Yashwantrao
Chavan
Maharashtra
Open University

MBA 301

MBA : SECOND YEAR

SEMESTER III

COMPULSORY COURSE

STRATEGIC MANAGEMENT

Unit 1 :	Introduction to Strategic Management	1
Unit 2 :	Strategy Formulation and Defining Vision	17
Unit 3 :	Defining Mission, Goals and Objectives	31
Unit 4 :	External Assessment	47
Unit 5 :	Organisational Appraisal : The Internal Assessment - 1	79
Unit 6 :	Organisational Appraisal: Internal Assessment - 2	93
Unit 7 :	Corporate Level Strategies	119
Unit 8 :	Business Level Strategies	151
Unit 9 :	Strategic Analysis and Choice	169
Unit 10 :	Strategy Implementation	195
Unit 11 :	Structural Implementation	217
Unit 12 :	Behavioural Implementation	237
Unit 13 :	Functional and Operational Implementation	263
Unit 14 :	Strategic Evaluation and Control	283

YASHWANTRAO CHAVAN MAHARASHTRA OPEN UNIVERSITY

VICE-CHANCELLOR : Prof. E. Vayunandan

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Open University, Nashik

Prof. Vinay. K. Nangia
Professor & Former Head
Department of Business Studies,
Indian Institute of Technology (IIT)
Roorkee

Authors

Dr. Sheetal Sharma
Dean Academics & Professor
IILM Lucknow
Uttar Pradesh, India

Dr. Latika Ajitkumar Ajbani
Assistant Professor, YCMOU

Dr. Surendra Patole
Assistant Professor, YCMOU

Editor

Dr. Vinay Sharma
Associate Professor
Department of Management Studies
Indian Institute of Technology (IIT)
Roorkee, Uttarakhand, India
Visiting Professor, IIM, Lucknow

Instructional Technology Editing & Programme Co-ordinator

Dr. Latika Ajitkumar Ajbani
Assistant Professor
School of Commerce & Management
Yashwantrao Chavan Maharashtra
Open University, Nashik

Production

Shri. Anand Yadav
Manager, Print Production Centre, Y. C. M. Open University, Nashik- 422 222

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MBA 301

Introduction

In recent years, the development of ICT and digitization has increased the need to develop new products and services and build business models that transcend industries and merge different technologies. Technology innovation in the past closely pursued and developed specialist knowledge, but with the development of unprecedented new products and services based on new concepts, innovations increasingly arise from merging one technology field with another. Amid continuous environmental change, dynamic strategic management to deliberately and constantly create new positioning (including new products, services, and business models) and values is an important theme for practitioners on a day-to-day basis. How should companies exploit and implement strategy under a dynamically fluctuating environment? What is the essence of dynamic strategic management? These issues are common points of deliberation for strategy researchers and numerous corporate leaders alike. The research question I would like to pose as a specialist in the fields of innovation and strategic management is that of how to achieve this corporate strategy for dynamic strategic management. This book suggests a framework and case studies for dynamic strategic management theory for strengthening existing business and taking new positions to target new business (products, services, and business models) under a rapidly changing environment. The essence of strategic management goes beyond companies simply adapting to environmental change while creating appropriate strategies for the future. It also involves companies optimizing the individual management elements that comprise the corporate system (including organization, strategy, operation, and leadership) in alignment with these factors, and achieving continuance and growth through integrative and dynamic development. How companies consider congruence with the environment and dynamically transform corporate boundaries to adapt to the environment (or create new environments) has become a key theme in the implementation of corporate strategy. In this book the optimal design of a corporate system comprising the management elements of strategy, organization, operation, and leadership aimed at designing corporate boundaries compatible with the environment.

- Dr. Vinay Sharma
Dr. Sheetal Sharma
Dr. Latika Ajitkumar Ajbani
Dr. Surendra Patole

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Message from the Vice-Chancellor

Dear Students,

Greetings!!!

I offer cordial welcome to all of you for the Master's degree programme of Yashwantrao Chavan Maharashtra Open University.

As a post graduate student, you must have autonomy to learn, have information and knowledge regarding different dimensions in the field of Commerce & Management and at the same time intellectual development is necessary for application of knowledge wisely. The process of learning includes appropriate thinking, understanding important points, describing these points on the basis of experience and observation, explaining them to others by speaking or writing about them. The science of education today accepts the principle that it is possible to achieve excellence and knowledge in this regard.

The syllabus of this course has been structured in this book in such a way, to give you autonomy to study easily without stirring from home. During the counseling sessions, scheduled at your respective study centre, all your doubts will be clarified about the course and you will get guidance from some experienced and expert professors. This guidance will not only be based on lectures, but it will also include various techniques such as question-answers, doubt clarification. We expect your active participation in the contact sessions at the study centre. Our emphasis is on 'self study'. If a student learns how to study, he will become independent in learning throughout life. This course book has been written with the objective of helping in self-study and giving you autonomy to learn at your convenience.

During this academic year, you have to give assignments and complete the Project work wherever required. You have to opt for specialization as per programme structure. You will get experience and joy in personally doing above activities. This will enable you to assess your own progress and thereby achieve a larger educational objective.

We wish that you will enjoy the courses of Yashwantrao Chavan Maharashtra Open University, emerge successful and very soon become a knowledgeable and honorable Master's degree holder of this university.

Best Wishes!

- Vice-Chancellor

Syllabus

STRATEGIC MANAGEMENT MBA-301

UNIT 1 : INTRODUCTION TO STRATEGIC MANAGEMENT

Definition of Strategic Management—Nature of Strategic Management—Dimensions of Strategic Management—Need for Strategic Management—Benefits of Strategic Management—Risks involved in Strategic Management—Strategic Management Process.

UNIT 2 : STRATEGY FORMULATION AND DEFINING VISION

Aspects of Strategy Formulation—Business Vision—Defining Vision—Nature of Vision—Characteristics of Vision Statements—Importance of Vision—Advantages of Vision.

UNIT 3 : DEFINING MISSION, GOALS AND OBJECTIVES

Defining Mission—Importance of Mission Statement—Characteristics of a Mission Statement—Components of a Mission Statement—Formulation of Mission Statement—Evaluating Mission Statements—Concept of Goals and Objectives.

UNIT 4 : EXTERNAL ASSESSMENT

Concept of Environment—Porter's Five Force Analysis—The Five Forces—Forces that Shape Competition—Industry Analysis—Framework for Industry Analysis —Competitive Analysis—Environmental Scanning—Features of Environmental Analysis—Techniques of Environmental Scanning.

UNIT 5 : ORGANISATIONAL APPRAISAL: THE INTERNAL ASSESSMENT 1

Importance of Internal Analysis—SWOT Analysis—Carrying out SWOT Analysis—Steps in SWOT Analysis—Critical Assessment of SWOT Analysis—Advantages and Limitations.

UNIT 6 : ORGANISATIONAL APPRAISAL: INTERNAL ASSESSMENT 2

Strategy and Culture—Value Chain Analysis—Analysis—Conducting a Value Chain Analysis—Usefulness of the Value Chain Analysis—Organisational Capability Factors—Resources—Strategic Importance of Resources—Critical Success Factors—Benchmarking.

UNIT 7 : CORPORATE LEVEL STRATEGIES

Expansion Strategies—Retrenchment Strategies—Turnaround Strategy—Divestment—Bankruptcy—Liquidation—Combination Strategies—Internationalization—Cooperation Strategies—Joint Ventures—Strategic—Alliances—Consortia—Restructuring.

UNIT 8 : BUSINESS LEVEL STRATEGIES

Industry Structure—Positioning of the Firm—Generic Strategies Risks in Competitive Strategies—Critical Assessment of Generic Strategies—Comment on Porter's Generic Strategies—Business Tactics.

UNIT 9 : STRATEGIC ANALYSIS AND CHOICE

Process for Strategic Choice—Focusing on a few Alternatives—Considering Selection Factors—Evaluating the Alternatives—Making the Actual Choice—Industry Analysis—Corporate Portfolio Analysis—Display Matrices—Balancing the Portfolio—Portfolio and other Analytical Models—Contingency Strategies.

UNIT 10 : STRATEGY IMPLEMENTATION

Activating Strategies—Nature of Strategy Implementation—Barriers and Issues in Strategy Implementation—Model for Strategy Implementation—Resource Allocation—Importance of Resource Allocation—Managing Resource Conflict—Criteria for Resource Allocation Process—Factors affecting Resource Allocation—Difficulties in Resource Allocation.

UNIT 11 : STRUCTURAL IMPLEMENTATION

Basic Principles of Organisational Structure—Relation between Strategy and Structure—Improving Effectiveness of Traditional Organisational Structures—Types of Organisational Structures—Modular Organisation—Towards Boundary less Structures—Structures for Strategies.

UNIT 12 : BEHAVIOURAL IMPLEMENTATION

Stakeholders and Strategy—Strategic Leadership—Leadership Approaches—Corporate Culture and Strategic Management—Influence of Culture on Behaviour—Creating Strategy Supportive Culture—Personal Values and Ethics—Importance of Ethics—Approaches to Ethics—Building an Ethical Organisation—Social Responsibility and Strategic Management—Responsibilities of Business—Need for CSR: The Strategy.

UNIT 13 : FUNCTIONAL AND OPERATIONAL IMPLEMENTATION

Functional Strategies—Nature of Functional Strategies—Need for Functional Strategies—Functional Plans and Policies—Operational Plans and Policies—Importance of Operational Strategy—Components of Operational Plan and Policies—Personnel (HR) Plans and Strategies—HR Planning—Staffing—Training and Development—Performance Management—Compensation and Rewards—Industrial Relations.

UNIT 14 : STRATEGIC EVALUATION AND CONTROL

Nature of Strategic Evaluation and Control—Types of General Control Systems—Basic Characteristics of Effective Evaluation and Control System—Strategic Control—Types of Strategic Control—Approaches to Strategic Control—Operational Control—Setting of Standards—Measurement of Performance—Identifying Deviations—Taking Corrective Action—Techniques of Strategic Control.

UNIT 1 : INTRODUCTION TO STRATEGIC MANAGEMENT

NOTES

1.0 Unit Objectives

1.1 Introduction

1.2 Definition of Strategic Management

1.3 Nature of Strategic Management

1.4 Dimensions of Strategic Management

1.5 Need for Strategic Management

1.6 Benefits of Strategic Management

1.7 Risks involved in Strategic Management

1.8 Strategic Management Process

1.9 Summary

1.10 Key Terms

1.11 Questions and Exercises

1.12 Further Reading and References

1.0 Unit Objectives

After reading this unit, you should be able to:

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

- Discuss the strategic management process

1.1 Introduction

Strategic Management is exciting and challenging. It makes fundamental decisions about the future direction of a firm – its purpose, its resources and how it interacts with the environmentin which it operates. Every aspect of the organisation plays a role in strategy – its people, itsfinances, its production methods, its customers and so on.Strategic Management can be described as the identification of the purpose of the organisationand the plans and actions to achieve that purpose. It is that set of managerial decisions andactions that determine the long-term performance of a business enterprise. It involves formulatingand implementing strategies that will help in aligning the organisation and its environment toachieve organisational goals. Strategic management does not replace the traditional managementactivities such as planning, organising, leading or controlling. Rather, it integrates them into abroader context taking into account the external environment and internal capabilities and theorganisation's overall purpose and direction. Thus, strategic management involves thosemanagement processes in organisations through which future impact of change is determinedand current decisions are taken to reach a desired future. In short, strategic management is aboutenvisioning the future and realizing it.

1.2 Definition of Strategic Management

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

Later in the unit, weintroduce the elements and the process of strategic management and the importance, benefitsand limitations of strategic management.

NOTES

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

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

– Alfred Chandler, 1962

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

– Glueck and Jauch, 1984

Check Your Progress

Discuss the various elements of strategic management?

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

– Fed R David, 1997

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

– Pearce and Robinson, 1988

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

– Johnson and Sholes, 2002

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

– Dess, Lumpkin & Taylor, 2005

We observe from the above definitions that different authors have defined strategic managementin different ways. Note that the definition of Chandler that we have quoted above is from theearly 1960s, the period when strategic management was being recognized as a separate discipline.

This definition consists of three basic elements:

l. Determination of long-term goals

2. Adoption of courses of action

3. Allocation of resources to achieve those goals

Though this definition is simple, it does not consist of all the elements and does not capture theessence of strategic management.The definitions of Fred R. David, Pearce and Robinson, Johnson and Sholes and Dell, Lumpkinand Taylor are some of the definitions of recent origin. Taken together, these definitions capturethree main elements that go to the heart of strategic management. The three on-going processesare strategic analysis, strategic formulation and strategic implementation. These threecomponents parallel the processes of analysis, decisions and actions. That is, strategicmanagement is basically concerned with:

1. Analysis of strategic goals (vision, mission and objectives) along with the analysis of theexternal and internal environment of the organisation.

NOTES

2. Decisions about two basic questions:

   (a) What businesses should we compete in?

   (b) How should we compete in those businesses to implement strategies?

3. Actions to implement strategies. This requires leaders to allocate the necessary resourcesand to design the organisation to bring the intended strategies to reality. This also involvesevaluation and control to ensure that the strategies are effectively implemented.The real strategic challenge to managers is to decide on strategies that provide competitive advantage which can be sustained over time. This is the essence of strategic management, and Dess, Lumpkin and Taylor have rightly captured this element in their definition.

1.3 Nature of Strategic Management

Strategic Management can be defined as the art & science of formulating, implementing, and evaluating, cross-functional decisions that enable an organisation to achieve its objectives.

