to achieve the organization’s objectives. Strategic management focuses on integrating management, marketing, finance/accounting, production/operations, research and development, and computer information systems to achieve organizational success.

Managers at all companies face three basic critical questions in thinking strategically about their company’s present circumstances and prospects:-

**Where are we now?** Must consider the company’s market position and the competitive pressures it confronts, its resources strengths and capabilities, its competitive shortcomings, the appeal its products and services have to customers, and its current performance.

**Where do we want to go?** Deals with the direction of in which management believes the company should be headed in light of the company’s present situation and the winds of market change – new markets and customer groups that the company should be adding, the improvements in competitive market position the company is aiming for, and the geographic scope and product line makeup of the company’s business in the years to come.

 **How will we get there?** Deal with crafting and executing a strategy to get the company from where it is to where it wants to go.

An organization is considered efficient and operationally effective if it is characterized by coordination between objectives and strategies. “***Without strategy, the organization is like a ship without a rudder.***” It is like a tramp, which has no particular destination to go to. Without an appropriate strategy effectively formulated and implemented, the future is always dark and hence, more are the chances of business failure.

* 1. **Stages of Strategic Management**

The strategic management process consists of three stages:

**Strategic formulation:** includes developing a business vision and mission, identifying an organization’s external opportunities and threats, determining internal strengths and weaknesses, establishing long-term objectives, generating alternatives strategies, and choosing particular strategies to pursue. Strategic-formulation issues include deciding what new business to enter, what business to abandon, how to allocate resources, whether to expand operations or diversify, whether to enter international markets, whether to merge or form a joint venture, and how to avoid a hostile takeover. Since no organization has unlimited resources, strategists must decide which alternative strategies will benefit the firm most.

**Strategy implementation:** requires a firm to establish annual objectives, revise policies, motivate employees, and allocate resources so that formulated strategies can be executed; strategy implementation includes developing a strategy supportive culture, creating an effective organizational structure, redirecting marketing efforts, preparing budgets, developing and utilizing information systems, and linking employee compensation to organizational performance. Implementing means mobilizing employees and managers to put formulated strategies into action. It is often considered to the most difficult stage in management, it requires personal discipline, commitment, and sacrifice. The challenge of implementation is to stimulate managers and employee’s through-out an organization to work with pride and enthusiasm toward achieving stated objectives.

**Strategy evaluation:** is the final stage in strategic management. Managers greatly need to know when particular strategies are not working well. All strategies are subject to future modification because external and internal factors are constantly changing. Three fundamental strategy evaluation activities are (1) reviewing external and internal factors that are the bases for current strategies, (2) measuring performance, and (3) taking corrective actions.

**1.3. Key terms in strategic Management**

**1. Competitive Advantage:** Strategic management is all about gaining and maintaining competitive advantage. This term can be defined as “anything that a firm does especially well compare to rival firms.” When a firm can do something that rival firms cannot do, or owns something that rival firm’s desire, that can represent a competitive advantage. Normally, a firm can sustain a competitive advantage for only a certain period due to rival firms imitating and undermining that advantage. Thus it is not adequate to simply obtain competitive advantage. A firm must strive to achieve sustained competitive advantage by (1) continually adapting to changes in external trends and events and internal capabilities, competencies, and resources; and by (2) effectively formulating, implementing, and evaluating strategies that capitalize upon those factors.

**2. Strategists:** are individuals who are most responsible for the success or failure of an organization. Strategists have various job titles, such as Chief executive officer, president, executive director….strategists differ as much as organizations themselves, and these difference must be considered in the formulation, implementation and evaluation of strategies. They differ in their attitudes, values, ethics willingness to take risks, concern for social responsibility, concern for profitability, concern for short-term versus long-run aims, and management style.

**3. Mission statements**: are “enduring statements of purpose that distinguish one business from other similar firms. A mission statement identifies the scope a firms operations in product and market terms”. “What is our business?” a clear mission statement describes the values and priorities of an organization.

**4. External opportunities and threats:** refers to economic, social, cultural, demographic, environmental, political, legal, governmental, technological, and competitive trends and events that could significantly benefit or harm an organization in the future. It is largely beyond the control of a single organization.

**5. Internal strengths and weaknesses:** are controllable activities within an organization that are performed especially well or poorly. The process of identifying and evaluating organizational strengths and weaknesses in the functional areas of a business is an essential strategic management activity. Organizations strive to pursue strategies that capitalize on internal strengths and improve on internal weaknesses.

**6. Long-term (more than one year) objectives**: Are specific results that an organization seeks to achieve in pursuing its basic mission. Objectives are essential for organizational success because they provide direction, aid in evaluation, create synergy, reveal priorities, allow coordination, and provide a basis for effective planning, organizing, motivating, and controlling activities. It should be challenging, measurable, consistent, reasonable, and clear.

**7. Strategies:** are the means by which long-term objectives will be achieved. Business strategies may include geographical expansion, diversification, acquisition, product development, market penetration.

**8. Annual objectives**: are short-term milestones that organizations must achieve to reach long-term objectives. It should be stated in terms of functional areas and is important in strategy implementation while long-term objectives are particularly important in strategy formulation.

**9. Policies**: is the means by which annual objectives will be achieved. It includes guidelines, rules, and procedures established to support efforts to achieve stated objectives. It is guide to decision making and stated in terms of functional areas.

**1.4. Overview of types of Strategy**

Alternative strategies that an enterprise could pursue can be categorized into **integration**, **intensive**, **diversification**, and **defensive** strategies.

**Integration strategies:** allow a firm to gain control over **distributors**, **suppliers**, and/or **competitors**. Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as vertical integration strategies.

**Intensive Strategies:** Market penetration, market development, and product development are sometimes referred to as intensive strategies because they require intensive efforts if a firm’s competitive position with existing products is to improve.

**Diversification Strategies**: There are two general types of diversification strategies. These are: **related** and **unrelated**. Businesses are said to be related when their value chains possess competitively valuable cross-business strategic fits; businesses are said to be unrelated when their value chains are so dissimilar that no competitively valuable cross-business relationships exist.

**Defensive Strategies**: In addition to integrative, intensive, and diversification strategies, organizations also could pursue defensive strategies like: Retrenchment, Divestiture, and Liquidation.

**1.5. The Strategic Management Model**

The strategic-management process can best be studied and applied using a model. Every model represents some kind of process. It is a widely accepted, comprehensive model of the strategic-management process. This model does not guarantee success, but it does represent a clear and practical approach for formulating, implementing, and evaluating strategies. Relationships among major components of the strategic-management process are shown in the model.

Perform external audit

Measure and Evaluate performance

Implement strategy

Implement strategy: Mgmt issue

Generate, evaluate, and select strategies

Establish long-term objectives

Develop Vision and Mission statement

Perform internal audit

 Strategy formulation strategy implementation strategy evaluation

Fig. 1 comprehensive strategic model

Identifying an organization’s existing vision, mission, objectives, and strategies is the logical starting point for strategic management because a firm’s present situation and condition may preclude certain strategies and may even dictate a particular course of action. The strategic-management process is dynamic and continuous. A change in any one of the major components in the model can necessitate a change in any or all of the other components. For instance, a shift in the economy could represent a major opportunity and require a change in long-term objectives and strategies; a failure to accomplish annual objectives could require a change in policy; or a major competitor’s change in strategy could require a change in the firm’s mission. Therefore, strategy formulation, implementation, and evaluation activities should be performed on a continual basis, not just at the end of the year or semiannually. The strategic-management process never really ends.

**1.6**. **Benefit of Strategic Management**

Strategic management allows an organization to be more proactive than reactive in shaping its own future; it allows an organization to initiate and influence (rather than just respond to) activities—and thus to exert control over its own destiny.

Historically, the principal benefit of strategic management has been to help organizations formulate better strategies through the use of a more systematic, logical, and rational approach to strategic choice. This certainly continues to be a major benefit of strategic management, but research studies now indicate that the process, rather than the decision or document, is the more important contribution of strategic management. Communication is a key to successful strategic management.

***Financial Benefits***: The organizations using strategic-management concepts are more profitable and successful than those that do not. Businesses using strategic-management concepts show significant improvement in sales, profitability, and productivity compared to firms without systematic planning activities. High-performing firms tend to do systematic planning to prepare for future fluctuations in their external and internal environments.

***Nonfinancial****:* Benefits Besides helping firms avoid financial demise, strategic management offers other tangible benefits, such as an *enhanced awareness of external threats, an improved understanding of competitors’ strategies, increased employee productivity, reduced resistance to change, and a clearer understanding of performance–reward relationships*. Strategic management enhances the problem-prevention capabilities of organizations because it promotes interaction among managers at all divisional and functional levels.