Strategic management is different in nature from other aspects of management. An individual manager is most often required to deal with problems of operational nature. He generally focuses on day-to-day problems such as the efficient production of goods, the management of a sales force, the monitoring of financial performance or the design of some new system that will improve the level of customer service.!

1.4 Dimensions of Strategic Management

The characteristics of strategic management are as follows:

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

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

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

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

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

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

1.5 Need for Strategic Management

No business firm can afford to travel in a haphazard manner. It has to travel with the support of some route map. Strategic management provides the route map for the firm. It makes it possible for the firm to take decisions concerning the future with a greater awareness of their implications. It provides direction to the company; it indicates how growth could be achieved. The external environment influences the management practices within any organisation. Strategy links the organisation to this external world. Changes in these external forces create both opportunities and threats to an organisation's position – but above all, they create uncertainty. Strategic planning offers a systematic means of coping with uncertainty and adapting to change.

It enables managers to consider how to grasp opportunities and avoid problems, to establishand coordinate appropriate courses of action and to set targets for achievement.

Thirdly, strategic management helps to formulate better strategies through the use of a moresystematic, logical and rational approach. Through involvement in the process, managers andemployees become committed to supporting the organisation. The process is a learning, helping,educating and supporting activity. An increasing number of firms are using strategic management for the following reasons:

1. It helps the firm to be more proactive than reactive in shaping its own future.

2. It provides the roadmap for the firm. It helps the firm utilize its resources in the best possible manner.
3. It allows the firm to anticipate change and be prepared to manage it.

4. It helps the firm to respond to environmental changes in a better way.
5. It minimizes the chances of mistakes and unpleasant surprises.
6. It provides clear objectives and direction for employees.

1.6 Benefits of Strategic Management

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

– Harlan Cleveland

The above quotation sums up why today's decision-makers must plan and manage strategically. In developing as well as in industrialized countries, the increasingly rapid nature of change as well as a greater openness in the political and economic environments, requires a different set of perspective from that needed during more stable times. When a certain degree of equilibrium existed in the environment, as during the 1950s, with constant positive economic growth, low debt, manageable budgets and relative environmental stability, managers could concentrate almost exclusively on the internal dimensions of themorganisations and assume constancy in the external environment. Forward calculations weresimple, inputs were predictable, and planning was mostly an arithmetic exercise.

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

Therefore, today's enterprises need strategic management to reap the benefits of business opportunities, overcome the threats and stay ahead

in the race. The purpose of strategicmanagement is to exploit and create new and different opportunities for tomorrow; while long term planning, in contrast, tries to optimize for tomorrow the trends of today.

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Today, all top companies are involved in strategic management. They are finding ways torespond to competitors, cope with difficult environmental changes, meet changing customerneeds and effectively use available resources.

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

l. Strategic thinking

2. Strategic decision-making

3. Strategic approach

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

1. ***It reduces uncertainty:*** Planning forces managers to look ahead, anticipate change anddevelop appropriate responses. It also encourages managers to consider the risks associated with alternative responses or options.

2. ***It provides a link between long and short terms:*** Planning establishes a means of coordination between strategic objectives and the operational activities that support the objectives.

3. ***It facilitates control:*** By setting out the organisation's overall strategic objectives and ensuring that these are replicated at operational level, planning helps departments to move in the same direction towards the same set of goals.

4. ***It facilitates measurement:*** By setting out objectives and standards, planning provides a basis for measuring actual performance.

NOTES

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

1. ***Financial Benefits:*** Research indicates that organisations that engage in strategicmanagement are more *profitable* and *successful* than those that do not. Businesses thatfollowed strategic management concepts have shown significant improvements in *sales*,*profitability* and *productivity* compared to firms without systematic planning activities.

2. ***Non-financial benefits:*** Besides financial benefits, strategic management offers otherintangible benefits to a firm. They are;

(a) Enhanced awareness of external threats

(b) Improved understanding of competitors' strategies

(c) Reduced resistance to change

(d) Clearer understanding of performance-reward relationship

(e) Enhanced problem-prevention capabilities of organisation

(f) Increased interaction among managers at all divisional and functional levels

(g) Increased order and discipline.

Check Your Progress

Depict the model of strategic management and explain its components?

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

1. It allows for identification, prioritization and exploitation of opportunities.

2. It provides objective view of management problems.

1.7 Risks involved in Strategic Management

Strategic management is an intricate and complex process that takes an organisation intounchartered territory. It does not provide a ready-to-use prescription for success. Instead, ittakes the organisation through a journey and offers a framework for addressing questions and solving problems. Strategic management is not, therefore, a guarantee for success; it can be dysfunctional if conducted haphazardly. The following are its limitations:

1. It is a costly exercise in terms of the time that needs to be devoted to it by managers. Thenegative effect of managers spending time away from their normal tasks may be quite serious.

2. A negative effect may arise due to the non-fulfilment of the expectations of the participating managers, leading to frustration and disappointment.

3. Another negative effect of strategic management may arise if those associated with the formulation of strategy are not intimately involved in the implementation of strategies.

1.8 Strategic Management Process

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

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

for the development of more specificobjectives and the choice of strategies to achieve them

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2. ***Strategic Choice:*** The analysis stage provides the basis for strategic choice. It allows managers to consider what the organisation could do given the mission, environment and capabilities – a choice which also reflects the values of managers and other stakeholders.

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

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

1.9 Summary

Strategic or institutional management is the conduct of drafting, implementing andevaluating cross-functional decisions that will enable an organisation to achieve its longtermobjectives. It is a level of managerial activity under setting goals and over tactics.It is the process of specifying the organisation's mission, vision and objectives, developingpolicies and plans, often in terms of projects and programs, which are designed to achievethese objectives, and then allocating resources to implement the policies and plans, projectsand programs. Strategic management provides overall direction to the enterprise and is closely related to the field of Organisation Studies.

Although a sense of direction is important, it can also stifle creativity, especially if it isrigidly enforced. In an uncertain and ambiguous

world, fluidity can be more importantthan a finely tuned strategic compass.

When a strategy becomes internalized into a corporate culture, it can lead to group think.It can also cause an organisation to define itself too narrowly.Even the most talented manager would no doubt agree that “comprehensive analysis isimpossible” for complex problems.

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Formulation and implementation of strategy must thus occur side-by-side rather thansequentially, because strategies are built on assumptions which, in the absence of perfectknowledge, will never be perfectly correct. The essence of being “strategic” thus lies in a capacity for “intelligent trial-and error” rather than linear adherence to finally honed and detailed strategic plans. Strategic management is a question of interpreting, and continuously reinterpreting, the possibilities presented by shifting circumstances for advancing an organisation’s objectives.

1.10 Key Terms

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

Financial Benefits: profits associated with strategic management

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

Non-financial Benefits: intangible benefits associated with strategic management

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

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

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

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

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

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

1.11 Questions and Exercises

1. Discuss the various elements of strategic management.
2. Examine the significance of strategic management.
3. "Strategic management process is the way in which strategists determine objectives and strategic decisions". Discuss.
4. Bring out the distinguishing features of strategic management.
5. Can the process of strategic management really be depicted in a given model or it is a prompt and dynamic process? Give reasons.
6. Depict the model of strategic management and explain its components.
7. Suppose you are the Managing Director of an organisation. Your organisation is runninginto losses due to poor management and decision making. How will you analyse the situation and move your organisation out of the situation?
8. Have you ever challenged, shaken old work methods? What problems did you encounter? Did you overcome them? How? If no, what were the reasons for their beinginsurmountable?
9. With reference to a day's work, what steps do you take to organise and prioritize your tasks?

10. Describe a specific instance, in a group situation, where you made your views known about an issue important to yourself. What was the issue, and why was it crucial?
11. Outline in very broad terms how you would create a strategy for say, a public interest campaign.

NOTES

Check your progress

Fill in the blanks:

1. Strategic management provides overall .... to the enterprise.
2. Strategic management is a question of interpreting, and continuously ...., the possibilities presented by .... circumstances for advancing an organisation's objectives.
3. The foundation of strategy is a definition of organisational ....
4. Organisations set up appropriate monitoring and control systems, develop standards and targets to judge ....
5. .... and .... of strategy rarely proceed according to plan.
6. The first step in the strategic management process is to develop the corporate .... and ....
7. Once a firm has committed itself to a particular strategy, its .... and .... are tied to it.
8. A .... can be defined as the overall goal of an organisation that all business activities and processes should contribute toward achieving.
9. Formulation and implementation of strategy must occur side-by-side rather than ....
10. When a strategy becomes internalized into a corporate culture, it can lead to ....
11. Strategic planning goes far beyond the .... process.

12. Generally, only the .... has the perspective needed to understand the broad implications behind the strategic plans.
13. The real strategic goals are realized only along with the analysis of the .... and .... environment of the organisation.
14. Developing an organisational strategy involves .... main elements.
15. Strategic planning is a .... exercise in terms of the time that needs to be devoted to it by managers.

NOTES

Answers:

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

1.12 Further Reading and References

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UNIT 2: STRATEGY FORMULATION AND DEFINING VISION

NOTES

2.0 Unit Objectives

2.1 Introduction

2.2 Aspects of Strategy Formulation

2.3 Business Vision

- 2.3.1 Defining Vision
- 2.3.2 Nature of Vision
- 2.3.3 Characteristics of Vision Statements
- 2.3.4 Importance of Vision
- 2.3.5 Advantages of Vision

2.4 Summary

2.5 Key Terms

2.6 Questions and Exercises

2.7 Further Reading and References

2.0 Unit Objectives

After studying this unit, you should be able to:

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

2.1 Introduction

NOTES

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

Strategy formulation is vital to the well-being of a company or organisation. It produces a clearset of recommendations, with supporting justification, that revise as necessary the mission andobjectives of the organisation, and supply the strategies for accomplishing them. In formulation,we are trying to modify the current objectives and strategies in ways to make the organisationmore successful. This includes trying to create "sustainable" competitive advantages – althoughmost competitive advantages are eroded steadily by the efforts of competitors.A good recommendation should be: effective in solving the stated problem(s), practical (can be Notesimplemented in this situation, with the resources available), feasible within a reasonable time frame, cost-effective, not overly disruptive, and acceptable to key "stakeholders" in theorganisation. It is important to consider "fits" between resources plus competencies withopportunities, and also fits between risks and expectations.

There are four primary steps in this phase:

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

4. Deciding on the alternatives that should be implemented or recommended.In organisations, and in the practice of strategic management, strategies must be implementedto achieve the intended results. Here it has to be remembered that the most wonderful strategyin the history of the world is useless if not implemented successfully.

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2.2 Aspects of Strategy Formulation

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

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

Let us understand each of them one by one.

1. ***Corporate Level Strategy :*** In this aspect of strategy, we are concerned with broad decisions about total organisation's scope and direction. Basically, we consider what changes should be made in our growth objective and strategy for achieving it, the lines of business we are in, and how these lines of business fit together. It is useful to think of three components of corporate level strategy:

Check Your Progress

Given the vision, as the new Director, what ideas would you want to implement to achievethe vision?

(a) ***Growth or directional strategy*** (what should be our growth objective, ranging from retrenchment through stability to varying degrees of growth - and how do we accomplish this).

(b) ***Portfolio strategy*** (what should be our portfolio of lines of business, which implicitlyrequires reconsidering how much concentration or diversification we should have),and

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(c) ***Parenting strategy*** (how we allocate resources and manage capabilities and activitiesacross the portfolio – where do we put special emphasis, and how much do we integrate our various lines of business).

2. ***Competitive Strategy:***It is quite often called as Business Level Strategy. This involves deciding how the company will compete within each Line of Business (LOB) or Strategic Business Unit (SBU). In this second aspect of a company's strategy, the focus is on how to compete successfully in each of the lines of business the company has chosen to engage in. The central thrust is how to build and improve the company's competitive position for each of its lines of business. A company has competitive advantage whenever it can attract customers and defend against competitive forces better than its rivals. Companies want to develop competitive advantages that have some sustainability (although the typical term "sustainable competitive advantage" is usually only true dynamically, as a firm works to continue it).

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

2.3 Business Vision

The first task in the process of strategic management is to formulate the organisation's visionand mission statements. These statements define

the organisational purpose of a firm. Togetherwith objectives, they form a "hierarchy of goals."

- Plans
- Objectives
- Goals
- Mission
- Vision

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

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

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

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

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

1. Core ideology
2. Envisioned future

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Core ideology is based on the enduring values of the organisation ("what we stand for and whywe exist"), which remain unaffected by environmental changes. Envisioned future consists of along-term goal (what we aspire to become, to achieve, to create") which demands significantchange and progress.

2.3.1 Defining Vision

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

2.3.2 Nature of Vision

A vision represents an animating dream about the future of the firm. By its nature, it is hazy andvague. That is why Collins describes it as a "Big hairy audacious goal" (BHAG). Yet it is apowerful motivator to action. It captures both the minds and hearts of people. It articulates aview of a realistic, credible, attractive future for the organisation, which is better than what nowexists. Developing and implementing a vision is

one of the leader's central roles. He should notonly have a "strong sense of vision", but also a "plan" to implement it.

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

2.3.3 Characteristics of Vision Statements

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

1. ***Possibility***means the vision should entail innovative possibilities for dramatic organisational improvements.

2. ***Desirability***means the extent to which it draws upon shared organisational norms andvalues about the way things should be done.

3. ***Action ability***means the ability of people to see in the vision, actions that they can takethat are relevant to them.