In General, strategic management offers the following benefits:

* It allows for identification, prioritization, and exploitation of opportunities.
* It provides an objective view of management problems.
* It represents a framework for improved coordination and control of activities.
* It minimizes the effects of adverse conditions and changes.
* It allows major decisions to better support established objectives.
* It allows more effective allocation of time and resources to identified opportunities.
* It allows fewer resources and less time to be devoted to correcting erroneous or ad hoc decisions.
* It creates a framework for internal communication among personnel.
* It helps integrate the behavior of individuals into a total effort.
* It provides a basis for clarifying individual responsibilities.
* It encourages forward thinking.
* It provides a cooperative, integrated, and enthusiastic approach to tackling problems and opportunities.
* It encourages a favorable attitude toward change.
* It gives a degree of discipline and formality to the management of a business

 **Why some Firms Do No Strategic Planning**

Some firms do not engage in strategic planning, and some firms do strategic planning but receive no support from managers and employees. Some reasons for poor or no strategic planning are as follows:

* ***Lack of knowledge or experience in strategic planning***—No training in strategic planning.
* ***Poor reward structures***—When an organization assumes success, it often fails to reward success. When failure occurs, then the firm may punish.
* ***Firefighting***—An organization can be so deeply embroiled in resolving crises and firefighting that it reserves no time for planning.
* ***Waste of time***—Some firms see planning as a waste of time because no marketable product is produced. Time spent on planning is an investment.
* ***Too expensive***—Some organizations see planning as too expensive in time and money. • Laziness—People may not want to put forth the effort needed to formulate a plan.
* ***Content with success***—Particularly if a firm is successful, individuals may feel there is no need to plan because things are fine as they stand. But success today does not guarantee success tomorrow.
* ***Fear of failure***—By not taking action, there is little risk of failure unless a problem is urgent and pressing. Whenever something worthwhile is attempted, there is some risk of failure.
* ***Overconfidence***—As managers amass experience, they may rely less on formalized planning. Rarely, however, is this appropriate. Being overconfident or overestimating experience can bring decease. Forethought is rarely wasted and is often the mark of professionalism.
* ***Prior bad experience***—People may have had a previous bad experience with planning, that is, cases in which plans have been long, cumbersome, impractical, or inflexible. Planning, like anything else, can be done badly.
* ***Self-interest***—When someone has achieved status, privilege, or self-esteem through effectively using an old system, he or she often sees a new plan as a threat.
* ***Fear of the unknown***—People may be uncertain of their abilities to learn new skills, of their aptitude with new systems, or of their ability to take on new roles.

**1.7. Business Ethics and Strategy**

Every business has an ethical duty to each of its associates namely, owners, or stockholders, employees, customers, suppliers and the community at large. Business is a cooperative activity whose very existence requires ethical behavior. Business ethics is applied ethics. It is an application of our understanding of what is good and right to that assortment of institutions, technologies, transactions, activities and pursuits that we call business. Strategy means merely that over the long run and for most of the part, ethical behavior can give a company significant competitive advantages over companies that are not ethical.

Corporate social responsibility is generally seen as the business contribution to sustainable development which has been defined as “development that meets the present needs without compromising the ability of future generations to meet their own needs”, and is generally understood as focusing on how to achieve the integration of economic, environmental, and social imperatives. Today it is generally accepted that business firms have social responsibilities that extend well beyond what in the past was commonly referred to simply as the ‘business economic function.’ In earlier times managers in most cases had only to concern themselves with the economic results of their decisions. Today, managers must also consider and weigh the legal, ethical, moral and social impact of each of their decision.

**Stakeholders and Ethics**

Organization has moral duties and morally responsible for its acts to stakeholders.

* A company’s duty to employees arises out of respect for the worth and dignity of individuals who devote their energies to the business and who depend on the business for their economic well being. Principled strategy making requires that employee related decisions be made equitably and compassionately with concern for due process and for the impact that strategic change has on employee’s lives. At best the chosen strategy should promote employee interests and concerns such as compensation, career opportunities, job security and overall working conditions. At worst the chosen strategy should not disadvantage employees. Even in crisis situations, businesses have an ethical duty to minimize whatever hardship have to be imposed in the form of workforce reductions, plant closing, job transfers, relocations, retraining and loss of income.
* The duty to the customer arises out of expectations that attend the purchase of a good /services. However, the question which still about are should a seller voluntarily inform consumers that its products contain ingredients that though officially approved for use are suspected of having potentially harmful effect? Is it ethical for cigarette manufacturers to advertise at all?
* **A company’s ethical duty to suppliers arises out of the market relationship that exists between them. They are both partners b/c the quality of suppliers’ affects the quality of a firm’s own product and in the sense that their business is connected. they are adversaries in the sense that the suppliers wants the highest price and profit it can get while the buyer wants a cheaper price, better quality and speeder service. A company confronts several ethical issues in its supplies relationship. “Is it ethical to threaten to cease doing business with a supplier unless supplier agrees not to do business with key competitors?**
* **A company’s ethical duty to the community at large stems from its status as a member of the community and as an institution of society. Communities and society are reasonable in expecting businesses to be good citizens- to pay their fair share of taxes, for fire, and police protection, waste removal, streets and high ways and so on, and to exercise care in the impact their activities have on their environment, on society, and on the communities in which they operate. E.g. advertisement.**

***Chapter- Two***

***Strategy Formulation: The Business Mission, Vision and value***

***2.1. Vision and Mission statement***

**Vision: Serve the purpose of stating what an organization wishes to achieve in long run. Strategic vision is a road map of a company’s future; it creates a picture of a company’s destination and provides a rationale for why this destination makes good business sense for the company. Strategic vision is concerned with “*where we are going and why,”* i.e. it portrays a company’s future business scope. Strategic visions become real only when the vision statement is imprinted in the minds of organization members and then translated into mission and objectives. Therefore, effectively communicating the strategic vision down the line to lower-level managers and employees is almost as important as ensuring the strategic soundness of the organization’s long-term direction and business model.** Many organizations have both a vision and mission statement, but the **vision statement should be established first and foremost**.

**The vision of an organization is the expectation of the owner of the organization and putting this vision into action is mission. Mission is relatively less abstract, subjective, qualitative philosophical and non-imaginative. A company’s mission statement usually deals with the company’s present business scope and purpose-“*where we are now, what we do, and why we are here.*” Mission has a societal orientation and is a statement which reveals what an organization intends to do for a society. It is a public statement which gives direction for different activities which organizations have to carry on. Organization’s mission becomes the cornerstone for strategy.** Sometimes called **a *creed******statement****, a* ***statement of purpose****, a* ***statement of philosophy****,* a statement of ***beliefs***, a statement of ***business principles***, or a statement “***defining our business***,”

What is the difference between a mission statement and a vision statement?

* A mission statement concerns what an organization is all about.
* A vision statement is what the organization wants to become.

A **mission statement** answers three key questions:

* What do we do?
* For whom do we do it?
* What is the benefit?

A **vision statement**, describes how the future will look if the organization achieves its mission. A mission statement gives the overall purpose of an organization, while a vision statement describes a picture of the "***preferred future***." A mission statement explains what the organization does, for whom and the benefit.

**Examples:**

|  |
| --- |
| **Centers for Disease Control**  |
| **Mission** | To promote health and quality of life by preventing and controlling disease, injury, and disability |
| **Vision** | Healthy People in a Healthy World |
| **Minnesota Department of Health** |
| **Mission** | To protect, maintain and improve the health of all Minnesotans. |
| **Vision** | Keeping All Minnesotans Healthy |

**Nature of Business Mission**

* **It gives social reasoning. It specifies the role which the organization plays society. It is the basic reason for existence**
* **It is philosophical and visionary and relates to top management values. It has long term perspective.**
* **It legitimizes societal existence**
* **It reflects corporate philosophy, identity, character and image of organization.**

**Characteristics of Business Mission**

**In order to be effective a mission statement should possess the following characteristics.**

* **A mission statement should be realistic and achievable.**
* **It should neither be too broad nor be too narrow.**
* **A mission statement should not be ambiguous. It must be clear for action.**
* **It should have societal linkage. Linking the organization to society will build long term perspective in a better way.**
* **It should not be static. To cope up with ever changing environment, dynamic aspects be looked into.**
* **It should be motivating for members of the organization and of society.**

**Components of an Effective Mission Statement**

Most practitioners and academicians of strategic management consider an effectively written mission statement to exhibit nine *mission statement components*.

1. ***Customers****:*  Who are the firm’s customers?
2. ***Products or services****:* What are the firm's major products or services?
3. ***Markets****:* Where does the firm compete?
4. ***Technology****:* What is the firm's basic technology?
5. ***Concern for survival, growth, and profitability****:* What is the firm's commitment towards economic objectives?
6. ***Philosophy****:* What are the basic beliefs, core values, aspirations and philosophical priorities of the firm?
7. ***Self-concept****:* What are the firm's major strengths and competitive advantages?
8. ***Concern for public image****:* What is the firm's public image?
9. ***Concern for employees****:* What is the firm's attitude/orientation towards employees?

**The Process of Developing Vision and Mission Statements**

A widely used approach to developing a vision and mission statement is first to select **several articles** about these statements and ask **all managers to read** these as background information. Then ask managers themselves to **prepare a vision and mission statement for the organization**. A facilitator, or committee of top managers, should then merge these statements into a single document and distribute the draft statements 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 documents, organizations can more easily obtain managers’ support for other strategy formulation, implementation, and evaluation activities. During the process of developing vision and mission statements, some organizations use **discussion groups of managers** to develop and modify existing statements. Some organizations hire an outside **consultant or facilitator** to manage the process and help draft the language.

**Business values**

## Business values are the benefits that a firm’s generates for its stakeholders. This includes a firm’s long term ability to create revenue, product, services, employment, quality of life, and investment returns.

**Here are some examples of core values from which you may wish to choose:**

* Dependability. - Consistency.
* Honesty. - Reliability.
* Efficiency - Loyalty - Open-mindedness.

 **Objectives and goals**

**Goals** are general guidelines that explain what you want to achieve in your community. They are usually long-term and represent global visions such as: The Millennium Development Goals are: eg

* To eradicate extreme poverty and hunger;
* To achieve universal primary education;
* To promote gender equality and empower women

## Objectives: define strategies or implementation steps to attain the identified goals. Unlike goals, objectives are specific, measurable, and have a defined completion date. They are more specific and outline the “who, what, when, where, and how” of reaching the goals.

## The *Difference* between goals and objectives

## Goals are broad while objectives are narrow

## Goals are general intentions; objectives are precise

## Goals are intangible; objectives are tangible

##  Goals are abstract; objectives are concrete

## Goals are more influenced by external environment than objective.

**Chapter Three**

**External Environmental Analysis**

* 1. **The Nature of External Audit**

The purpose of an external audit is to develop a *finite* list of *opportunities* that could benefit a firm and *threats* that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats.

* 1. **The Process of Performing an External Audit**

The process of performing an external audit must involve as many managers and employees as possible. Involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms’ industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. Once information is gathered, it should be assimilated and evaluated. These key external factors should be listed and prioritized ++++++++++++++++++++++and then ranked from 1 for the most important opportunity/threat to 20 for the least important opportunity/threat.

* 1. **Analysis of Key External Factors**

External forces can be divided into five broad categories:

1. *Economic forces;*
2. *Social, cultural, demographic, and natural environment forces;*
3. *Political, governmental, and legal forces;*
4. *Technological forces; and*
5. *Competitive forces****.***

***Relationships among these forces and an organization are***:

An organization opportunities and threats

Competitors

Suppliers

Distributors

Creditors

Customers

Communities

Stockholders

 Labor unions Governments

Trade associations’ Special interest groups Products

Services

Markets

Economic forces

Social, cultural, demographic, and natural environment forces

Political, governmental, and legal forces

Technological forces

 and

Competitive forces

Figure 3.1 The relationship between key external forces and an organization

External trends and events, such as the global economic recession, significantly affect products, services, markets, and organizations worldwide. Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of *products* *developed*, the nature of *positioning* and *market segmentation* strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both *suppliers* and *distributors*. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

1. **Economic Forces**

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, when interest rates rise, funds needed for capital expansion become more costly or unavailable. When stock prices increase, the desirability of equity as a source of capital for market development increases. Also, when the market rises, consumer and business wealth expands. An economic variable of significant importance in strategic planning is gross domestic product (GDP), especially across countries. Trends in the dollar’s value have significant and unequal effects on companies in different industries and in different locations.

***Key Economic Variables to Be Monitored*:**

* Availability of credit
* Propensity of people to spend
* Interest rates
* Inflation rates
* Money market rates
* Federal government budget deficits
* Gross domestic product trend
* Tax rates
* Price fluctuations
* Income differences by region and consumer groups
* Demand shifts for different categories of goods and services
* Consumption patterns
* Unemployment trends
* Worker productivity levels
* Value of the dollar in world markets
* Stock market trends
* Foreign countries’ economic conditions
* Monetary policies
* Fiscal policies
1. **Social, Cultural, Demographic, and Natural Environment Forces**

Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. Social, cultural, demographic, and environmental trends are shaping the way people live, work, produce, and consume.

 **Key Social, Cultural, Demographic, and Natural Environment Variables:**

* Attitudes toward retirement
* Attitudes toward product quality
* Attitudes toward customer service
* Pollution control
* Attitudes toward foreign peoples
* Energy conservation
* Social programs
* Number of churches
* Number of church members
* Social responsibility
* Attitudes toward saving
* Number of special-interest groups
* Number of marriages
* Number of divorces, births, deaths
* Immigration and emigration rates
* Social Security programs
* Life expectancy rates
* Per capita income
* Location of retailing, manufacturing
* Attitudes toward investing
* Buying habits
1. **Political, Governmental and Legal Forces**

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

**Some Political, Governmental, and Legal Variables**

* + - * Government regulations or deregulations
			* Changes in tax laws
			* Special tariffs
* Political action committees
* Changes in patent laws
* Environmental protection laws
* Level of defense expenditures
* Legislation on equal employment
* Level of government subsidies
* Number of patents
* Import–export regulations
* Government fiscal and monetary policy changes

Local, state, and federal laws; regulatory agencies; and special-interest groups can have a major impact on the strategies of small, large, for-profit, and nonprofit organizations.

1. **Technological Forces**

Revolutionary technological changes and discoveries are having a dramatic impact on organizations. The Internet has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility.

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: *chief information officer (CIO)* and *chief technology officer (CTO)*. This trend reflects the growing importance of *information technology (IT)* in strategic management. A CIO and CTO work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations’ *products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position*. Not all sectors of the economy are affected equally by technological developments. The *communications, electronics, aeronautics, and pharmaceutical industries* are much more volatile than the *textile, forestry*, and *metals industries*.

**Examples of the Impact of Wireless Technology**

* Airlines—Many airlines now offer wireless technology in flight.
* Automotive—Vehicles are becoming wireless.
* Banking—Visa sends text message alerts after unusual transactions.
* Education—Many secondary (and even college) students may use smart phones for math because research shows this to be greatly helpful.
* Energy—Smart meters now provide power on demand in your home or business.
1. **Competitive Forces**

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information.

Addressing questions about competitors such as:

* What are the major competitors’ strengths?
* What are the major competitors’ weaknesses?
* What are the major competitors’ objectives and strategies?
* How vulnerable are the major competitors to our alternative company strategies?
* How vulnerable are our alternative strategies to successful counterattack by our major competitors?
* How are our products or services positioned relative to major competitors?

 **Competitive Intelligence Programs**

Competitive intelligence (CI) is a systematic and ethical process for gathering and analyzing information about the competition’s activities and general business trends to further a business’s own goals. Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors’ weaknesses can represent external opportunities; major competitors’ strengths may represent key threats. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

 **Market Commonality and Resource Similarity**

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. *Market commonality* can be defined as *the number and significance of markets that a firm competes in with rivals*. *Resource similarity* *is the extent to which the type and amount of a firm’s internal resources are comparable to a rival*. One way to analyze competitiveness between two or among several firms is to investigate *market commonality* and *resource similarity* issues while looking for areas of potential competitive advantage along each firm’s value chain.

* 1. **Competitive Analysis: Porter’s Five-Forces Model**

Porter’s Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries.

The collective impact of competitive forces is so brutal in some industries that the market is clearly “unattractive” from a profit-making standpoint. Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage. According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

Potential development of substitute products

Bargaining power of suppliers

Rivalry among competing firms

Bargaining power of consumer

Potential entry of new competitors

Figure 3.2: The Five-Force Model of Competition

The following three steps for using *Porter’s Five-Forces* *Model* can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

1. Identify key aspects or elements of each competitive force that impact the firm.
2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.
4. **Rivalry Among Competing Firms**

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

The intensity of rivalry among competing firms tends to **increase** as *the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry’s products declines, and as price cutting becomes common.*

***Conditions That Cause High Rivalry among Competing Firms***

* When the product is perishable
* When rivals have excess capacity
* When consumer demand is falling
* When rivals have excess inventory
* When rivals sell similar products/services
* High number of competing firms
* Similar size of firms competing
* Similar capability of firms competing
* Falling demand for the industry’s products
* Falling product/service prices in the industry
* When barriers to leaving the market are high
* When barriers to entering the market are low
* When fixed costs are high among firms competing

As rivalry among competing firms intensifies, industry profits **decline**, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the “opportunity.”

1. **Potential Entry of New Competitors**

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms’ increases. Barriers to entry, however, can include the need to *gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.*

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist’s job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms’ strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

1. **Potential** **Development of Substitute Products**

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals’ plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers’ switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms’ plans for increased capacity and market penetration.

1. **Bargaining Power of Suppliers**

The bargaining power of suppliers affects the intensity of competition in an industry, especially *when there is a large number of suppliers, when there are only a few good substitute raw materials.* It is often in the best interest of both *suppliers* and *producers* to assist each other with reasonable *prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability* for all concerned. Firms may pursue a *backward integration* strategy to gain control or ownership of *suppliers*. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm’s needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to:

(1) Reduce inventory and logistics costs (e.g., through just-in-time deliveries)

(2) Speed the availability of next-generation components

(3) Enhance the quality of the parts and components being supplied and reduce defect rates.

1. **Bargaining Power of Consumers**

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

Consumers gain increasing bargaining power under the following circumstances:

* If they are particularly important to the seller
* If sellers are struggling in the face of falling consumer demand
* If they are informed about sellers’ products, prices, and costs
* If they have discretion in whether and when they purchase the product.

**Industrial Analysis: The External Factors Evaluation (EFE) Matrix**

An External Factor Evaluation (EFE) Matrix allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information.

**The EFE Matrix can be developed in five steps:**

*Step 1:* List key external factors as identified in the external-audit process. Include a total of 15 to 20 factors, including both opportunities and threats that affect the firm and its industry. List the opportunities first and then the threats. Be as specific as possible, using percentages, ratios, and comparative numbers whenever possible.

*Step 2*: Assign to each factor a weight that ranges from 0.0 (not important) to 1.0 (very important). The weight indicates the relative importance of that factor to being successful in the firm’s industry. Opportunities often receive higher weights than threats, but threats can receive high weights if they are especially severe or threatening. Appropriate weights can be determined by comparing successful with unsuccessful competitors or by discussing the factor and reaching a group consensus. The sum of all weights assigned to the factors must equal 1.0.

*Step 3:* Assign a rating between 1 and 4 to each key external factor to indicate how effectively the firm’s current strategies respond to the factor, where 4 = the response is superior, 3 = the response is above average, 2 = the response is average and 1 = the response is poor.

*Step 4:* Multiply each factor’s weight by its rating to determine a weighted score.