4. ***Articulation***means that the vision has imagery that is powerful enough to communicateclearly a picture of where the organisation is headed.

Check Your Progress

"Employees have a greater role to play in formulating strategy". Comment?

2.3.4 Importance of Vision

Having a strategic vision is linked to competitive advantage, enhancing organisational performance, and achieving sustained organisational growth. Clear vision enables firms to determine how well organisational leaders are performing and to identify gaps between the vision and current practices. Organisations preparing for transformational change regularly undertake "envisioning" exercises to help guide them into the future. The visioning process itself can enhance the self-esteem of the people who participate in it because they can see the potential fruits of their labours.Conversely, a "lack of vision" is associated with organisational decline and failure. As Beaverargues "Unless companies have clear vision about how they are going to be distinctly differentand unique in adding and satisfying their customers, they are likely to be the corporate failurestatistics of tomorrow". Lacking vision is used to explain why companies fail to build their corecompetencies despite having access to adequate resources to do so. Business strategies that lackvisionary content may fail to identify when change is needed. Lack of an adequate process fortranslating shared vision into collective action is associated with the failure to produce transformational organisational change.

2.3.5 Advantages of Vision

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

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

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

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

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

2.4 Summary

Strategic management is the set of managerial decisions and action that determines theway for the long-range performance of the company.It

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includes environmental scanning, strategy formulation, strategy implementation,evaluation and control.Strategy formulation is the development of long range plans for the effective managementof environmental opportunities and threats in light of corporate strengths and weaknesses.It includes defining the corporate mission, specifying achievable objectives, developingstrategies and setting policy guidelines.Corporate strategy is one, which decides what business the organisation should be in, andhow the overall group of activities should be structured and managed.Competitive Strategy is concerned with creating and maintaining a competitive advantagein each and every area of business.Strategy that is related to each functional area of business such as production, marketingand personnel is called functional strategy.Corporate vision is a short, succinct, and inspiring statement of what the organisation intends to become and to achieve at some point in the future, often stated in competitiveterms.

2.5 Key Terms

***Core Ideology**:* based on the enduring values of the organisation

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

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

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

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

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

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

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

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

2.6 Questions and Exercises

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

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9. Critically analyse the leader dominated approach. Is there a better approach?
10. Do you think business vision should be reviewed and upgraded after every few years?Justify your answer by giving suitable arguments.

Check your progress

Fill in the blanks:

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

Answers:

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

2.7 Further Reading and References

Books

- Thompson and AJ. Strickland, *Strategic Management*, Business Publications, Texas, 1984.
- Fred R. David, *Strategic Management – Concepts and Cases*, Pearson Education Inc., 2005.
- Ian Palmer, Richard Dunford and Gib Akin, *Managing Organisational Change*, Tata McGraw-Hill, New Delhi, 1957.

UNIT 3 : DEFINING MISSION, GOALS AND OBJECTIVES

3.0 Unit Objectives

3.1 Introduction

3.2 Defining Mission

3.3 Importance of Mission Statement

3.4 Characteristics of a Mission Statement

3.5 Components of a Mission Statement

3.6 Formulation of Mission Statements

3.7 Evaluating Mission Statements

3.8 Concept of Goals and Objectives

3.8.1 Goals

3.8.2 Objectives

3.9 Summary

3.10 Key Terms

3.11 Questions and Exercises

3.12 Further Reading and References

3.0 Unit Objectives

After studying this unit, you should be able to:

- Define mission
- State the importance, characteristics and components of mission

- Evaluate mission statements
- Explain the concept of goals and objectives

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3.1 Introduction

"A mission statement is an enduring statement of purpose". A clear mission statement is essential for effectively establishing objectives and formulating strategies. A mission statement is the purpose or reason for the organisation's existence. A well-conceived mission statement defines the fundamental, unique purpose that sets it apart from other companies of its type and identifies the scope of its operations in terms of products offered and markets served. It also includes the firm's philosophy about how it does business and treats its employees. In short, the mission describes the company's product, market and technological areas of emphasis in a way that reflects the values and priorities of the strategic decision makers. As Fred R. David observes, mission statement is also called a creed statement, a statement of purpose, a statement of philosophy etc. It reveals what an organisation wants to be and whom wants to serve. It describes an organisation's purpose, customers, products, markets, philosophy and basic technology. In combination, these components of a mission statement answer a key question about the enterprise: "What is our business?"

3.2 Defining Mission

Thompson defines mission as "The essential purpose of the organisation, concerning particularly why it is in existence, the nature of the business it is in, and the customers it seeks to serve and satisfy". Hunger and Wheelen simply call the mission as the "purpose or reason for the organisation's existence". A mission can be defined as a sentence describing a company's function, markets and competitive advantages. It is a short

written statement of your business goals and philosophies. It defines what an organisation is, why it exists and its reason for being. At a minimum, a mission statement should define who are the primary customers of the company, identify the products and services it produces, and describe the geographical location in which it operates.

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Example:

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

Check Your Progress

"Mission describes the present and vision the future". With this statement in mind compare mission and vision statements?

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

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3.3 Importance of Mission Statement

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

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

3.4 Characteristics of a Mission Statement

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

1. ***Not lengthy:*** A mission statement should be brief.

2. ***Clearly articulated:*** It should be easy to understand so that the values, purposes, and goals of the organisation are clear to everybody in the organisation and will be a guide to them.

3. ***Broad, but not too general:*** A mission statement should achieve a fine balance between specificity and generality.

4. ***Inspiring:*** A mission statement should motivate readers to action. Employees should find it worthwhile working for such an organisation.

5. ***It should arouse positive feelings and emotions*** of both employees and outsiders about the organisation.
6. ***Reflect the firm's worth:*** A mission statement should generate the impression that the firm is successful, has direction and is worthy of support and investment.
7. ***Relevant:*** A mission statement should be appropriate to the organisation in terms of its history, culture and shared values.
8. ***Current:*** A mission statement may become obsolete after some time. As Peter Druckerpoints out, "Very few mission statements have anything like a life expectancy of thirty, let alone, fifty years. To be good enough for ten years is probably all one can normally expect". Changes in environmental factors and organisational factors may necessitate modification of the mission statement.
9. ***Unique:*** An organisation's mission statement should establish the individuality and uniqueness of the company.
10. ***Enduring:*** A mission statement should continually guide and inspire the pursuit of organisational goals. It may not be fully achieved, but it should be challenging for managers and employees of the organisation.
11. ***Dynamic:*** A mission statement should be dynamic in orientation allowing judgments about the most promising growth directions and the less promising ones.
12. ***Basis for guidance:*** Mission statement should provide useful criteria for selecting a basis for generating and screening strategic options.
13. ***Customer orientation:*** A good mission statement identifies the utility of a firm's products or services to its customers, and attracts customers to the firm.
14. ***A declaration of social policy:*** A mission statement should contain its philosophy about social responsibility including its obligations to the stakeholders and the society at large.

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15. ***Values, beliefs and philosophy:*** The mission statement should lay emphasis on the values the firm stands for; company philosophy, known as "company creed", generally accompanies or appears within the mission statement.

3.5 Components of a Mission Statement

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

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

3.6 Formulation of Mission Statements

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

1. In many cases, the mission is inherited i.e. the founder establishes the mission which may remain unchanged down the years or may be modified as the conditions change.
2. In some cases, the mission statement is drawn up by the CEO and board of directors or a committee of strategists constituted for the purpose.
3. Engaging consultants for drawing up the mission statement is also common.
4. Many companies hold brainstorming sessions of senior executives to develop a mission statement. Soliciting employee's views is also common.
5. According to Fred R. David, an ideal approach for developing a mission statement would be to select several articles about mission statements and ask all managers to read these as background information. Then ask managers to prepare a draft mission statement for the organisation. A facilitator or a committee of top managers, merge these statements into a single document and distribute this draft mission statement to all managers. Then the mission statement is finalized after taking inputs from all the managers in a meeting.

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6. Decision on how best to communicate the mission to all managers, employees and external constituencies of an organisation are needed when the document is in its final form. Some organisations even develop a videotape to explain the mission statement and how it was developed.
7. The practice in Indian companies appears to be a consultative-participative route. For Example, at Mahindra and Mahindra, workshops were conducted at two levels within the organisation with corporate planning group acting as facilitators. The State Bank of India went one step ahead by inviting labour unions to partake in the exercise. Satyam Computers went one more step ahead by involving their joint venture companies and overseas clients in the process.

Mission of two Global Companies

Mission Statement of IBM

At IBM, we strive to lead in the invention, development and manufacture of the industry's most advanced information technologies, including computer systems, software, and storage systems and microelectronics. We translate these advanced technologies into value for our customers through our professional solutions, services and consulting businesses worldwide.

Mission Statement of FedEx

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

Source: ibm.com and fedex.com

3.7 Evaluating Mission Statements

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

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1. The mission statement is clear and understandable to all parties involved. The organisation can articulate and relate to it.
2. The mission statement is brief enough for most people to remember.
3. The mission statement clearly specifies the purpose of the organisation. This includes a clear statement about:

A. What needs the organisation is attempting to fill (not what products or services are offered)?

B. Who the organisation's target populations are?

C. How the organisation plans to go about its business; that is, what it's primary technologies are?

4. The mission statement should have a primary focus on a single strategic thrust.
5. The mission statement should reflect the distinctive competence of the organisation (e.g., what can it do best? What is its unique advantage?)
6. The mission statement should be broad enough to allow flexibility in implementation, but not so broad as to permit lack of focus.
7. The mission statement should serve as a template and be the same means by which the organisation can make decisions.
8. The mission statement must reflect the values, beliefs and philosophy of operations of the organisation.
9. The mission statement should reflect attainable goals.
10. The mission statement should be worked so as to serve as an energy source and rallying point for the organisation (i.e., it should reflect commitment to the vision).

Check Your Progress

Are goals and objectives the same thing? Justify your answer. Discuss the unique characteristics of goals and objectives?

3.8 Concept of Goals and Objectives

3.8.1 Goals

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The terms "goals and objectives" are used in a variety of ways, sometimes in a conflicting sense. The term "*goal"* is often used interchangeably with the term "*Objective*". But some authors prefer to differentiate the two terms. A *goal* is considered to be an open-ended statement of what one wants to accomplish with no quantification of what is to be achieved and no time criteria for its completion. For example, a simple statement of "increased profitability" is thus a goal, not an objective, because it does not state how much profit the firm wants to make. Objectives are the end results of planned activity. They state what is to be accomplished by when and should be quantified. For example, "increase profits by 10% over the last year" is an objective. As may be seen from the above, "goals" denote what an organisation hopes to accomplish in a future period of time. They represent a future state or outcome of the effort put in now. "Objectives" are the ends that state specifically how the goals shall be achieved. In this sense, objectives make the goals operational. Objectives are concrete and specific in contrast to goals which are generalized. While goals may be qualitative, objectives tend to be mainly quantitative, measurable and comparable.

Stated vs. Operational Goals

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

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

3.8.2 Objectives

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

Characteristics of Objectives

Well – stated objectives should be:

1. Specific
2. Quantifiable

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

Role of Objectives

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

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

Nature of Objectives

The following are the characteristics of objectives:

Hierarchy of Objectives : In a multi – divisional firm, objectives should be established for the overall company as well as for each division. Objectives are generally established at the corporate, divisional and functional levels, and as such, they form a hierarchy. The zenith of the hierarchy is the mission of the organisation. The objectives at each level contribute to the objectives at the next higher level.

Long-range and Short-range Objectives : Organisations need to establish both long-range and short-range objectives (Long–range means more than one year, and short–range means one year and less.) Short-range objectives spell out the near – term results to be achieved. By doing so, they indicate the ***speed*** and the ***level of performance*** aimed at each succeeding period.

Multiplicity of Objectives : Organisations pursue a number of objectives. At every level in the hierarchy, objectives are likely to be multiple. *Example:* The marketing division may have the objective of sales and distribution of products. This objective can be broken down into a group of objectives for the product, distribution, research and promotion activities. To describe a single, specific goal of an organisation is to say very little about it. It turns out that there are several goals involved.

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

3.9 Summary

- A mission can be defined as a sentence describing a company's function, markets and competitive advantages.
- Developing your mission statement is the step which moves your

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strategic planning process from the present to the future.

- The mission should be broad enough to allow for the diversity (new products, new services, new markets) one requires for one's business.
- The mission statement should also be specific enough to provide the focus necessary to the success of your business.
- Once a mission statement has been set, every organisation needs to periodically reviewand possibly revise it to make sure it accurately reflects its goals and the business and economic climates evolve.

3.10 Key Terms

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

Company self-concept: how much does the company knows itself

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

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

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

3.11 Questions and Exercises

1. "Mission describes the present and vision the future". With this statement in mind compare mission and vision statements.
2. Are goals and objectives the same thing? Justify your answer. Discuss the unique characteristics of goals and objectives.

3. Suppose you are going to open a new mobile device manufacturing company. Prepare a mission statement for your company. (Try and include as many elements mentioned in the unit as possible)
4. "It is necessary to review the mission statement periodically". Justify the statement
5. How can a mission statement set the tone of the organisation?
6. Analyse the characteristics of a good mission statement.
7. "Like an individual should know him/herself inside out, an organisation should also know itself". Substantiate
8. "Goals are general in nature while objectives are specific". Explain using suitable examples.
9. Explain the concept of stated and operational goals with the help of appropriate examples.