*Step 5:* Sum the weighted scores for each variable to determine the total weighted score for the organization*. Example table 3.1EFE Matrix for a Local Ten-Theatre Cinema Complex*

|  |
| --- |
|  **Key External Factors Weight Rating Weight**  **score** |
|  **Opportunities**  |
| 1. Rowan County is growing 8% annually

 in population 0.05 3 0.15 1. TDB University is expanding 6% annually 0.08 4 0.32
2. Major competitor across town recently

ceased operations 0.08 3 0.24 1. Demand for going to cinema growing 10% annually 0.07 2 0.14
2. Two new neighborhoods being developed within 3 miles 0.09 1 0.09
3. Disposable income among citizens grew 5% in prior year 0.06 3 0.18
4. Unemployment rate in county declined to 3.1% 0.03 2 0.06
 |
|  **Threats**  |
| 1. Trend toward healthy eating eroding concession sales 0.12 4 0.48
2. Demand for online movies and DVDs growing 10% annually 0.06 2 0.12
3. Commercial property adjacent to cinemas for sale 0.06 3 0.18
4. TDB University installing an on-campus movie theatre 0.04 3 0.12
5. County and city property taxes increasing 25% this year 0.08 2 0.16
6. Local religious groups object to R-rated movies being shown 0.04 3 0.12
7. Movies rented from local Blockbuster store up 12% 0.08 2 0.16
8. Movies rented last quarter from Time Warner up 15% 0.06 1 0.06
 |
|  Total **1.00** **2.58** |

Regardless of the number of key opportunities and threats included in an EFE Matrix, the highest possible total weighted score for an organization is 4.0 and the lowest possible total weighted score is 1.0. The average total weighted score is 2.5. A total weighted score of 4.0 indicates that an organization is responding in an outstanding way to existing opportunities and threats in its industry. In other words, the firm’s strategies effectively take advantage of existing opportunities and minimize the potential adverse effects of external threats. A total score of 1.0 indicates that the firm’s strategies are not capitalizing on opportunities or avoiding external threats.

 **The Competitive Profile Matrix (CPM)**

The Competitive Profile Matrix (CPM) identifies a firm’s major competitors and its particular strengths and weaknesses in relation to a sample firm’s strategic position. The weights and total weighted scores in both a CPM and an EFE have the same meaning. However, critical success factors in a CPM include both internal and external issues; therefore, the ratings refer to strengths and weaknesses, where 4 = major strength, 3 = minor strength, 2= minor weakness, and 1 = major weakness. The critical success factors in a CPM are not grouped into opportunities and threats as they are in an EFE. In a CPM, the ratings and total weighted scores for rival firms can be compared to the sample firm. This comparative analysis provides important internal strategic information.

Table 3.2 An Example Competitive Profile Matrix

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Critical success factors  | Weight  | Company 1 | Company 2 | Company 3 |
| Rating  | Score  | Rating  | Score  | Rating  | Score  |
| Advertising  | 0.20 | 1 | 0.20 | 4 | 0.80 | 3 | 0.60 |
| Product Quality  | 0.10 | 4 | 0.40 | 3 | 0.30 | 2 | 0.20 |
| Price Competitiveness  | 0.10 | 3 | 0.30 | 2 | 0.20 | 4 | 0.40 |
| Management  | 0.10 | 4 | 0.40 | 3 | 0.20 | 3 | 0.30 |
| Financial Position  | 0.15 | 4 | 0.60 | 2 | 0.30 | 3 | 0.45 |
| Customer Loyalty  | 0.10 | 4 | 0.40 | 3 | 0.30 | 2 | 0.20 |
| Global Expansion  | 0.20 | 4 | 0.80 | 1 | 0.20 | 2 | 0.40 |
| Market Share  | 0.05 | 1 | 0.05 | 4 | 0.20 | 3 | 0.15 |
| Total | 1.00 |  | 3.15 |  | 2.50 |  | 2.70 |

Note: (1) The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength. (2) As indicated by the total weighted score of 2.50, Competitor 2 is weakest. (3) Only eight critical success factors are included for simplicity; this is too few in actuality.

In this example, the two most important factors to being successful in the industry are “advertising” and “global expansion,” as indicated by weights of 0.20.

Note in Table above that Company 1 is strongest on “product quality,” as indicated by a rating of 4, whereas Company 2 is strongest on “advertising.” Overall, Company 1 is strongest, as indicated by the total weighted score of 3.15.

* 1. **The Industrial Organization (I/O) View**

The Industrial Organization (I/O) approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces.

Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates. Managing strategically from the I/O perspective entails; firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O theorists contend that external factors in general and the industry in which a firm chooses to compete has a stronger influence on the firm’s performance than do the internal functional decisions managers make in marketing, finance, and the like. Firm performance, they contend, is primarily based more on industry properties, such as economies of scale, barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether *external or internal factors are more important in gaining and maintaining competitive advantage*. Effective integration and understanding of both *external and internal* factors is the key to securing and keeping a competitive advantage.

**3.5 Sources of External Information**

A wealth of strategic information is available to organizations from both published and unpublished sources.

**Unpublished sources include**: *customer surveys, market research, speeches at professional and shareholders’ meetings, television programs, interviews, and conversations with stakeholders*.

**Published sources** include: *periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.*

* 1. **Forecasting Tools and Techniques**

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, and shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats**.**

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here**.**

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when *historical data* are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate**.**

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own.

**Chapter Four**

**Internal Environment Assessment**

Up on completing this chapter, students should be able to:

* Define the internal environment.
* Explain the nature of internal audit.
* Evaluate the relationship among the functional areas of business
* Develop Internal Factor Evaluation (IFE) Matrix
	1. **The Nature of an Internal Audit**

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths/weaknesses, coupled with external opportunities/threats and a clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses.

* 1. **The Process of Performing Internal Audit**

The process of performing an internal audit closely parallels the process of performing an external audit. Representative Managers’ and employees from throughout the firm need to be involved in determining a firm’s strengths and weaknesses.

The process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of the issues, problems, concerns, and needs of all the functional areas.

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm’s operations. Critical success factors, consisting of both strengths and weaknesses, must be identified and prioritized. Managers from different units of the organization, supported by staff, should be charged with determining the 10 to 20 most important strengths and weaknesses that should influence the future of the organization.

* 1. **Key Internal Forces**

It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production/operations; there are many sub areas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Within large organizations, each division has certain strengths and weaknesses.

A firm’s strengths that cannot be easily matched or imitated by competitors are called distinctive competencies. Building competitive advantages involves taking advantage of distinctive competencies. Strategies are designed in part to improve on a firm’s weaknesses, turning them into strengths and maybe even into distinctive competencies.

The Process of Gaining Competitive Advantage in a Firm is described:

**Weaknesses ⇒ Strengths ⇒ Distinctive Competencies ⇒ Competitive Advantage**

**The internal audit requires gathering and assimilating information about the firm’s:**

* Management,
* Marketing,
* Finance/Accounting,
* Production/Operations,
* Research and Development (R&D), and
* Management Information Systems (MIS) operations.
	+ 1. **Management**

The functions of management consist of five basic activities: planning, organizing, motivating, staffing, and controlling. When evaluating each functional area of the organization; evaluating checklist should be necessary.

The following checklist of questions can help determine specific strengths and weaknesses in the functional area of business. An answer of **NO** to any question could indicate a potential weakness. Positive or **YES** answers to the checklist questions suggest potential areas of strength.

**Marketing Audit Checklist of Questions**

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

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customers’ needs and wants for products and services. There are seven basic functions of marketing: (1) customer analysis, (2) selling products/services, (3) product and service planning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis. Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

**Marketing Audit Checklist of Questions**

* **The following questions about marketing must be examined in strategic planning:**
	1. Are markets segmented effectively?
	2. Is the organization positioned well among competitors?
	3. Has the firm’s market share been increasing?
	4. Are present channels of distribution reliable and cost effective?
	5. Does the firm have an effective sales organization?
	6. Does the firm conduct market research?
	7. Are product quality and customer service good?
	8. Are the firm’s products and services priced appropriately?
	9. Does the firm have an effective promotion, advertising, and publicity strategy?
	10. Are marketing, planning, and budgeting effective?
	11. Do the firm’s marketing managers have adequate experience and training?
	12. Is the firm’s Internet presence excellent as compared to rivals?
		1. **Finance/Accounting Audit**

Financial condition is often considered the single best measure of a firm’s competitive position and overall attractiveness to investors. Determining an organization’s financial strengths and weaknesses is essential to effectively formulating strategies. A firm’s liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives.

**Finance/Accounting Audit Checklist**

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

The production/operations function of a business consists of all those activities that transform inputs into goods and services. Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services.

**Production/Operations Audit Checklist**

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

The fifth major area of internal operations that should be examined for specific strengths and weaknesses is research and development (R&D). Many firms today conduct no R&D, and yet many other companies depend on successful R&D activities for survival. Firms pursuing a product development strategy especially need to have a strong R&D orientation.

**Research and Development Audit**

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

Information ties all business functions together and provides the basis for all managerial decisions. It is the cornerstone of all organizations. Information represents a major source of competitive management advantage or disadvantage. Assessing a firm’s internal strengths and weaknesses in information systems is a critical dimension of performing an internal audit.

**Management Information Systems Audit**

1. Do all managers in the firm use the information system to make decisions?
2. Is there a chief information officer or director of information systems position in the firm?
3. Are data in the information system updated regularly?
4. Do managers from all functional areas of the firm contribute input to the information system?
5. Is the information system user-friendly?
6. Do all users of the information system understand the competitive advantages that information can provide firms?
7. Are computer training workshops provided for users of the information system?
	1. **Value Chain Analysis (VCA)**

According to Porter, the business of a firm can best be described as a value chain, in which *total revenues minus total costs* of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses.

* 1. **Internal Factor Evaluation (IFE) Matrix**

A summary step in conducting an internal strategic-management audit is to construct an Internal Factor Evaluation (IFE) Matrix. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas.

**Steps in developing an IFE Matrix**

**Step 1**: List key internal factors as identified in the internal-audit process. Use a total of from 10 to 20 internal factors, including both *strengths* and *weaknesses.* List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers.

**Step 2:** Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm’s industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.

**Step 3**: Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating = 1), a minor weakness (rating = 2), a minor strength (rating = 3), or a major strength (rating = 4). Note that strengths must receive a 3 or 4 rating and weaknesses must receive a 1 or 2 rating. Ratings are thus company-based, whereas the weights in step 2 are industry-based.

**Step 4**: Multiply each factor’s weight by its rating to determine a weighted score for each variable.

**Step 5**: Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position.

A Sample Internal Factor Evaluation Matrix for a Retail Computer Store

|  |  |  |  |
| --- | --- | --- | --- |
| Key Internal Factors | Weight | Rating  | Weighted Score |
| **Strengths** |  |  |  |
|  Inventory turnover increased from 5.8 to 6.7 | 0.05 | 3 | 0.15 |
| Average customer purchase increased from $97 to $128  | 0.07 | 4 | 0.28 |
| Employee morale is excellent  | 0.10 | 3 | 0.30 |
| In-store promotions resulted in 20 percent increase in sales  | 0.05 | 3 | 0.15 |
| Newspaper advertising expenditures increased 10 percent  | 0.02 | 3 | 0.06 |
| Revenues from repair/service segment of store up 16 % | 0.15 | 3 | 0.45 |
| In-store technical support personnel have MIS degrees  | 0.05 | 4 | 0.20 |
| Store’s debt-to-total assets ratio declined to 34 percent  | 0.03 | 3 | 0.09 |
|  Revenues per employee up 19 percent  | 0.02 | 3 | 0.06 |
| **Weakness**  |  |  |  |
| Revenues from software segment of store down 12 %  | 0.10 | 2 | 0.20 |
| Location of store negatively impacted by new Highway  | 0.15 | 2 | 0.30 |
| Carpet and paint in store somewhat in disrepair  | 0.02 | 1 | 0.02 |
| Bathroom in store needs refurbishing  | 0.02 | 1 | 0.02 |
| Revenues from businesses down 8 percent  | 0.04 | 1 | 0.04 |
| Store has no Web site  | 0.05 | 2 | 0.10 |
| Supplier on-time delivery increased to 2.4 days  | 0.03 | 1 | 0.03 |
| Often customers have to wait to check out  | 0.05 | 1 | 0.05 |
| **Total** | **1.00** |  | **2.50** |

Table 4.1 IFE matrix

An example of an IFE Matrix is provided above for a retail computer store. Note that the two most important factors to be successful in the retail computer store business are “revenues from repair/service in the store” and “location of the store.” Also note that the store is doing best on “average customer purchase amount” and “in-store technical support.” The store is having major problems with its carpet, bath- room, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store receives a 2.5 total weighted score, which on a 1-to-4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

* 1. **The Resource-Based View (RBV)**

Some researchers emphasize the importance of the internal audit part of the strategic management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying: In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy.

The Resource-Based View (RBV) approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage. In contrast to the I/O theory presented in the previous chapter, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories:

* physical resources,
* human resources, and
* organizational resources

The basic premise of the RBV is that the mix, type, amount, and nature of a firm’s internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm’s unique resources and capabilities, and continually maintaining and strengthening those resources.

For a resource to be valuable, it must be either rare, hard to imitate, or not easily substitutable. Often called empirical indicators, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, non-imitable, and non- substitutable, the stronger a firm’s competitive advantage will be and the longer it will last.

**Chapter Five**

**Strategy Analysis and Choice**

At the end of this lesson students will be able to:

* Explain the nature of strategy analysis and choice.
* Understand different strategies
* Assess a comprehensive strategy formulation
* Explain the decision stage of strategy.
	1. **The Nature of Strategy Analysis and Choice**

Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm’s present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. Unless a desperate situation confronts the firm, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies derived from the firm’s vision, mission, objectives, external audit, and internal audit; they are consistent with, or build on, past strategies that have worked well.

* 1. **Type of Strategies**

Since the goals are different and the means to achieve them are different for different level, strategies are likely to be different. The level of strategy can be: *corporate level strategy, business level strategy*, and *functional/operational* level strategies.

* + 1. ***Corporate Level Strategies***

It is believed that strategic decision making is the responsibility of top management. At the corporate level, the board of directors and chief executive officers are involved in strategy making. Corporate planners and consultants may also be involved. Mostly corporate level strategies are futuristic, innovative and pervasive in nature. Under corporate level strategies, there are four strategic alternatives which are also called ***grand*** *strategies*. These are: *integration, intensive, diversification,* and *defensive* strategies.

## Integration Strategies

Forward integration, backward integration, and horizontal integration are sometimes collectively referred to as vertical integration strategies. Vertical integration strategies allow a firm to gain control over distributors, suppliers, and competitors.

* **Forward integration:** involves gaining ownership or increased control over distributors or retailers. Increasing numbers of manufacturers (suppliers) today are pursuing a forward integration strategy by establishing Web sites to directly sell products to consumers. This strategy is causing turmoil in some industries.
* **Backward integration:** Both manufacturers and retailers purchase needed materials from suppliers. Backward integration is a strategy of seeking ownership or increased control of a firm’s suppliers. This strategy can be especially appropriate when a firm’s current suppliers are unreliable, too costly, or cannot meet the firm’s needs.
* **Horizontal integration:** refers to a strategy of seeking ownership of or increased control over a firm’s competitors. One of the most significant trends in strategic management today is the increased use of horizontal integration as a growth strategy. Mergers, acquisitions, and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies.
* **Mergers –** is combining different companies in to a single company in order to enhance the financial and operational strengths of both organizations.Merger can be absorption or consolidation. Merger by absorption is merger two or more companies in to a single company where one survivors and other loss their existence. Merger by consolidation is also merger two or more companies together and both companies seek to exist. In this type of merger both companies form a new company.
* **Acquisition –** refers to an act of acquiring in another entity or company**.** Acquiring company obtains the majority *stake* in the acquired firms. Both companies exist and no new company is formed.
1. **Intensive strategies**

Market penetration, market development, and product development are sometimes referred to as intensive strategies because they require intensive efforts if a firm’s competitive position with existing products is to improve.

* **Market penetration**: A market penetration strategy seeks to increase market share for present products or services in present markets through greater marketing efforts. This strategy is widely used alone and in combination with other strategies. Market penetration includes increasing the number of salespersons, increasing advertising expenditures, offering extensive sales promotion items, or increasing publicity efforts.
* **Market development:** Market development involves introducing present products or services into new geographic areas.
* **Product development**: Product development is a strategy that seeks increased sales by improving or modifying present products or services.

## Diversification Strategies

There are three general types of *diversification strategies:* concentric, horizontal, and conglomerate.

* **Concentric Diversification**

 Adding new, but related, products or services is widely called *concentric diversification*.

* **Conglomerate Diversification**

Adding new, unrelated products or services Adding new, unrelated products or services is called *conglomerate diversification*

* **Horizontal Diversification**

Adding new, unrelated products or services for present customers is called *horizontal diversification.* This strategy is not as risky as conglomerate diversification because a firm already should be familiar with its present customers.

 **IV Defensive strategies**

In addition to integrative, intensive, and diversification strategies, organizations also could pursue defensive strategies like: Retrenchment, Divestiture, and Liquidation.

* **Retrenchment:** Retrenchment occurs when an organization regroups through cost and asset reduction to reverse declining sales and profits. Sometimes called a turn- around or reorganizational strategy, retrenchment is designed to fortify an organization’s basic distinctive competence.
* **Divestiture**: Selling a division or part of an organization is called *divestiture.* Divestiture often is used to raise capital for further strategic acquisitions or investments.
* **Liquidation:** Selling all of a company’s assets, in parts, for their tangible worth is called liquidation. Liquidation is recognition of defeat and consequently can be an emotionally difficult strategy. However, it may be better to cease operating than to continue losing large sums of money.

## *Business Level Strategy*

## Michael Porter’s Five Generic Strategies

According to Porter, strategies allow organizations to gain competitive advantage from three different bases:

* Cost leadership,
* Differentiation, and
* Focus. Porter calls these bases generic strategies.

## Firms choose from among five business-level strategies to establish and defend their desired strategic position against competitors:

## Type 1: Cost Leadership—Low Cost

## Type 2: Cost Leadership—Best Value

## Type 3: Differentiation

## Type 4: Focus—Low Cost

## Type 5: Focus—Best Value

Differentiation

Cost

Leadership

Focus

##  Large

Type 1

Type 2

Type 3

-

|  |
| --- |
| Size of market  |

##

Type 3

-

Type 4

Type 5

##  Small

##

##  FIGURE 5-1 generic strategies

## Cost leadership

Cost leadership emphasizes producing standardized products at a *very low per-unit cost* for consumers who are *price-sensitive*. Two alternative types of cost leadership strategies can be defined.