Check your progress

Fill in the blanks:

1. The mission statement should have a primary focus on a .... strategic thrust.
2. The mission statement should reflect .... goals.
3. A mission can be defined as a sentence describing a company's ...., ... and ....
4. It is more important to communicate the mission statement to ....than to ....
5. A mission statement should be appropriate to the organisation in terms of its ...., ... and ....
6. Every firm has to secure its survival through .... and ....
7. A focus on customer satisfaction causes managers to realize the importance of providing excellent ....
8. The company .... provides a distinctive and accurate picture of the company's managerial outlook.

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9. ....can't be quantified, whereas ....can be quantified.
10. Objectives are inter-..............................and inter-.................. .

Answers:

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

3.12 Further Reading and References

Books

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UNIT 4: EXTERNAL ASSESSMENT

NOTES

4.0 Unit Objectives

4.1 Introduction

4.2 Concept of Environment

4.3 Porter's Five Force Analysis

4.3.1 The Five Forces

4.3.2 Forces that Shape Competition

4.4 Industry Analysis

4.4.1 Framework for Industry Analysis

4.4.2 Industry Analysis

4.5 Competitive Analysis

4.6 Environmental Scanning

4.6.1 Features of Environmental Analysis

4.6.2 Techniques of Environmental Scanning

4.7 Summary

4.8 Key Terms

4.9 Questions and Exercises

4.10 Further Reading and References

4.0 Unit Objectives

After studying this unit, you should be able to:

- Realise the concept of environment
- Discuss porter's five forces theory

- Explain the concept of industry analysis
- Discuss environment scanning

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4.1 Introduction

At a time of fast growth, rapid changes and cut throat competition as exists in about all industries,it is a challenge for the companies to establish a strategic agenda for dealing with these contendingcurrents and to grow despite them.A company must understand how the above currents work in its industry and how they affectthe company in its particular situation. For this a very useful tool is used by the analysts. Thename of this tool is external analysis. External assessment is a step where a firm identifies opportunities that could benefit it andthreats that it should avoid. It includes monitoring, evaluating, and disseminating of informationfrom the external and internal environments to key people within the corporation.

4.2 Concept of Environment

Environment literally means the surroundings, external objects, influences or circumstances under which someone or something exists. The environment of any organisation is "the aggregateof all conditions, events and influences that surround and affect it." Davis, K, The Challenge of Business, (New York: McGraw Hill, 1975), p. 43.Environment refers to all external forces which have a bearing on the functioning of business. Jauch and Gluecke has defined environment as "The environment includes factors outside the firm which can lead to opportunities or a threat to the firm. Although there are many factors themost important of the sectors are socio-economic, technological, supplier, competitor and govt."The recent changes in tariff rates have changed the toy industry of India with the market nowbeing dominated by Chinese products. A slight change in

the Reserve Bank of India's monetarypolicy can increase or decrease interest rates in the market. A slight shift in the government'sfiscal policy can shift the whole demand curve towards the right or the left.

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Importance of Business Environment

1. ***Environment is Complex:*** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these interact with each otherto create new sets of influences.

2. ***It is Dynamic:*** The environment by its very nature is a constantly changing one. The varied influences operating upon it impart dynamism to it and cause it to continually change its shape and character.

3. ***Environment is multi -faceted:*** The same environmental trend can have different effectson different industries. For instance, GATS is an opportunity for some companies but athreat for others.

4. ***It has a far-reaching impact:*** The environment has a far-reaching impact on organisationsin that the growth and profitability of an organisation depends critically on theenvironment in which it exists.

5. ***Its impact on different firms with in the same industry differs:*** A change in environmentmay have different bearings on various firms operating in the same industry. In thepharmaceutical industry in India, for instance, the impact of the new IPR (IntellectualProperty Rights) law will different for research-based pharmacy companies such as Ranbaxy and Dr. Reddy's Lab and will be different for smaller pharmacy companies.

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6. ***It may be an opportunity as well as a threat to expansion:*** Developments in the generalenvironment often provide opportunities for expansion in terms of both products andmarkets.

7. ***Changes in the environment can change the competitive scenario:*** General environmentalchanges may alter the boundaries of an industry and change the nature of its competition.This has been the case with deregulation in the telecom sector in India. Since deregulation,every second year new competitors emerge, old foes become friends and M&As followevery new regulation.

8. ***Sometimes developments are difficult to predict with any degree of accuracy:*** Macroeconomic developments such as interest rate fluctuations, the rate of inflation, andexchange rate variations are extremely difficult to predict on a medium or a long termbasis. On the other hand, some trends such as demographic and income levels can be easyto forecast.

4.3 Porter's Five Force Analysis

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

4.3.1 The Five Forces

In essence, the job of the strategist is to understand and cope with competition. However, managers define competition too narrowly, as if it occurs only among today's direct competitors.Yet competition for profits

goes beyond established industry rivals. It includes four other competitive forces as well: customers, suppliers, potential entrants and substitutes.

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

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

Each of these forces affects a firm's ability to compete in a given market. Together, they determine the profit potential for a particular industry.

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4.3.2 Forces that Shape Competition

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

Check Your Progress

"The five forces model provides the rationale for increasing or decreasing resources commitment". Comment?

1. ***The Threat of New Entrants:*** The first of Porter's Five Forces model is the threat of new entrants. New entrants bring new capacity and often substantial resources to an industry with a desire to gain market share. Established companies already

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operating in an industry often attempt to discourage new entrants from entering the industry to protect their share of the market and profits. Particularly when big new entrants are diversifying from other markets into the industry, they can leverage existing capabilities and cash flows to shake up competition. Pepsi did this when it entered the bottled water industry, Microsoft did when it began to offer internet browsers, and Apple did when it entered the music distribution business.

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

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

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

   (c) ***Capital requirements:*** The need to invest large financial resources in order to compete can deter new entrants. Capital may be necessary not only for fixed assets, but also to extend customer credit, build inventories and fund start-up losses.

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The barrier is particularly great if the capital is required for unrecoverable expenditure, such as up-front advertising or research and development. While major corporations have the financial resources to invade almost any industry, the capital requirements in certain fields limit the pool of likely entrants. It is important not to overstate the degree to which capital requirements alone deter entry; if industry returns are attractive and are expected to remain so, and if capital markets are efficient, investors will provide new entrants with the funds they need.

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

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

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

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(i) Proprietary technology

(ii) Preferential access to raw material sources

(iii) Government subsidies

(iv) Favorable geographical locations

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

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

    (b) Existing companies possess substantial resources to fight back

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

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

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

4. ***Intensity of Rivalry among Competitors:*** The second of Porter's Five-Forces model is the intensity of rivalry among established companies within an industry. Rivalry means the competitive struggle between companies in an industry to gain market share from each other. Firms use tactics like price discounting, advertising

campaigns, new product introductions and increased customer service or warranties. Intense rivalry lowers prices and raises costs. It squeezes profits out of an industry. Thus, intense rivalry among established companies constitutes a strong threat to profitability. Alternatively, if rivalry is less intense, companies may have the opportunity to raise prices or reduce spending on advertising etc. which leads to higher level of industry profits.

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The intensity of rivalry is greatest under the following conditions:

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

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

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

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

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

and cause the selling prices to fall throughout the industry.

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

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5. ***Bargaining power of buyers :*** The third of Porter's five competitive forces is the bargaining power of buyers. Bargaining power of buyers refers to the ability of buyers to bargain down prices charged by firms in the industry or driving up the costs of the firm by demanding better product quality and service. By forcing lower prices and raising costs, powerful buyers can squeeze profits out of an industry. Thus, powerful buyers should beviewed as a threat. According to Porter, buyers are most powerful under the following conditions:

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

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

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

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

(e) ***The quality of buyer's products :*** If the quality of buyer's product is little affected by industry's products, buyers are more price sensitive. Most of the above sources of buyer power can be attributed to consumers as a group as well as to industrial and commercial buyers. The buying power of retailers is determined by the same factors, with one important addition. Retailers can gain significant bargaining power over manufacturers when they can influence consumers. Purchasing decisions as they do in audio components, jewellery, appliances, sporting goods etc., are examples.

6. ***Bargaining power of suppliers :*** The fourth of Porter's Five Forces model is the bargaining power of suppliers. Suppliers are companies that supply raw materials, components,equipment, machinery and associated products. Powerful suppliers make more profits by charging higher prices, limiting quality or services or shifting the costs to industry participants. Powerful suppliers squeeze profits out of an industry and thus, they are a threat. A supplier's bargaining power will be high under the following conditions:

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

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suppliers can then dictate prices, quality and terms.

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

(c) ***Dependence of supplier group on the firm :*** When suppliers sell to several firms and the firm does not represent a significant fraction of its sales, suppliers are prone to exert power. In other words, the supplier group does not depend heavily on the industry for revenues. Suppliers serving many industries will not hesitate to extract maximum profits from each one. If a particular industry accounts for a large portion of a supplier group's volume or profit, however, suppliers will want to protect the industry through reasonable pricing.

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

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

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

7. ***Threat of substitute products :*** The fifth of Porter's Five Forces model is the threat of substitute products. A substitute performs the same or a similar function as an industry's product. Video

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conferences are a substitute for travel. Plastic is a substitute for aluminium. E-mail is a substitute for a mail. All firms within an industry compete with industries producing substitute products. For example, companies in the coffee industry compete indirectly with those in the tea and soft drink industries because all these serve the same need of the customer for refreshment. The existence of close substitutes is a strong competitive threat because this limits theprice that companies in one industry can charge for their product. In other words, when the threat of substitutes is high, industry profitability suffers. If an industry does not ward off the substitutes through product performance, marketing, price or other means, it will suffer in terms of profitability and growth potential in the following circumstances:

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

(b) ***The buyer's switching costs to the substitutes is low :*** For example, switching from a proprietary, branded drug to a generic drug usually involves minimum switching costs. Strategists should be particularly alert to changes in other industries that may make attractive substitutes. For example, improvements in plastic materials prompted the automobile manufactures to substitute plastic for steel in many automobile components. *Task* Compare FMCG and Automobile sectors based on Porter's five forces model.

4.4 Industry Analysis

Each business operates among a group of firms that produce competing products or services known as an "industry". An industry is

thus a group of firms producing similar products or services. By similar products we mean products that customers perceive to be substitutes for one another.

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Example : Firms that produce and sell textiles such as Reliance Textiles, Raymond, S. Kumar's etc. belong to the textile industry. Similarly, firms that produce PCs, such as Apple, Compaq, AT&T, IBM, etc. belong to the Microcomputer industry. Although there are usually some differences among competitors, each industry has its own set of "rules of combat" governing such issues as product quality, pricing and distribution. This is especially true in industries that contain a large number of firms offering standardized products and services. As such, it is important for strategic managers to understand the structure of the industry in which their firms operate before deciding how to compete successfully. Industry analysis is therefore a critical step in the strategic analysis of a firm. In a perfect world, each firm would operate in one clearly defined industry. However, many firms compete in multiple industries, and strategic managers in similar firms often differ in their conceptualization of the industry environment. In addition, the advent of Internet has completely changed the way business is done. As a result, the process of industry definition and analysis can be specially challenging when internet competition is considered. The basic purpose of industry analysis is to assess the strengths and weaknesses of a firm relative to its competitors in the industry. It tries to highlight the structural realities of particular industry and the extent of competition within that industry. Through industry analysis, an organisation can find whether the chosen field is attractive or not and assess its own position within the industry.

4.4.1 Framework for Industry Analysis

Industry analysis covers two important components:

1. Industry environment
2. Competitive environment

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

Industry Analysis

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

Competitive Analysis

Competitive analysis basically addresses two questions:

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

4.4.2 Industry Analysis

1. ***Industry Features :*** Industries differ significantly. So, analyzing a company's industry begins with identifying the industry's dominant economic features and forming a picture of the industry landscape. An industry's dominant economic features include such factors as:
   - (a) Overall size
   - (b) Market growth rate
   - (c) Geographic boundaries of the market
   - (d) Number and sizes of competitors
   - (e) Pace of technological change
   - (f) Product innovations etc.

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

Example: Video games, computers and pharmaceuticals.

2. ***Industry Boundaries :*** All the firms in the industry are not similar to one another. Firms within the same industry could differ across various parameters, such as:
   (a) Breadth of market
   (b) Product/service quality
   (c) Geographic distribution
   (d) Level of vertical integration
   (e) Profit motives

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

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

   (b) ***Consolidated Industries :*** A consolidated industry is dominated by a small number of large companies (an oligopoly) or in extreme cases, by just one company (a monopoly). These companies are in a position to determine industry prices. In consolidated industries, one company's competitive actions or moves directly affect the market share of its rivals, and thus their profitability. When one company cuts prices, the competitors also cut prices. Rivalry increases

as companies attempt to undercut each other's prices or offer customers more value in their products, pushing industry profits down in the process. The consequence is a dangerous competitive spiral.

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According to Michael Porter, industries can be categorized into:

- **Emerging industries :** Are those in the introductory and growth phases of their life cycle.
- **Mature industries :** Are those who reached the maturity stage of their life cycle.
- **Declining industries :** Are those in the transition stage from maturity to decline.
- **Global industries :** Are those with manufacturing bases and marketing operations in several countries. Competition varies during each stage of industry life cycle.

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

Industry structure consists of four elements:

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

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

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

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

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

(a) Profit potential

(b) Growth prospects

(c) Competition

(d) Industry barriers etc.

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

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6. ***Industry performance :*** This requires an examination of data relating to:
   - (a) Production
   - (b) Sales
   - (c) Profitability
   - (d) Technological advancements etc.