* **Type 1** is a **low-cost strategy** that offers products or services to a wide range of customers at the lowest price available on the market.
* **Type 2** is a **best-value strategy** that offers products or services to a wide range of customers at the best price-value available on the market; the best-value strategy aims to offer customers a range of products or services at the lowest price available compared to a rival’s products with similar attributes. Both Type 1 and Type 2 strategies target a **large market**.
* **Differentiation**

Porter’s **Type 3** generic strategy is *differentiation,* a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive. Differentiation involves making your products or services different from and more attractive than those of your competitors. Durable products protected by barriers to quick copying by competitors are best. Successful differentiation can mean greater product flexibility, greater compatibility, lower costs, improved service, less maintenance, greater convenience, or more features. Product development is an example of a strategy that offers the advantages of differentiation. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty because consumers may become strongly attached to the differentiation features. Special features that differentiate one’s product can include superior service, spare parts availability, engineering design, product performance, useful life, gas mileage, or ease of use.

* **Focus**

Focus means producing products and services that fulfill the needs of small groups of consumers. Two alternative types of focus strategies are Type 4 and Type 5.

* **Type 4** is a **low-cost focus** strategy that offers products or services to a **small range (niche group**) of customers at the lowest price available on the market.
* **Type 5** is a best-value focus strategy that offers products or services to a small range of customers at the best **price-value** available on the market. Sometimes called **“focused differentiation,”** the best-value focus strategy aims to offer a niche group of customers products or services that meet their tastes and requirements better than rivals’ products do.
	+ 1. ***Functional (Operating) Level Strategy***

##  This level of strategy is at the operating end of the organization. Decisions related to training, investment in plant, advertising, sales promotion, total quality management, market segmentation etc. this decision is almost tactical. They deal with a relatively restricted plan providing objectives for specific function, allocation of resources among different operations within the functional area and coordination between them.

* 1. **A Comprehensive Strategy-Formulation Framework**

Important strategy-formulation techniques can be integrated into a three-stage decision making framework. The strategy formulation framework consists of three stages:

* ***Stage one – Input stage: consists of External Factor Evaluation (EFE) matrix, Internal Factor Evaluation (IFE) matrix and competitive profile matrix (CPM).***
* ***Stage two – Matching stage: consists of Strength-Weakness-Opportunity-Threat (SWOT) matrix, Strategic Position and Action Evaluation (SPACE) matrix, Boston Consulting Group (BCG) matrix, Internal – External (IE) matrix and Grand strategy matrix.***
* ***Stage Three – Decision stage: involves a single technique called Quantitative Strategic Planning Matrix (QSPM).***

**Stage 1: The Input stage**

 (EFE) Matrix

(IFE) Matrix

 (CPM)

**Stage 2: Matching stage**

Grand Strategy Matrix

 (IE) Matrix

 (BCG) matrix

 (SPACE) Matrix

 (SWOT) Matrix

**Stage 3: Decision stage**

Quantitative Strategic Planning Matrix (QSPM)

* + 1. **The Input Stage**

Procedures for developing an EFE Matrix, an IFE Matrix, and a CPM were presented in Chapters 3 and 4. The information derived from these three matrices provides basic input information for the matching and decision stage matrices. The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings.

* + 1. **The Matching Stage**

Strategy is sometimes defined as the *match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors.* The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: the SWOT Matrix, the SPACE Matrix, the BCG Matrix, the IE Matrix, and the Grand Strategy Matrix. These tools rely upon information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. Matching external and internal critical success factors is the key to effectively generating feasible alternative strategies.

* + 1. **Strength – Weakness – Opportunity –Threat (SWOT) Matrix**

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps managers develop **four** types of strategies: ***SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats)*** Strategies.

* **SO Strategies** - use a firm’s internal strengths to take advantage of external opportunities.
* **WO Strategies** - aim at improving internal weaknesses by taking advantage of external opportunities.
* **ST Strategies** - use a firm’s strengths to avoid or reduce the impact of external threats.
* **WT Strategies**- are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation.

**Steps to develop SWOT Matrix**

* + - 1. List the firm’s key external opportunities.
			2. List the firm’s key external threats.
			3. List the firm’s key internal strengths.
			4. List the firm’s key internal weaknesses.
			5. Match internal strengths with external opportunities, and record the resultant SO Strategies in the appropriate cell.
			6. Match internal weaknesses with external opportunities, and record the resultant WO Strategies.
			7. Match internal strengths with external threats, and record the resultant ST Strategies.
			8. Match internal weaknesses with external threats, and record the resultant WT Strategies.

**Example: A SWOT Matrix for a Retail Computer Store**

|  |  |  |
| --- | --- | --- |
|  | **Strengths** | **Weaknesses** |
|  | 1. Inventory turnover up 5.8 to 6.7 1.
2. Average customer purchase up $97 to $128
3. Employee morale is excellent
4. In-store promotions = 20% increase in sales
5. Newspaper advertising expenditures down 10%
6. Revenues from repair/service in-store up 16%
7. In-store technical support persons have MIS degrees
8. Store’s debt-to-total assets ratio down 34%
 | 1. Software revenues in store down 12%
2. Location of store hurt by new Hwy 34
3. Carpet and paint in store in disrepair
4. Bathroom in store needs refurbishing
5. Total store revenues down 8%
6. Store has no Web site
7. Supplier on-time-delivery up to 2.4 days
8. Customer checkout process too slow
 |
| **Opportunities** | **SO Strategies**1. Add 4 new in-store

 promotions monthly  (S4,O3)1. Add 2 new repair/service

 persons (S6, O5)1. Send flyer to all seniors

 over age 55 (S5, O5)  | **WO Strategies**1. Purchase land to build new store (W2, O2)
2. Install new carpet/paint/bath (W3, W4, O1)
3. Up Web site services by 50% (W6, O7, O8)
4. Launch mailout to all Realtors in city (W5, O7)
 |
| 1. Population of city growing 10%
2. Rival computer store opening 1 mile away
3. Vehicle traffic passing store up 12%
4. Vendors average six new products/yr
5. Senior citizen use of computers up 8%
6. Small business growth in area up 10%
7. Desire for Web sites up 18% by Realtors
8. Desire for Web sites up 12% by small firms
 |
| **Threats** | **ST Strategies**1. Hire two more repair persons and market these new services (S6, S7, T1)
2. Purchase land to build new store (S8, T3)
3. Raise out-of-store service calls from $60 to $80 (S6, T5)
 | **WT Strategies**1. Hire 2 new cashiers (W8, T1, T4)
2. Install new carpet/paint/ bath (W3, W4, T1)
 |
| 1. Best Buy opening new store in 1yr nearby
2. Local university offers computer repair
3. New bypass Hwy 34 in 1 yr will divert traffic
4. New mall being built nearby
5. Gas prices up 14%
6. Vendors raising prices 8%
 |

* + 1. **The Strategic Position and Action Evaluation (SPACE) Matrix**

The Strategic Position and Action Evaluation (SPACE) Matrix, another important Stage 2 matching tool. Its four-quadrant framework indicates whether ***aggressive, conservative, defensive, or competitive*** strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent ***two internal dimensions*** (***financial position [FP***] and ***competitive position*** [***CP***]) and ***two external dimensions*** (***stability position [SP]*** and ***industry position [IP***]). These four factors are perhaps the most important determinants of an organization’s overall strategic position.

 FP

 **Aggressive**

Backward, forward, horizontal integration

• Market penetration

 • Market development

• Product development

• Diversification (related or unrelated)

 **Conservative**

 • Market penetration

• Market development

 • Product development

 • Related diversification

 CP IP

 **Defensive**

 • Retrenchment

• Divestiture

 • Liquidation

 **Competitive**

Backward, forward, horizontal integration

 • Market penetration

 • Market development

• Product development

 SP

Figure 5.4. SPAC Matrix

**The steps required to develop a SPACE Matrix**:

1. Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).
2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions. Assign a numerical value ranging from -1 (best) to -7 (worst) to each of the variables that make up the SP and CP dimensions. On the FP and CP axes, make comparison to competitors. On the IP and SP axes, make comparison to other industries.
3. Compute an average score for FP, CP, IP, and SP by summing the values given to the variables of each dimension and then by dividing by the number of variables included in the respective dimension.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis in the SPACE Matrix.
5. Add the two scores on the x-axis and plot the resultant point on X. Add the two scores on the y-axis and plot the resultant point on Y. Plot the intersection of the new xy point.
6. Draw a directional vector from the origin of the SPACE Matrix through the new intersection point. This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.
* When a firm’s directional vector is located in the ***aggressive quadrant*** an organization is in an excellent position to use its internal strengths to (1) take Advantage of external opportunities, (2) overcome internal weaknesses, and (3) avoid external threats. Therefore, market penetration, market development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible.
* The directional vector may appear in the ***conservative quadrant*** which implies staying close to the firm’s basic competencies and not taking excessive risks. Conservative strategies most often include market penetration, market development, product development, and related diversification.
* The directional vector may be located in the lower-left or ***defensive quadrant*** of the SPACE Matrix, which suggests that the firm should focus on rectifying internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification.
* Finally, the directional vector may be located in the lower-right or ***competitive quadrant*** of the SPACE Matrix, indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development and product development.

|  |  |
| --- | --- |
| Financial Position (FP) | Ratings |
| The bank’s primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent. The bank’s return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70. The bank’s net income was $183 million, down 9 percent from a year earlier. The bank’s revenues increased 7 percent to $3.46 billion.  | 1.01.03.0 4.09.0 |
| Industry Position (IP) |  |
| Deregulation provides geographic and product freedom. Deregulation increases competition in the banking industry. Pennsylvania’s interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia.  | 4.0 2.04.0**10.0** |
| Stability Position (SP) |  |
| Less-developed countries are experiencing high inflation and political instability. Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries. Banking deregulation has created instability throughout the industry | -4.0-5.0 -4.0**-13.0** |
| Competitive Position (CP) |  |
| The bank provides data processing services for more than 450 institutions in 38 states. Superregional banks, international banks, and nonbanks are becoming increasingly competitive. The bank has a large customer base.  | -2.0-5.0-2.0**-9.0** |

 SP Average is -13.0 ÷ 3 = -4.33 IP Average is +10.0 ÷ 3 = 3.33

 CP Average is -9.0 ÷ 3 = -3.00 FP Average is +9.0 ÷ 4 = 2.25

 Directional Vector Coordinates: x- axis: -3.00 + (+3.33) = +0.33

 y- axis: -4.33 + (+2.25) = -2.08

 The bank should pursue ***Competitive Strategies***.