7. ***Industry practices :*** Industry practices refer to what a majority of players in the industry do with respect to products, pricing, promotion, distribution etc. This aspect involves issues relating to:
   - (a) Product policy
   - (b) Pricing policy
   - (c) Promotion policy
   - (d) Distribution policy
   - (e) R&D policy
   - (f) Competitive tactics.

8. ***Industry's future prospects :*** The future outlook of an industry can be anticipated based on such factors as:
   - (a) Innovation in products and services
   - (b) Trends in consumer preferences
   - (c) Emerging changes in regulatory mechanisms
   - (d) Product life cycle of the industry
   - (e) Rate of growth etc.

4.5 Competitive Analysis

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

1. How these forces work in an industry?

2. How they affect the firm in its particular situation?

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The essence of strategy formulation is coping with competition. Intense competition in an industry is neither a coincidence nor a bad luck. It is rooted in its underlying economics. There are two theories of economics – theory of monopoly and theory of perfect competition. These represent two extremes of industry competition. In a monopoly context, a single firm is protected by barriers to entry, and has an opportunity to appropriate all the profits generated in the industry. In a "perfectly competitive" industry, competition is unbridled and entry to the industry is easy. This kind of industry structure, of course, offers the worst prospects for long-run profitability. The weaker the forces collectively, however, the greater the opportunity for superior performance in terms of profit.

4.6 Environmental Scanning

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

Check Your Progress

Discuss Industry analysis using Porter's five forces theory?

4.6.1 Features of Environmental Analysis

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

Holistic Exercise

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

Continuous Activity

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

Exploratory Process

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

4.6.2 Techniques of Environmental Scanning

So far, we have discussed the constituents of macro and operating environment and how these can become a threat or opportunity. As a corporate strategist, one has to identify the impact of these environmental forces on firm's choice of direction and action. Environmental analysis involves two phases, viz; information gathering and evaluation.

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Glueck and Jauch mention the following sources for environmental analysis:

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

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

1. PESTEL analysis
2. SWOT analysis
3. ETOP
4. QUEST
5. EFE Matrix
6. CPM
7. Forecasting techniques
    (a) Time series analysis
    (b) Judgmental forecasting
    (c) Expert opinion
    (d) Delphi's technique

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(e) Multiple scenario

(f) Statistical modelling

(g) Cross-impact analysis

(h) Brainstorming

(i) Demand/hazard forecasting

The above techniques are briefly discussed below:

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

SWOT Analysis : SWOT analysis is discussed in more detail in Unit 5.

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

1. ***List environmental factors :*** The different aspects of the general as well as relevant environmental factors are listed.

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For example, economic environment can be divided into rate of economic growth, rate of inflation, fiscal policy etc.

2. ***Assess impact of each factor :*** At this stage, the impact of each factor is assessed closely and expressed in qualitative (high, medium or low) or quantitative factors (1, 2, 3). It is to be noted that not all identified environmental factors will have the same degree of impact. The impact is assessed as positive or negative.
3. ***Get a big picture :*** In the final stage, the impact of each factor and its importance is combined to produce a summary of the overall picture.

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

1. List 10 to 20 important opportunities and threats.

2. Assign a weight to each factor from 0.0 (not important) to 1.0 (most important). The higher the weight, the more important is the factor to the current and future success of the company.

3. Assign a rating to each factor 1(poor), 2 (average), 3 (above average), 4 (superior). The rating indicates how effectively the firm's current strategies respond to that particular factor.

4. Multiply each factor's weight by its rating to determine a weighted score.

5. Finally, add the individual weighted scores for all the external factors to determine the total weighted score for the organisation.

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QUEST : QUEST (Quick Environment Scanning Technique) is a four step process, which uses scenario buildingfor environmental analysis.

The four steps are:

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

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

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

Forecasting Techniques : Macro environmental and industry scanning and analysis are only marginally useful if what they do is to reveal current conditions. To be truly useful, such analysis must forecast future trends and changes. Forecasting is a way of estimating the future events that are likely to have a major impact on the enterprise. It is a technique whereby managers try to predict the

future characteristics of the environment to help managers take strategic decisions. Various techniques are used to forecast future situations. Important among these are:

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1. ***Time series analysis :*** Extrapolation is the most widely practiced form of forecasting. Simply stated, extrapolation is the extension of present trends into the future. It rests on the assumption that the world is reasonably consistent and changes slowly in the short run. They attempt to carry a series of historical events forward into the future. Because time series analysis projects historical trends into the future, its validity depends on the similarity between past trends and future conditions.
2. ***Judgemental forecasting :*** This is a forecasting technique in which employees, customers, suppliers etc., serve as a source of information regarding future trends. For example, sales representatives may be asked to forecast sales growth in various product categories based on their interaction with customers. Survey instruments may be mailed to customers, suppliers or trade associations to obtain their judgments on specific trends.
3. ***Expert opinion :*** This is a non-quantitative technique in which experts in a particular area attempt to forecast likely developments. Knowledgeable people are selected and asked to assign importance and probability rating to various future developments. This type of forecast is based on the ability of a knowledgeable person to construct probable future developments on the interaction of key variables. The delphi technique is one such technique.
4. ***Delphi Technique :*** This is a forecasting technique in which the opinion of experts in the appropriate field are obtained

about the probability of the occurrence of specified events. The responses of the experts are compiled and a summary is sent to each expert. This process is repeated until consensus is arrived at regarding the forecast of a particular event.

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5. ***Statistical modelling :*** It is a quantitative technique that attempts to discover causal factors that link two or more-time series together. They use different sets of equations. Regression analysis and other econometric methods are examples. Although very useful for grasping historical trends, statistical modelling is based on historical data. As the patterns of relationships change, the accuracy of the forecast deteriorates.
6. ***Cross-impact Analysis :*** By this analysis, researchers analyze and identify key trends that will impact all other trends. The question is then put: "If event A occurs, what will be the impact on all other trends". The results are used to build "domino chains", with one event triggering others.
7. ***Brainstorming :*** Brainstorming is a technique to generate a number of alternatives by a group of 6 to 10 persons. The basic ground rule is to propose ideas without first mentally evaluating them. No criticism is allowed. Ideas tend to build on previous ideas until a consensus is reached. This is a good technique to create ideas.
8. ***Demand/Hazard forecasting :*** Researchers identify major events that would greatly affect the firm. Each event is rated for its convergence with several major trends taking place in society and its appeal to a group of the public; the higher the event's convergence and appeal, the higher its probability of occurring.

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4.7 Summary

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

4.8 Key Terms

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

Environment: The totality of surrounding conditions.

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

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

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

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

4.9 Questions and Exercises

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

forces that determine the nature of competition." Discuss.

10. Is it feasible to create strategic group in any industry? Explain the rationale behind creating these groups.

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11. Present a critical assessment of industry life cycle analysis.
12. These days, the industry uses a very popular term- hyper-competition. Find out what it means and elucidate through examples.

Check your progress

Fill in the blanks:

1. At the level of marketing strategy, a competitor has four variables: ...., ..., ... and ....
2. Competitors' reactions can be studied at .... levels.
3. The five forces and strategic group models present a .... picture of competition while emphasizing the role of ....
4. The shakeout stage ends when the industry enters its .... stage.
5. Under the shakeout stage, ... are forced out, and a small number of industry leaders emerge.
6. The .... represents all the players in the game and analyses how their interactions affect the firm's ability to generate and appropriate value.
7. Buyers, suppliers, new entrants and substitute products are all .... forces.
8. A primary industry may be considered as a group of ...., whereas a secondary industry includes ....
9. ...., ... and .... are essential for conducting an environmental survey.
10. Analyzing a company's industry begins with identifying the industry's dominant .... features.

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11. A .... industry is dominated by a small number of large companies.
12. Defining an industry's boundaries is incomplete without an understanding of its .... attributes.
13. Firms that enjoy .... can charge lower prices than their competitors.
14. With Porter's framework, a strong competitive force can be regarded as a ....
15. .... are the one-time costs that a customer has to bear to switch from one product to another.
16. The new entrant's need to secure .... for the product can create a barrier to entry.

Answers:

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

4.10 Further Reading and References

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UNIT 5: ORGANISATIONAL APPRAISAL : THE INTERNAL ASSESSMENT 1

5.0 Unit Objectives

5.1 Introduction

5.2 Importance of Internal Analysis

5.3 SWOT Analysis

5.3.1 Carrying out SWOT Analysis

5.3.2 Steps in SWOT Analysis

5.3.3 Critical Assessment of SWOT Analysis

5.3.4 Advantages and Limitations

5.4 Summary

5.5 Key Terms

5.6 Questions and Exercises

5.7 Further Reading and References

5.0 Unit Objectives

After studying this unit, you should be able to:

- State the importance of internal analysis
- Discuss SWOT analysis

5.1 Introduction

Internal analysis is also referred to as "internal appraisal", "organisational audit", "internal corporate assessment" etc. Over the years, research has shown that the overall strengths and weaknesses of a firm's resources and capabilities are more important for a strategy than environmental factors. Even where the industry was unattractive and generally unprofitable, firms that came out with superior products enjoyed good profits.,Managers perform internal analysis to identify the strengths and weaknesses of a firm's resources and capabilities. The basic purpose is to build on the strengths and overcome the weaknesses in order to avail of the opportunities and minimize the effects of threats. The ultimate aim is to gain and sustain competitive advantage in the marketplace.

5.2 Importance of Internal Analysis

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

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

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

5.3 SWOT Analysis

SWOT stands for strengths, weaknesses, opportunities and threats. SWOT analysis is a widely used framework to summaries a company's situation or current position. Any company undertaking strategic planning will have to carry out SWOT analysis: establishing its current position in the light of its strengths, weaknesses, opportunities and threats. Environmental and industry analyses provide information needed to identify opportunities and threats, while internal analysis provides information needed to identify strengths and weaknesses. These are the fundamental areas of focus in SWOT analysis. SWOT analysis stands at the core of strategic management. It is important to note that strengths and weaknesses are intrinsic (potential) value creating skills or assets or the lack thereof, relative to competitive forces. Opportunities and threats, however, are external factors that are not created by the company, but emerge as a result of the competitive dynamics caused by 'gaps' or 'crunches' in the market. We had briefly mentioned about the meaning of the terms opportunities, threats, strengths and weaknesses. We revisit the same for purposes of SWOT analysis.

Check Your Progress

Analyses the role of internal analysis in strategy formulation?

1. ***Opportunities:*** An opportunity is a major favourable situation in a firm's environment. Examples include market growth, favourable

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changes in competitive or regulatory framework, technological developments or demographic changes, increase in demand, opportunity to introduce products in new markets, turning R&D into cash by licensing or selling patents etc. The level of detail and perceived degree of realism determine the extent of opportunity analysis.

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

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

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

5.3.1 Carrying out SWOT Analysis

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

5.3.2 Steps in SWOT Analysis

The three important steps in SWOT analysis are:

1. Identification
2. Conclusion
3. Translation

1. ***Identification:***

(a) Identify company resource strengths and competitive capabilities

(b) Identify company resource weaknesses and competitive deficiencies

(c) Identify company's opportunities

(d) Identify external threats

2. ***Conclusion:***

(a) Draw conclusions about the company's overall situation.

3. ***Translation:*** Translate the conclusions into strategic actions by acting on them:

(a) Match the company's strategy to its strengths and opportunities

(b) Correct important weaknesses

(c) Defend against external threats

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

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

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

TOWS Matrix?

TOWS matrix is just an extension of SWOT matrix. TOWS stand for threats, opportunities, weaknesses and strengths. This matrix was proposed by Heinz Weihrich as a strategy formulation – matching tool. TOWS matrix illustrates how internal strengths and weaknesses can be matched with external opportunities and threats to generate four sets of possible alternative strategies. This matrix can be used to generate corporate as well as business strategies. To generate a TOWS matrix, the following steps are to be followed:

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

The four sets of strategies that emerge are:

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

ST Strategies : ST strategies use a company's strengths as a way to avoid threats. A company may use its technological, financial and marketing strengths to combat a new competition. For example, Hindustan Lever has been employing this strategy to fight the increasing

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Check Your Progress

What points would you keep in mind to enhance the quality of the material while devisinga SWOT Analysis?

competition from companies like Nirma, Procter & Gamble etc.

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

WT Strategies : WT Strategies are basically defensive strategies and primarily aimed at minimizing weaknesses and avoiding threats. For example, managerial weakness may be solved by change of managerial personnel, training and development etc. Weakness due to excess manpower may be addressed by restructuring, downsizing, delayering and voluntary retirement schemes. External threats may be met by joint ventures and other types of strategic alliances. In some cases, an unprofitable business that cannot be revived may be divested. Strategies which utilize a strength to take advantage of an opportunity are generally referred toas "exploitative" or "developmental strategies". Strategies which use a strength to eliminate a weakness may be referred to as "blocking strategies". Strategies which overcome a weakness to take advantage of an opportunity or eliminate a threat may be referred to as "remedial strategies". The TOWS matrix is a very useful tool for generating a series of alternative strategies that the decision-makers of the firm might not otherwise have considered. It can be used for the company as a whole or it can be used for a specific business unit within a company. However, it may be noted that the TOWS matrix is only one of many ways to generate alternative strategies.