* + 1. **The Boston Consulting Group (BCG) Matrix**

When a firm’s divisions compete in different industries, a separate strategy often must be developed for each business. The Boston Consulting Group (BCG) Matrix and the Internal-External (IE) Matrix are designed specifically to enhance a multidivisional firm’s efforts to formulate strategies.

The BCG Matrix graphically portrays differences among divisions in terms of ***relative market share position*** and ***industry growth rate***. The BCG Matrix allows a multidivisional organization to manage its ***portfolio of businesses*** by examining the ***relative market share*** ***position*** and the ***industry growth rate*** of each division relative to all other divisions in the organization.

**Relative market share position** - is defined as *the ratio of a division’s own market share (or revenues) in a particular industry to the market share (or revenues) held by the largest rival firm in that industry*.

Relative market share position is given on the x-axis of the BCG Matrix. The midpoint on the x-axis usually is set at 0.50, corresponding to a division that has half the market share of the leading firm in the industry. The y-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the y-axis could range from -20 to +20 percent, with 0.0 being the midpoint.

On the BCG Matrix, divisions located in Quadrant I are called “***Question Marks***,” those located in Quadrant II are called “***Stars***,” those located in Quadrant III are called “***Cash Cows***,” and those divisions located in Quadrant IV are called “***Dogs***.”

* **Question Marks**—Divisions in Quadrant I have a *low* ***relative market share position***, yet they compete in a ***high-growth industry***. Generally these firms’ cash needs are high and their cash generation is low. These businesses are called Question Marks because the organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them.
* **Stars**—Quadrant II businesses (Stars) represent the organization’s best long-run opportunities for growth and profitability. Divisions with a ***high relative market share*** and a ***high industry growth*** rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward and horizontal integration; market penetration; market development; and product development are appropriate strategies.
* **Cash Cows**—Divisions positioned in Quadrant III have a ***high relative market share*** position but compete in a low-growth industry. Called Cash Cows because they generate cash in excess of their needs, they are often milked. Cows were yesterday’s Stars. Cash Cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong Cash Cows. However, as a Cash Cow division becomes weak, retrenchment or divestiture can become more appropriate.
* **Dogs**—Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are Dogs in the firm’s portfolio. Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through retrenchment.

 RELATIVE MARKET SHARE POSITION

Dogs

IV

Cash Cows

III

 High Medium low

 1.0 0.5 0.0

Question Marks

I

Stars

II

INDUSTRY SALES GROWTH RAT

 High +20

 Medium 0

 Low -20

* + 1. **Internal – External (IE) Matrix**

The IE Matrix is based on two key dimensions: the *IFE total weighted scores on the x-axis* and the *EFE total weighted scores on the y-axis*. Recall that each division of an organization should construct an IFE Matrix and an EFE Matrix for its part of the organization. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix.

On the x-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a ***weak internal position***; a score of 2.0 to 2.99 is considered ***average***; and a score of 3.0 to 4.0 is ***strong***.

 Similarly, on the y-axis, an EFE total weighted score of 1.0 to 1.99 is considered ***low***; a score of 2.0 to 2.99 is ***medium***; and a score of 3.0 to 4.0 is ***high***.

 THE IFE TOTAL WEIGHT SCORE

 Strong (3.0 to 4.0) Average (2.0 to 2.99) Week (1.0 to 1.99)

 4.0 3.0 2.0 1.0

 High

THE EFE TOTAL WEIGHTED SCORES

III

 (3.0 to 4.0)

I

II

 3.0

 Medium

IV

V

VI

 (2.0 to 2.99)

 2.0

 Low

VIII

VII

IX

 (1.0 to 1.99)

 1.0

 Figure 5.5 IE matrix

The IE Matrix can be divided into **three major regions** that have different strategy implications.

* First,the prescription for divisions that fall into cells I, II, or IV can be described as **grow and build.** Integration and intensive strategies are most appropriate strategies**.**
* Second, divisions that fall into cells III, V, or VII can be managed best **withhold and maintain** strategies; market penetration and product development are two commonly employed strategies for these types of divisions.
* Third, a common prescription for divisions that fall into cells VI, VIII, or IX is **harvest** or **divest**. Successful organizations are able to achieve a portfolio of businesses positioned in or around cell I in the IE Matrix.
	+ 1. **Decision Stage**

**The Quantitative Strategic Planning Matrix (QSPM)**

The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and Competitive Profile Matrix that make up Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal critical success factors.

**Components of QSPM**: *Strategic Alternatives, Key Factors, Weights, Attractiveness Scores (AS), Total Attractiveness Scores (TAS), and the Sum Total Attractiveness Score.*

**Steps to develop QSPM:**

Step 1: ***Make a list of the firm’s key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM***. This information should be taken directly from the EFE Matrix and IFE Matrix.

Step 2: ***Assign weights to each key external and internal factor***. These weights are identical to those in the EFE Matrix and the IFE Matrix.

Step 3: ***Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing***. Record these strategies in the top row of the QSPM.

Step 4: ***Determine the Attractiveness Scores (AS)*** defined as numerical values that indicate the relative attractiveness of each strategy in a given set of alternatives. The range for Attractiveness Scores is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. By attractive, we mean the extent that one strategy, compared to others, enables the firm to either capitalize on the strength, improve on the weakness, exploit the opportunity, or avoid the threat.

Step 5: ***Compute the Total Attractiveness Scores***. Total Attractiveness Scores (TAS) are defined as the product of multiplying the weights (Step 2) by the Attractiveness Scores (Step 4) in each row.

Step 6 ***Compute the Sum Total Attractiveness Score***. Add Total Attractiveness Scores in each strategy column of the QSPM. The Sum Total Attractiveness Scores (STAS) reveal which strategy is most attractive in each set of alternatives. Higher scores indicate more attractive strategies, considering all the relevant external and internal factors that could affect the strategic decisions.

 Example: A QSPM for a Retail Computer Store

|  |
| --- |
|  STRATEGIC ALTERNATIVES |
|  |  |  1 Buy New Land and Build New Larger Store |  2Fully Renovate Existing Store |
|  Key Factors | Weight  | AS  |  TAS |  AS |  TAS |
|  Opportunities 1. Population of city growing 10%
2. Rival computer store opening 1 mile away
3. Vehicle traffic passing store up 12%
4. Vendors average six new products/year
5. Senior citizen use of computers up 8%
6. Small business growth in area up 10%
7. Desire for Web sites up 18% by Realtors
8. Desire for Web sites up 12% by small firms

 Threats 1. Best Buy opening new store nearby in 1 year
2. Local university offers computer repair
3. New bypass for Hwy 34 in 1 year will divert traffic
4. New mall being built nearby
5. Gas prices up 14%
6. Vendors raising prices 8%

 Strength 1. Inventory turnover increased from 5.8 to 6.7
2. Average customer purchase increased from $97 to $128
3. Employee morale is excellent
4. In-store promotions resulted in 20% increase in sales
5. Newspaper advertising expenditures increased 10%
6. Revenues from repair/service segment of store up 16%
7. In-store technical support personnel have MIS college degrees
8. Store’s debt-to-total assets ratio declined to 34%
9. Revenues per employee up 19%

 Weakness 1. Revenues from software segment of store down 12%
2. Location of store negatively impacted by new Hwy 34
3. Carpet and paint in store somewhat in disrepair
4. Bathroom in store needs refurbishing
5. Revenues from businesses down 8%
6. Store has no Web site
7. Supplier on-time delivery increased to 2.4 days
8. Often customers have to wait to check out

Total  | 0.100.100.080.050.050.100.06 0.060.150.080.120.080.040.031.00.050.070.100.050.020.150.050.030.02 0.100.150.020.020.040.050.030.051.0 | 4 2 1 — ————4\_42—— —2———4—4——4113——2 | 0.400.200.080.600.480.160.140.600.120.600.020.020.120.104.36  | 244—————3\_14———4———3—2——1444——4 | 0.200.400.320.450.120.320.280.450.060.150.080.080.160.203.27 |

In actual practice, the store did ***purchase the new land and build a new store.***

In decision stage QSPM the two alternative strategies—(1) buy new land and build new larger store and (2) fully renovate existing store—are being considered by a computer retail store. Note by sum total attractiveness scores of 4.63 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store.

**Chapter Six**

At the end of this unit, students will be able to:

* Explain the nature of strategy implementation.
* Describe the key concepts in strategy implementation.
* explain the importance of implementing strategy

**Strategy Implementation: Management Issues**

* 1. **The Nature of Strategy Implementation**

Successful strategy formulation *does not guarantee successful strategy implementation*. It is always more difficult to do something (*strategy implementation*) than to say you are going to do it (*strategy formulation*). Strategy implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

 **Strategy Implementation**

* Is managing forces during the action
* Focuses on efficiency
* Requires special motivation and leadership skills.
* Requires coordination among many individuals

**Strategy Formulation**

* Is positioning forces before the action
* Focuses on effectiveness.
* Requires good intuitive and analytical skills
* Requires coordination among a few individuals

Implementing strategies requires such actions as adding new departments, closing facilities, hiring new employees, changing an organization’s pricing strategy, developing financial budgets, developing new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly between manufacturing, service, and governmental organizations.