5.3.3 Critical Assessment of SWOT Analysis

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SWOT analysis is one of the most basic techniques for analysing firm and industry conditions. It provides the "raw material" for analysing internal conditions as well as external conditions of a firm. SWOT analysis can be used in many ways to aid strategic analysis. For example, it can be used for a systematic discussion of a firm's resources and basic alternatives that emerge from such an analysis. Such a discussion is necessary because a strength to one firm may be a weakness for another firm, and vice-versa. For example, increased health consciousness of people is a threat to some firms (e.g. tobacco) while it is an opportunity to others (e.g. health clubs). According to Johnson and Sholes (2002), a SWOT analysis summarises the key issues from the business environment and the strategic capability of an organisation that impacts strategy development. This can also be useful as a basis for judging future courses of action. The aim is to identify the extent to which the current strengths and weaknesses are relevant to, and capable of, dealing with the changes taking place in the business environment. It can also be used to assess whether there are opportunities to exploit further the unique resources or core competencies of the organisation. Overall, SWOT analysis helps focus discussion on future choices and the extent to which the company is capable of supporting its strategies.

5.3.4 Advantages and Limitations

Advantages

1. It is simple.
2. It portrays the essence of strategy formulation: matching a firm's internal strengths and weaknesses with its

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external opportunities and threats.

3. Together with other techniques like Value Chain Analysis and RBV, SWOT analysis improves the quality of internal analysis.

Limitations

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

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

5.4 Summary

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

5.5 Key Terms

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

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

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

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

5.6 Questions and Exercises

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

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9. "SWOT analysis stands at the core of strategic management". Substantiate
10. Conduct a SWOT analysis for any two major companies in the FMCG market.

Check your progress

Fill in the blanks:

1. SWOT stands for ...., ..., ... and ....
2. An .... is a major favourable situation in a firm's environment.
3. .... is something a company possesses or is good at doing.
4. SWOT Analysis provides the "raw material" for analyzing .... and .... conditions of a firm.
5. .... portrays the essence of strategy formulation.
6. SWOT's focus on the external environment is too ....
7. …………………is the starting point of developing competitive advantage.
8. Increase in competition and high inflation rate are potential……………………for a company.
9. At the………………stage of SWOT analysis, companies try to correct their major weaknesses.
10. ……………………matrix is just an extension of the SWOT matrix.

Answers:

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

5.7 Further Reading and References

NOTES

Books

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UNIT 6: ORGANISATIONAL APPRAISAL: INTERNAL ASSESSMENT 2

NOTES

6.0 Unit Objectives

6.1 Introduction

6.2 Strategy and Culture

6.3 Value Chain Analysis

6.3.1 Analysis

6.3.2 Conducting a Value Chain Analysis

6.3.3 Usefulness of the Value Chain Analysis

6.4 Organisational Capability Factors

6.4.1 Resources

6.4.2 Strategic Importance of Resources

6.4.3 Critical Success Factors

6.5 Benchmarking

6.6 Summary

6.7 Key Terms

6.8 Questions and Exercises

6.9 Further Reading and References

6.0 Unit Objectives

After studying this unit, you Should be able to:

- Realise the concept between strategy and culture

- Discuss value chain analysis
- Identify organisational capability factors
- Describe the concept of benchmarking

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6.1 Introduction

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

6.2 Strategy and Culture

An organisation's culture can exert a powerful influence on the behaviour of all employees. It can, therefore, strongly affect a company's ability to adopt new strategies. A problem for a strong culture is that a change in mission, objectives, strategies or policies is not likely to be successful if it is in opposition to the culture of the company. Corporate culture has a strong tendency to resist change because its very existence often rests on preserving stable relationships and patterns of behaviour. For example, the male-dominated Japanese centered corporate culture of the giant Mitsubishi Corporation created problems for the company when it implemented its growth strategy in North America. The alleged sexual harassment of its female employees by male supervisors resulted in lawsuits and a boycott of the company's automobiles by women activists. There is no one best corporate culture. An optimal culture is

one that best supports the mission and strategy of the company. This means that, like structure and leadership, corporate culture should support the strategy. Unless strategy is in complete agreement with the culture, any significant change in strategy should be followed by a change in the organisation's culture.

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Although corporate cultures can be changed, it may often take long time and requires much effort. A key job of management therefore involves "managing corporate culture". In doing so, management must evaluate what a particular change in strategy means to the corporate culture, assess if a change in culture is needed and decide if an attempt to change culture is worth the likely costs.

'FIT' between Strategy and Culture

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

Check Your Progress

"Organisation does not have a 'best' or a 'worst' culture", Substa- ntiate?

6.3 Value Chain Analysis

Every organisation consists of a chain of activities that link together to develop the value of the business. They are basically purchasing of raw materials, manufacturing, distribution, and marketing of goods and services. These activities taken together form its value

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chain. The value chain identifies where the value is added in the process and links it with the main functional parts of the organisation. It is used for developing competitive advantage because such chains tend to be unique to an organisation. It then attempts to make an assessment of the contribution that each part makes to the overall added value of the business. Essentially, Porter linked two areas together:

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

In a company with more than one product area, the analysis should be conducted at the level of product groups, not at corporate strategy level. Value Chain thus views the organisation as a chain of value-creating activities. Value is the amount that buyers are willing to pay for what a product provides them. A firm is profitable to the extent the value it receives exceeds the total cost involved in creating its products. Creating value for buyers that exceeds the cost of production (i.e. margin) is a key concept used in analysing a firm's competitive position. Porter has applied this idea to the activities of an organisation as a whole, arguing that it is necessary to examine activities separately in order to identify sources of competitive advantage.

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

1. Activities that differentiate the product

2. Activities that lower its costs

3. Activities that meet the customer's need quickly.

Competitive advantage, argues Michael Porter (1985), can be understood only by looking at a firm as a whole, and cost advantages and

successful differentiation are found in the chain of activities that a firm performs to deliver value to its customers.

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6.3.1 Analysis

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

1. Primary activities
2. Support activities

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

Support activities include such activities as procurement, HR etc. which either add value by themselves or add value through primary activities and other support activities. Advantage or disadvantage can occur at any one of the five primary and four secondary activities, which together form the value chain for every firm.

Primary Activities

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

Operations : These include all activities associated with transforming inputs into the final product, such as production, machining, packaging, assembly, testing, equipment maintenance etc. These activities are associated with collecting, storing, physically distributing the finished products to the customers. They include finished goods warehousing, material handling and delivery, vehicle operation, order processing and scheduling.

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

Support Activities

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

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

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

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

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

Johnson and Sholes (2002) observe that few organisations undertake all activities from production of raw materials to the point–of–sale of finished products themselves. But, the value chain exercise must incorporate the whole process, that is, the

entire value system. This means, for example, that even if an organisation does not produce its own raw materials, it must nevertheless seek to identify the role and impact of its supply sources on the final product. Similarly, even if it is not responsible for after-sales service, it must consider how the performance of those who deliver the service contribute to overall product/service cost and quality.

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6.3.2 Conducting a Value Chain Analysis

Value chain analysis involves the following steps.

Identify Activities

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

Allocate Costs

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

Identify the Activities that Differentiate the Firm

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

Examine the Value Chain

Once the value chain has been determined, managers need to

identify the activities that are critical to buyer satisfaction and market success. This is essential at this stage of the value chain analysis for the following reasons:

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1. If the company focuses on low-cost leadership, then managers should keep a strict vigil oncosts in each activity. If the company focuses on differentiation, advantage given by each activity must be carefully evaluated.
2. The nature of value chain and the relative importance of each activity within it, vary from industry to industry.
3. The relative importance of value chain can also vary by a company's position in a broader value system that includes value chains of upstream suppliers and downstream distributors and retailers.
4. The interrelationships among value-creating activities also need to be evaluated.

The final basic consideration in applying value chain analysis is the need to use a comparison when evaluating a value activity as a strength or weakness. In this connection, RBV and SWOT analysis will supplement the value chain analysis. To get the most out of the value-chain analysis, as already noted, one needs to view the concept in a broader context. The value chain must also include the firm's suppliers, customers and alliance partners. Thus, in addition to thoroughly understanding how value is created within the organisation, one must also know how value is created for other organisations involved in the overall supply chain or distribution channel in which the firm participates. Therefore, in assessing the value chains there are two levels that must be addressed.

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

6.3.3 Usefulness of the Value Chain Analysis

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

Analyzing the separate activities in the value chain helps management to address the following issues:

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

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

Cost Drivers

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

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

Value Drivers

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

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

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

6.4 Organisational Capability Factors

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

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6.4.1 Resources

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

1. ***Physical resources*** include plant and machinery, land and buildings, productioncapacity etc.
2. ***Financial resources*** include capital, cash, debtors, creditors etc.
3. ***Human resources*** include knowledge, skills and adaptability of human resources.
4. ***Intellectual capital*** is an intangible resource of an organisation. This includes theknowledge that has been captured in patents, brands, business systems, customer databases and relationships with partners. In a

knowledge-based economy, intellectual capital is likely to be the major asset of many organisations.

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Capabilities

Resources are not very productive on their own. They need organisational capabilities. Organisational capabilities are the skills that a firm employs to transform inputs into outputs. They reflect the ability of the firm in combining assets, people and processes to bring about the desired results. Prahalad and Hamel describe an organisational competence as a "bundle of skills and technologies", which are integrated in people skills and business processes. Capabilities are, therefore a function of the firm's resources, their application and organisation, internal systems and processes, and firm specific skill sets. Capabilities are rarely unique, and can be acquired by other firms as well in that industry. Some of these capabilities may become "distinctive competencies", when a firm performs them better than its rivals.

Core Competence

Superior performance does not merely come from resources alone because they can be imitated or traded. Superior performance comes by the way in which the resources are deployed to create competences in the organisation's activities. For example, the knowledge of an individual willnot improve an organisation's performance unless he or she is allowed to work on particular tasks which exploit that knowledge. Although an organisation will need to achieve a threshold level of competence in all of the activities and processes, only some will become core competences. Core competence refers to that set of distinctive competencies that provide a firm with a sustainable source of competitive advantage. Core competencies emerge over time, and reflect the firm's ability to deploy different resources and capabilities in a variety of contexts to gain and sustain competitive advantage.

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

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

Task Enlist at least five types of resources that all organisations have. An organisation uses different types of resources and exhibits a certain type of organisational capabilities to leverage those resources to bring about a competitive advantage, as shown in It is important to emphasize that resources by themselves do not yield a competitive advantage. Those resources need to be integrated into value creating activities. Thus the central theme of RBV is that competitive advantage is created and sustained through the bundling of several resources in unique combinations. Thus,

1. Competence is something an organisation is good at doing.
2. Core competence is a proficiently performed internal activity.
3. Distinctive competence is an activity that a company performs better than its rivals.
4. Distinctive competencies become the basis for competitive advantage.

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

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

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

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

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

6.4.2 Strategic Importance of Resources

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

Available Resources

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

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Threshold Resources

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

Unique Resources

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

Check Your Progress

"Integration of culture remains atop challenge in majority of mergers and acquisitions".Why?

6.4.3 Critical Success Factors

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

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

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

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

Rockart has also identified four major sources of CSFs:

1. ***Structure of the industry:*** Some CSFs are specific to the structure of the industry. Forexample, the extent of service support expected by the customers. Automobile companies have to invest in building a national network of authorized service stations to ensure service delivery to their customers.
2. ***Competitive strategy, industry position and geographic location:*** CSFs also arise from the above factors. For example, the large pool of English-speaking manpower

makes India an attractive location for outsourcing the BPO needs of American and British firms.

3. ***Environmental factors:*** CSFs may also arise out of the general/business environment of a firm, like the deregulation of Indian Industry. With the deregulation of telecommunications industry, many private companies had opportunities of growth.
4. ***Temporal factors:*** Certain short-term organisational developments like sudden loss of critical manpower (like the charismatic CEO) or break-up of the family owned business, may necessitate CSFs like "appointment of a new CEO" or "rebuilding the company image". Temporarily such CSFs would remain CSFs till the time they are achieved.

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6.5 Benchmarking

Benchmarking is the process of comparing the business processes and performance metrics including cost, cycle time, productivity, or quality to another that is widely considered to be an industry standard benchmark or best practice. Essentially, benchmarking provides a snapshot of the performance of a business and helps one understand where one is in relation to a particular standard. The result is often a business case and "Burning Platform" for making changes in order to make improvements. Also referred to as "best practice benchmarking" or "process benchmarking", it is a process used in management and particularly strategic management, in which organisations evaluate various aspects of their processes in relation to best practice companies' processes, usually within a peer group defined for the purposes of comparison. This then allows organisations to develop plans on how to make improvements or adapt specific best practices, usually with the

aim of increasing some aspect of performance. Benchmarking may be a one-off event, but is often treated as a continuous process in which organisations continually seek to improve their practices.

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Types of Benchmarking

Benchmarking can be of following types:

1. ***Process benchmarking:*** the initiating firm focuses its observation and investigation ofbusiness processes with a goal of identifying and observing the best practices from one or more benchmark firms. Activity analysis will be required where the objective is to benchmark cost and efficiency; increasingly applied to back-office processes where outsourcing may be a consideration.
2. ***Financial benchmarking:*** performing a financial analysis and comparing the results in an effort to assess your overall competitiveness and productivity.
3. ***Benchmarking from an investor perspective:*** extending the benchmarking universe to also compare to peer companies that can be considered alternative investment opportunities from the perspective of an investor.
4. ***Performance benchmarking:*** allows the initiator firm to assess their competitive position by comparing products and services with those of target firms.
5. ***Product benchmarking:*** the process of designing new products or upgrades to currentones. This process can sometimes involve reverse engineering which is taking apart competitors' products to find strengths and weaknesses.
6. ***Strategic benchmarking:*** involves observing how others compete. This type is usually notindustry specific, meaning it is best to look at other industries.