* 1. **Key concepts in strategy implementation**
		1. **Management issues**

Management issues central to strategy implementation include *establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategy supportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing*.

1. **Establishing Annual Objectives**

Establishing annual objectives is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to acceptance and commitment. Annual objectives are essential for strategy implementation because they (1) *represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long-term objectives; and (4) establish organizational, divisional, and departmental priorities*. The purpose of annual objectives can be summarized as follows:

* Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members.
* Annual objectives can be established based on an organization’s structure, should be consistent across hierarchical levels and form a network of supportive aims.
* They serve as standards of performance.
* They serve as an important source of employee motivation and identification.
* They give incentives for managers and employees to perform.
* They provide a basis for organizational design.

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization.

1. **Policies**

Broadly defined, policy refers to *specific guide- lines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals*. Policies are *instruments* for strategy implementation. Policies set *boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization’s objectives.* Policies facilitate solving recurring problems and guide the implementation of strategy. Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for *management control, allow coordination across organizational units, and reduce the amount of time managers spend making decisions*. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organizations have a policy manual that serves to guide and direct behavior.

**Some Issues That May Require a Management Policy**

* To centralize or decentralize employee-training activities
* To recruit through employment agencies, college campuses, and/or newspapers
* To promote from within or to hire from the outside
* To promote on the basis of merit or on the basis of seniority
* To tie executive compensation to long-term and/or annual objectives
* To allow much, some, or no overtime work
1. **Resource Allocation**

Resource allocation is a central management activity that allows for strategy implementation. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives. All organizations have at least *four types of resources* that can be used to achieve desired objectives. These are: *financial resources, physical resources, human resources,* and *technological resources*.

Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. The real value of any resource allocation program lies in the resulting accomplishment of an organization’s objectives.

1. **Managing Conflict**

Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues.

Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization.

1. **Matching Structure with Strategy**

Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural format for developing objectives and policies can significantly impact all other strategy implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization’s structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization’s structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Structure undeniably can and does influence strategy. Structure can shape the choice of strategies. But a more important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished.

 **Symptoms of an Ineffective Organizational Structure**

* Too many levels of management
* Too many meetings attended by too many people
* Too much attention being directed toward solving interdepartmental conflicts
* Too large a span of control
1. **Restructuring and Reengineering**
* **Restructuring** - Firms often employ restructuring when various ratios appear out of line with competitors as determined through benchmarking exercises. Recall that benchmarking simply involves comparing a firm against the best firms in the industry on a wide variety of performance- related criteria. Some benchmarking ratios commonly used in rationalizing the need for restructuring are headcount-to-sales-volume, or corporate-staff-to-operating-employees, or span-of-control figures.
* **Reengineering** - In reengineering, a firm uses information technology to break down functional barriers and create a work system based on business processes, products, or outputs rather than on functions or inputs. Cornerstones of reengineering are decentralization, reciprocal interdependence, and information sharing.
1. **Managing Resistance to Change**

Any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task. Resistance to change can be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information. Successful strategy implementation hinges upon managers’ ability to develop an organizational climate conducive to change.

Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, *three commonly* used *strategies* are:

1. **A force change strategy** – is *giving orders and enforcing those orders*; this strategy has the advantage of being *fast*, but it is plagued by *low commitment* and *high resistance*.
2. **An educative change strategy** - is one that *presents information to convince people the need for change*. This strategy is becomes *slow* and *difficult*. However, it evokes greater *commitment* and *less resistance*.
3. **Rational or self-interest change strategy** - is one that attempts to *convince individuals that the change is to their personal advantage*. When this appeal is successful, strategy implementation can be *relatively easy*. However, implementation changes are seldom to everyone’s advantage.
4. **Creating a Strategy-Supportive Culture**

Strategists should strive to preserve, emphasize, and build upon aspects of an existing culture that support proposed new strategies. Aspects of an existing culture that are antagonistic to a proposed strategy should be identified and changed. New strategies are often market-driven and dictated by competitive forces. For this reason, changing a firm’s culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture.

 **Chapter Seven**

 **Strategy Evaluation and Control**

At the end of this lesson students will be able to:

* Explain the nature of strategy evaluation.
* Describe a strategic evaluation
* Elaborate the characteristics of an effective evaluation system.
* Define the contingency model.
	1. **The Nature of Strategy Evaluation and Control**

The strategic management process results in decisions that can have significant, long lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse. Most strategists agree, therefore, that strategy evaluation is vital to an organization’s well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical.

Strategy evaluation includes three basic activities:

* Examining the underlying bases of a firm’s strategy,
* Comparing expected results with actual results, and
* Taking corrective actions to ensure that performance conforms to plans.

Adequate and timely feedback is the cornerstone of effective strategy evaluation. Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory.

Strategy evaluation is simply an appraisal of:

* How well an organization has performed?
* Have the firm’s assets increased?
* Has there been an increase in profitability?
* Have sales increased?
* Have productivity levels increased?
* Have profit margin, return on investment, and earnings-per-share ratios increased?
	1. **A Strategy-Evaluation Framework**

Strategy – Evaluation framework has three activities. These are: ***reviewing bases of strategy, measuring organizational performance, and taking corrective action.***

1. **Reviewing Bases of Strategy**

Reviewing the underlying bases of an organization’s strategy could be approached by developing a revised EFE Matrix and IFE Matrix. A revised IFE Matrix should focus on changes in the organization’s management, marketing, finance/accounting, production/operations, R&D, and management information systems strengths and weaknesses. A revised EFE Matrix should indicate how effective a firm’s strategies have been in response to key opportunities and threats.

*This analysis could also address such questions as the following:*

* How have competitors reacted to our strategies?
* How have competitors’ strategies changed?
* Have major competitors’ strengths and weaknesses changed?
* Why are competitors making certain strategic changes?

*Some key questions to address in evaluating strategies:*

1. Are our internal strengths still strengths?
2. Have we added other internal strengths? If so, what are they?
3. Are our internal weaknesses still weaknesses?
4. Do we now have other internal weaknesses? If so, what are they?
5. Are our external opportunities still opportunities?
6. Are there now other external opportunities? If so, what are they?
7. **Measuring Organizational Performance**

Another important strategy-evaluation activity is measuring organizational performance. This activity includes:

* Comparing expected results to actual results,
* Investigating deviations from plans,
* Evaluating individual performance, and
* Examining progress being made toward meeting stated objectives.

Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (poorly doing the right things).

Strategy evaluation is based on both ***quantitative*** and ***qualitative criteria***. ***Quantitative criteria*** commonly used to evaluate strategies are ***financial ratios***, which strategists use to make three critical comparisons:

1. Comparing the firm’s performance over different time periods,
2. Comparing the firm’s performance to competitors’, and
3. Comparing the firm’s performance to industry averages.

***Qualitative or intuitive judgments criteria*** in strategy evaluation are as follows:

1. How good is the firm’s balance of investments between high-risk and low-risk projects?
2. How good is the firm’s balance of investments between long-term and short-term projects?
3. How good is the firm’s balance of investments between slow-growing markets and fast-growing markets?
4. How good is the firm’s balance of investments among different divisions?
5. To what extent are the firm’s alternative strategies socially responsible
6. **Taking Corrective Actions**

The final strategy-evaluation activity, taking corrective actions, requires making changes to competitively reposition a firm for the future. Changes that may be needed are:

* Altering an organization’s structure,
* Replacing one or more key individuals,
* Selling a division, or revising a business mission
* Establishing or revising objectives,
* devising new policies,
* adding additional salespersons,
* differently allocating resources,
* Developing new performance incentives.

Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated. No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives. Strategy evaluation can lead to strategy-formulation changes, strategy-implementation changes, both formulation and implementation changes, or no changes at all.

* 1. **Characteristics of an Effective Evaluation System**

Strategy evaluation must meet several basic requirements to be effective.

* strategy- evaluation activities must be economical
* Strategy-evaluation activities also should be meaningful
* Strategy-evaluation activities should provide timely information
* Strategy evaluation should be designed to provide a true picture of what is happening.
* Strategy evaluation process should facilitate action.
* The strategy-evaluation process should not dominate decisions.
* Strategy evaluations should be simple

There is no one ideal strategy-evaluation system. The unique characteristics of an organization, including its size, management style, purpose, problems, and strengths, can determine a strategy-evaluation and control system’s final design.

* 1. **Contingency model**

Regardless of how carefully strategies are formulated, implemented, and evaluated, unforeseen events, such as strikes, boycotts, natural disasters, arrival of foreign competitors, and government actions, can make a strategy obsolete. To minimize the impact of potential threats, organizations should develop contingency plans as part of their strategy-evaluation process.

Contingency plans can be defined as ***alternative plans that can be put into effect if certain key events do not occur as expected***. Only high-priority areas require the insurance of contingency plans. Strategists cannot and should not try to cover all bases by planning for all possible contingencies. But in any case, contingency plans should be as simple as possible.

Some contingency plans commonly established by firms include the following:

* If a major competitor withdraws from particular markets as intelligence reports indicate, what actions should our firm take?
* If our sales objectives are not reached, what actions should our firm take to avoid profit losses?
* If demand for our new product exceeds plans, what actions should our firm take to meet the higher demand?
* If certain disasters occur—what actions should our firm take?
* If a new technological advancement makes our new product obsolete sooner than expected, what actions should our firm take?