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7. ***Functional benchmarking:*** a company will focus its benchmarking on a single function in order to improve the operation of that particular function. Complex functions such as Human Resources, Finance and Accounting and Information and Communication Technology are unlikely to be directly comparable in cost and efficiency terms and may need to be disaggregated into processes to make valid comparison.
8. ***Best-in-class benchmarking:*** involves studying the leading competitor or the company that best carries out a specific function.
9. ***Operational benchmarking:*** embraces everything from staffing and productivity to office flow and analysis of procedures performed.

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

The ***12 stage methodology*** consisted of:

1. Select subject ahead
2. Define the process
3. Identify potential partners
4. Identify data sources
5. Collect data and select partners
6. Determine the gap

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7. Establish process differences
8. Target future performance
9. Communicate
10. Adjust goal
11. Implement
12. Review/recalibrate.

The following is an example of a typical benchmarking methodology:

1. ***Identify your problem areas:*** Because benchmarking can be applied to any business processor function, a range of research techniques may be required. They include: informal conversations with customers, employees, or suppliers; exploratory research techniques such as focus groups; or in-depth marketing research, quantitative research, surveys, questionnaires, re-engineering analysis, process mapping, quality control variance reports, or financial ratio analysis. Before embarking on comparison with other organisations it is essential that one knows one's own organisation's function, processes; base lining performance provides a point against which improvement effort can be measured.
2. ***Identify other industries that have similar processes:*** For instance if one were interested in improving hand offs in addiction treatment he/she would try to identify other fields that also have hand off challenges. These could include air traffic control, cell phone switching between towers, transfer of patients from surgery to recovery rooms.

3. ***Identify organisations that are leaders in these areas:*** Look for the very best in any industry and in any country. Consult customers, suppliers, financial analysts, trade associations, and magazines to determine which companies are worthy of study.
4. ***Survey companies for measures and practices:*** Companies target specific business processes using detailed surveys of measures and practices used to identify business process alternatives and leading companies. Surveys are typically masked to protect confidential data by neutral associations and consultants.
5. ***Visit the "best practice" companies to identify leading edge practices:*** Companies typically agree to mutually exchange information beneficial to all parties in a benchmarking group and share the results within the group.
6. ***Implement new and improved business practices:*** Take the leading edge practices and develop implementation plans which include identification of specific opportunities, funding the project and selling the ideas to the organisation for the purpose of gaining demonstrated value from the process

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6.6 Summary

- Culture is a powerful component of an organisation's success, laying the tracks for strategyto roll out on.It is the foundation for profit, productivity and progress. While it can accelerate getting tothe next level of performance, it can just as easily act as drag.

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- Culture-strategy Fit is a leading organisational culture consulting firm conducting groundbreaking culture diagnosis and change projects to help organisations leverage their cultureto drive strategy and performance.
- It involves specifying the objective of the business venture or project and identifying theinternal and external factors that are favorable and unfavorable to achieving that objective.
- A value chain is a chain of activities.Products pass through all activities of the chain in order and at each activity the productgains some value.
- The chain of activities gives the products more added value than the sum of added valuesof all activities.
- It is important not to mix the concept of the value chain with the costs occurring throughout the activities.
- Benchmarking is an improvement tool whereby a company measures its performance orprocess against other companies' best practices, determines how those companies achieved their performance levels.Benchmarking uses the information to improve its own performance.

6.7 Key Terms

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

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

Cultural Fit: Compatibility of culture with other arenas.

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

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

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

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6.8 Questions and Exercises

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

Check your progress

Fill in the blanks:

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

Answers:

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

6.9 Further Reading and References

Books

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UNIT 7: CORPORATE LEVEL STRATEGIES

7.0 Unit Objectives

7.1 Introduction

7.2 Expansion Strategies

7.3 Retrenchment Strategies

7.3.1 Turnaround Strategy

7.3.2 Divestment

7.3.3 Bankruptcy

7.3.4 Liquidation

7.4 Combination Strategies

7.5 Internationalisation

7.6 Cooperation Strategies

7.6.1 Joint Ventures

7.6.2 Strategic Alliances

7.6.3 Consortia

7.7 Restructuring

7.8 Summary

7.9 Key Terms

7.10 Questions and Exercises

7.11 Further Reading and References

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7.0 Unit Objectives

After studying this unit, you should be able to:

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

7.1 Introduction

Corporate strategy is primarily about the choice of direction for the corporation as a whole. Thebasic purpose of a corporate strategy is to add value to the individual businesses in it. A corporatestrategy involves decisions relating to the choice of businesses, allocation of resources amongdifferent businesses, transferring skills and capabilities from one set of businesses to others, andmanaging and nurturing a portfolio of businesses in such a way as to obtain synergies amongproduct lines and business units, so that the corporate whole is greater than the sum of itsindividual business units. Managers at the corporate level act on behalf of shareholders and provide strategic guidance tobusiness units. In these circumstances, a key question that arises is to what extent and how mightthe corporate level add value to what the businesses do; or at least how it might avoid destroyingvalue.

Corporate strategy is thus concerned with two basic issues:

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

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

7.2 Expansion Strategies

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

Reasons for Pursuing Growth Strategies

Firms generally pursue growth strategies for the following reasons:

1. ***To obtain economies of scale:*** Growth helps firms to achieve large-scale operations, whereby fixed costs can be spread over a large volume of production.
2. ***To attract merit:*** Talented people prefer to work in firms with growth.
3. ***To increase profits:*** In the long run, growth is necessary for increasing profits of the organisation, especially in the turbulent and hyper–competitive environment.
4. ***To become a market leader:*** Growth allows firms to reach leadership positions in themarket. Companies such as

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Reliance Industries, TISCO etc. reached commanding heightsdue to growth strategies.

5. ***To fulfill natural urge:*** A healthy firm normally has a natural urge for growth. Growthopportunities provide great stimulus to such urge. Further, in a dynamic world characterizedby the growth of many firms around it, a firm would have a natural urge for growth.
6. ***To ensure survival:*** Sometimes, growth is essential for survival. In some cases, a firm maynot be able to survive unless it has critical minimum level of business. Further, if a firmdoes not grow when competitors are growing, it may undermine its competitiveness.

Categories of Growth Strategies

Growth strategies can be divided into three broad categories:

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

Concentration Strategies

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

Thus, there are three important intensive strategies:

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

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

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

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

(i) Regional expansion

(ii) National expansion

(iii) International expansion

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

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

(i) Developing product versions to appeal to other segments

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Check Your Progress

Explain the concept of product development. Under what conditions, do you think it is feasible?

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(ii) Entering other channels of distribution

(iii) Advertising in other media

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

(i) New untapped or unsaturated markets exist

(ii) New channels of distribution are available

(iii) The firm has excess production capacity

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

(v) The firm has resources for expanded operations

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

(a) Developing new product features

(b) Developing quality variations

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

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

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

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

(c) The firm is in a high growth industry

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

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

Integrative Strategies

Integration basically means combining activities relating to the present activity of a firm. Such a combination can be done on the basis of the industry value chain. A company performs a number of activities to transform an input to output. These activities include right from the procurement of raw materials to the production of finished goods and their marketing and distribution to the ultimate consumers. These activities are also called value chain activities. Vertical integration can be:

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Full integration: participating in all stages of the industry value chain.

Partial integration: participating in selected stages of the industry value chain.

A firm can pursue vertical integration by starting its own operations or by acquiring a company already performing the activities, it wants to bring in house. Thus, integration is basically of tw0 types:

1. Vertical integration and

2. Horizontal integration

Vertical Integration

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

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

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

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

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

Risks

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

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

1. It boosts the firm's capital investment.
2. It increases business risk.
3. It denies financial resources to more worthwhile pursuits.
4. It locks a firm into relying on its own in-house sources of supply.
5. It poses all kinds of capacity-matching problems.

6. It calls for radically different skills and capabilities, which may be lacked by the manufacturer.
7. Outsourcing of component parts may be cheaper and less complicated than in-house manufacturing.

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

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

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

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

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

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

Horizontal Integration

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

Recent acquisition of Arcelor by Mittal Steels and the acquisition of Corus by Tata Steel are goodexamples of horizontal integration. The most important advantage of horizontal integration is that it generally eliminates or reduces competition. Other advantages are:

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

When horizontal integration is appropriate Horizontal integration is an appropriate strategy when:

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

Diversification Strategies

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

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

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

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

2. ***Conglomerate diversification:*** Adding a new, but unrelated business is called conglomerate diversification. The new business will have no relationship to the company's technology, products or markets. For example, ITC which is basically a cigarette manufacturer, has diversified into hotels, edible oils, financial services etc. Similarly, Reliance Industries, which is basically a textile manufacturer, has diversified into petro chemicals, telecommunications, retailing etc. Unlike concentric diversification, conglomerate diversification does not result in much of synergy. The main objective is profit motive. But it has important advantages.

Advantages

(a) Business risk is scattered over diverse industries.

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

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

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

Disadvantages

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

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

Diversification into both Related and Unrelated Businesses: Some companies may diversify into both related and unrelated businesses. The actual practice varies from company to company.There are three types of enterprises in this respect:

1. ***Dominant business enterprises:*** In such enterprises, one major "core" business accounts for 50 to 80 per cent of total revenues and the remaining comes from small related and unrelated businesses, e.g. TISCO.

2. ***Narrowly diversified enterprise:*** These are enterprises that are diversified around a few (two to five) related or unrelated businesses e.g. BPL.

3. ***Broadly diversified enterprises:*** These enterprises are diversified around a wide-ranging collection of related and unrelated businesses e.g. ITC, Reliance Industries.

7.3 Retrenchment Strategies

They are the last resort strategies. A company may pursue retrenchment strategies when it has a weak competitive position in some or all of its product lines resulting in poor performance – sales are down

and profits are dwindling. In an attempt to eliminate the weaknesses that aredragging the company down, management may follow one or more of the followingretrenchment strategies.

1. Turnaround
2. Divestment
3. Bankruptcy
4. Liquidation

7.3.1 Turnaround Strategy

A firm is said to be sick when it faces a severe cash crunch or a consistent downtrend in its operating profits. Such firms become insolvent unless appropriate internal and external actions are taken to change the financial picture of the firm. This process of recovery is called "turnaroundstrategy".

When Turnaround becomes Necessary

Do companies turn sick overnight and qualify as potential candidates for turnaround or do they become sick slowly which can be stopped by timely corrective action? Obviously, the latter is true in most of the cases. But the reality is also that companies becoming sick often do not themselves recognize this fact, and fail to take timely action to remedy the situation. Despite the fact that factors that lead to sickness may vary from company to company, there aresome common signals which herald the onset of sickness. John M Harris has listed a dozen danger signals of impending sickness.

1. ***Decreasing market share :*** This is the most significant symptom of a major sickness. A company which is losing its market share to competition needs to sit up and take careful note. Regular monitoring of market share helps companies to keep a tag on

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themperformance in the market vis-à-vis their competitors. Any indication of declining market share should trigger off immediate corrective action.

2. ***Decreasing constant rupee sales :*** Sales figures, to be meaningful, should be adjusted for inflation. If constant rupee sales figures are showing a declining trend, then this is a danger signal to watch out.

3. ***Decreasing profitability :*** Profit figures are a good indication of a company's health. Care must be taken to interpret the profit figures correctly, so as to avoid any misjudgements. Decreasing profitability can show up as smaller profits in absolute terms or lower profits per rupee of sales or decreasing return on investment or smaller profit margins.

4. ***Increasing dependence on debt :*** A company overly reliant on debt soon gets into a tight corner with very few options left. A substantial rise in the amount of debt, a lopsided debtto- equity ratio and a lowered corporate credit rating may cause banks and other financial institutions to impose restrictions and become reluctant to lend money. Once financial institutions are hesitant to lend money, the company's rating on the stock market alsoslides down and it becomes very difficult for the company to raise funds from the public too.

5. ***Restricted dividend policies :*** Dividends frequently missed or restricted dividends signal danger. Often, such companies may have earlier paid substantially higher proportion of earnings as dividends when in fact they should have been reinvesting in the business. Current inability to pay dividends is an indication of the gravity of the situation.

6. ***Failure to reinvest sufficiently in the business :*** For a company to stay competitive and keep on the fast growth track, it is

essential to reinvest adequate amounts in plant, equipment and maintenance. When a business is growing, the combination of new investments and reinvestments often warrants borrowing. Companies which fail to recognize this fact and try to finance growth with only their internal funds are applying brakes in the path of growth.

7. ***Diversification at the expense of the core business :*** It is a well-observed fact that once companies reach a particular level of maturity in the existing business, they start looking for diversification. Often this is done at the cost of the core business, which then starts to deteriorate and decline. Diversification in new ventures should be sought as a supplement and not as a substitute for the primary core business.

8. ***Lack of planning :*** In many companies, particularly those built by individual entrepreneurs, the concept of planning is generally lacking. This can often result in major setbacks as limited thought or planning go into the actions and their consequences.

9. ***Inflexible chief executives :*** A chief executive who is unwilling to listen to fresh ideas from others is a signal of impending bad news. Even if the CEO recognises the danger signals, his unwillingness to accept any proposal from his subordinates further blocks the path towards recovery.

10. ***Management succession problems :*** When nearly all the top managers are in their modifies, there may be a serious vacuum at the second line of command. As these older managers retire or leave because of perception of decreasing opportunities, there is bound to be serious management crisis.

11. ***Unquestioning boards of directors :*** Directors, who have family, social or business ties with the chief executive or have served very long on the board, may no longer be objective in their

NOTES

judgment. Thus, these directors serve limited purpose in terms of questioning or cautioning the CEO about his actions.

12. ***A management team unwilling to learn from its competitors:*** Companies in decline often adopt a closed attitude and are not willing to learn anything from their competitors. Companies which have survived tough competitive times continuously analyse theircompetitors' moves.

Types of Turnaround Strategies

Slater has classified the turnaround strategies into two broad categories. These are strategic turnaround and operating turnaround. Whether a sick business needs strategic or operating turn-around can be ascertained by analysing the current strategic and operating health of the business. The operating turnarounds are easier to carry out and can be applied only when there are average to strong strategic strengths (product-market relationship) in the business. The strategic turnaround choices may involve either a new way to compete existing business or entering an altogether new business. Entering a new business as a turnaround strategy can be approached through the process of product portfolio management. The strategic turnaround focuses either on increasing the market share in a given product-market framework or by shifting the product-market relationship in a new direction by re-positioning.

The operating turnaround strategies are of four types. These are:

1. Revenue-increasing strategies
2. Cost-cutting strategies
3. Asset-reduction strategies
4. Combination strategies

The focus of all these choices is on short-term profit. Thus, if a sick firm is operating much belowits break-even, it must take steps to reduce the levels of fixed cost and help in reducing the totalcosts of the firm. In real life, it is always a difficult choice to identify the assets which can be sold without affecting the productivity of the business. To identify saleable assets, the firm may have to keep in mind its strategic move in the next two to three years. The turnaround strategies appropriate under different circumstances are:

If the sick firm is operating substantially but not extremely below its break-even point, then the most appropriate turnaround strategy is the one which generates extra revenues. These may be in the form of price reduction to increase sales, stimulating product demand through promotional efforts or sometimes by introducing scaled down versions of the main products of the firm. The increased quantities of product sales not only result in higher sales but also reduce the per unit cost, thus leading to higher operating profits. If the firm is operating closer but below break-even point then the turnaround strategy calls for application of combination strategies. Under combination strategies cost-reducing, revenue generating and asset-reduction actions are pursued simultaneously in an integrated and balanced manner. The combination strategies have a direct favourable impact on cash flows as well as on profits.

Turnaround Process

The process of turning a sick company into a profitable one is rather complex and difficult. It is complex because a successful turnaround strategy demands corrective actions in many deficient areas of the firm. It is necessary that all these actions are integrated and do not contradict each other.

7.3.2 Divestment

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Selling a division or part of an organisation is called divestiture. This strategy is often used to raise capital for further strategic acquisitions or investments. Divestiture is generally used as a part of turnaround strategy to get rid of businesses that are unprofitable, that require too much capital or that do not fit well with the firm's other activities. Divestiture is an appropriate strategy to be pursued under the following circumstances:

1. When a business cannot be turned around
2. When a business needs more resources than the company can provide
3. When a business is responsible for a firm's overall poor performance
4. When a business is a misfit with the rest of the organisation
5. When a large amount of cash is required quickly
6. When government's legal actions threaten the existence of a business.

Reasons for Divestitures

1. ***Poor fit of a division :*** When the parent company feels that a particular division within the company cannot be managed profitably; it may think of selling the division to another company. This does not mean the division itself is unprofitable. The other firm with greater expertise in the line of business could manage the division more profitably. This means the division can be managed better by someone else than the selling company.

2. ***Reverse synergy :*** Synergy refers to additional gains that can be derived when two firms combine. When synergy exists, the

combined entity is worth more than the sum of the parts valued separately. In other words, 2 + 2 = 5. Reverse synergy exists when the parts are worth more separately than they are within the parent company's corporate structure. In other words, 2 + 2 = 3. In such a case, an outside bidder might be able to pay more for a division than what the division is worth to the parent company.

NOTES

3. ***Poor performance :*** Companies may want to divest divisions when they are not sufficiently profitable. The division may earn a rate of return, which is less than the cost of capital of the parent company. A division may turn out to be unprofitable due to various reasons such as increase in the material and labour cost, decline in the demand etc.

4. ***Capital market factors :*** A divestiture may also take place because the post divestiture firm, as well as the divested division, has greater access to capital markets. The combined capital structure may not help the company to attract the capital from the investors. Some investors are looking at steel companies and others may be looking for cement companies. These two groups of investors are not interested in investing in combined company, with cement and steel businesses due to the cyclical nature of businesses. So each group of investors are interested in stand-alone cement or steel companies. So divestitures may provide greater access to capital markets for the two firms as separate companies rather than the combined corporation.

5. ***Cash flow factors :*** Selling a division results in immediate cash inflows. The companies that are under financial distress or in insolvency may be forced to sell profitable and valuable divisions to tide over the crisis.

Check Your Progress

"Horizontal integration eliminates or reduces competition". Comment?

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6. ***To release the managerial talent :*** Sometime the management may be overburdened with the management of the conglomerate leading to inefficiency. So they sell one or more divisions of the company. After the divestiture, the existing management can concentrate on the remaining businesses and can conduct the business more efficiently.

7. ***To correct the mistakes committed in investment decisions:*** Many companies in India diversified into unrelated areas during the pre-liberalization period. Afterwards they realised that such a diversification into unrelated areas was a big mistake. To correct the mistake committed earlier, they had to go for divestiture. This is because they moved into product market areas with which they had less familiarity than their existing activities.

8. ***To realise profit from the sale of profitable divisions :*** This type of divestiture occurs when a firm acquires under-performing businesses, makes it profitable and then sells it to other companies. The parent company may repeat this process to make profit out of it.

9. ***To reduce the debt burden :*** Many companies sell their assets or divisions to reduce their debt and bring the balance in the capital structure of the firm.

10. ***To help to finance new acquisitions :*** Companies may sell less profitable divisions and buy more profitable divisions in order to increase the profitability of the company as a whole.

Types of Divestitures

1. ***Spin-off :*** It is a kind of demerger when an existing parent company distributes on a prorate basis the shares of the new company to the shareholders of the parent company free of cost.

There is no money transaction, subsidiary's assets are not revalued, and transaction is treated as stock dividend. Both the companies exist and carry on their businesses independently after spin-off. During spin-off, a new company comes into existence.

2. ***Sell-off :*** It is a form of restructuring, where a firm sells a division to another company. When the business unit is sold, payment is received generally in the form of cash or securities. When the firm decides to sell a poorly performing division, this asset goes to another owner, who presumably values it more highly because he can use the asset more advantageously than the seller. The seller receives cash in the place of asset. So the firm can use this cash more efficiently than it was utilising the asset that was sold. The firm can also get premium for the assets because the buyer can more advantageously use such assets. Sell-off generally have positive impact on the market price of shares of both the buyer and seller companies. So sell-offs are beneficial for the shareholders of both the companies.

3. ***Voluntary corporate liquidation or bust-ups :*** It is also known as complete sell-off. The companies normally go for voluntary liquidation because they create value to the shareholders. The firm may have a higher value in liquidation than the current market value. Here the firm sells its assets/divisions to multiple parties which may result in a higher value being realised than if they had to be sold as a whole. Through a series of spinoffs or sell-offs a company may go ultimately for liquidation.

4. ***Equity carve outs :*** It is a different type of divestiture and different form of spin-off and sell off. It resembles Initial Public Offering (IPO) of some portion of equity stock of a wholly owned subsidiary by the parent company. The parent company may sell a 100% interest in subsidiary company or it may choose to remain

in the subsidiary's line of business by selling only a partial interest (shares) and keeping the remaining percentage of ownership. After the sale of shares to the public, the subsidiary company's shares will be listed and traded separately in the capital market.

5. ***Leveraged buyouts (LBO's) :*** A leveraged buyout is an acquisition of a company in which the acquisition is substantially financed through debt. Debt typically forms 70-90% of the purchase price. Much of the debt may be secured by the assets of the company (asset based lending). Firms with assets that have a high collateral value can more easily obtain such loans. So LBOs are generally found in capital intensive industries. Debt is obtained on the basis of company's future earnings potential.

7.3.3 Bankruptcy

This is a form of defensive strategy. It allows organisations to file a petition in the court for legal protection to the firm, in case the firm is not in a position to pay its debts. The court decides the claims on the company and settles the corporation's obligations.

7.3.4 Liquidation

Liquidation occurs when an entire company is dissolved and its assets are sold. It is a strategy of the last resort. When there are no buyers for a business which wants to be sold, the company may be wound up and its assets may be sold to satisfy debt obligations. Liquidation becomes the inevitable strategy under the following circumstances:

1. When an organisation has pursued both turnaround strategy and divestiture strategy, butfailed.

2. When an organisation's only alternative is bankruptcy. A company can legally declare bankruptcy first and then wind up the company to raise needed funds to pay debts.
3. When the shareholders of a company can minimize their losses by selling the assets of a business.

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7.4 Combination Strategies

A company can pursue a combination of two or more corporate strategies simultaneously. But a combination strategy can be exceptionally risky if carried too far. No organisation can afford to pursue all the strategies that might benefit the firm. Difficult decisions must be made. Priorities must be established. Organisations like individuals have limited resources, so organisations must choose among alternative strategies. In large diversified companies, a combination strategy is commonly employed when different divisions pursue different strategies. Also, organisations struggling to survive may employ a combination of several defensive strategies.

7.5 Internationalisation

When the focus of a business is its domestic operations, but a portion of its activities are outside the home country, it is called an "International Company". In other words, an international company is one that is primarily based in a single country but that acquires some meaningful share of its resources or revenues from other countries. For example, a small company engaged in exporting some of its products beyond its home country, is called "international" in its operations. Internationalisation involves creating an international division and exporting the products through that division. The firm really focuses on the domestic market, and exports what is demanded abroad. All control

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is retained at home office regarding product and marketing strategies. As a firm becomes more successful abroad, it might set up manufacturing and marketing facilities in the foreign country, and allow a certain degree of customization. Country units are allowed to make some minor adaptations to products to suit local needs. But they have far less independence and autonomy compared to multi-domestic companies. All sources of core competencies are centralized. The majority of large US multinationals pursued the international strategy in the decades following World War II. These companies centralized R&D and product development but established manufacturing facilities as well as marketing divisions abroad. Companies such as Mc Donald's and Kellogg's are examples of firms that followed such a strategy in the beginning. Although these companies do make some local adaptations, they are of a very limited nature. With increasing pressure to reduce costs due to global competition, especially from low-cost countries, the use of this strategy has become limited.

The disadvantages of this strategy are:

1. By concentrating most of its activities in one location, it fails to take advantage of thebenefit of an optimally distributed value chain.
2. It is susceptible to higher levels of currency risks, because the company is too closely associated with a single country and increase in the value of currency may suddenly make the product unattractive abroad.

Exporting

This means selling the products in other countries through an agent or a distributor. This choice offers avenues for larger firms to begin their international expansion with a minimum investment.

There are merits and demerits.

Merits

1. Less expensive
2. No need to set up manufacturing facilities abroad

Demerits

1. Not suitable for bulky, perishable or fragile goods
2. Import duties make the product expensive
3. High transportation costs
4. Cannot avail lower production costs in host country

7.6 Cooperation Strategies

Cooperative strategies such as strategic alliance and joint ventures are a logical and timely response to intense and rapid changes in economic activity, technology and globalisation. Apart from alliances between the firms operating within the same country, cross border alliances have also become increasingly popular these days. Alliances generally come in three basic types joint ventures, strategic alliance, and consortia.

7.6.1 Joint Ventures

In a joint venture, two firms contribute equity to form a new venture, typically in the host country to develop new products or build a manufacturing facility or set up a sales and distribution network (Eg. Maruti Suzuki). The commonly cited advantages are:

1. Improvement of efficiency
2. Access to knowledge

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3. Dealing with political risk factors

4. Collusions may restrict competition

Merits

1. Two partners bring complementary expertise to the new venture

2. Both parties share capital and risks.

3. Helps to meet host country regulations

Demerits

1. Two partners may fail to get along

2. The firm has to share profits with the partner

3. Host country culture may pose problems

7.6.2 Strategic Alliances

This is a collaborative partnership between two or more firms to pursue a common goal. Each partner in an alliance brings knowledge or resources to the partnership. Such an alliance is generally formed to access a critical capability not possessed in-house.

7.6.3 Consortia Notes

Consortia are defined as large interlocking relationships, cross holdings and equity stakes between businesses of an industry. There could be two forms of consortia:

1. ***Multipartner Consortia :*** These are multi-partner alliances intended to share an underlying technology. One of the most important European based consortiums to date is Air Bus

Industries. Airbus brings together four European aerospace firms from Britain, France, Germany and Spain

2. ***Cross - holding Consortia :*** These include large Japanese Keiretsus (Sumitomo, Mitsubishi, and Mitsui) and Korean Chaebols (Daewoo, LG, Hyundai, and Samsung). Two important features of cross-holding consortia are building long-term focus and gaining technological critical mass among affiliated member companies.

7.7 Restructuring

Restructuring is another means by which the corporate office can add substantial value to a business. Here, the corporate office tries to find either poorly performing business units with unrealized potential or businesses on the threshold of significant, positive change. The parent intervenes, often selling off the whole or part of the businesses, changing the management, reducing payroll and unnecessary expenses, changing strategies, and infusing the business with new technologies, processes, reward systems, and so forth. When the restructuring is complete, the company can either "sell high" and capture the added value or keep the business in the corporate family and enjoy the financial and competitive benefits of the enhanced performance. For the restructuring strategy to work, the corporate office must have insights to detect businesses competing in industries with a high potential for transformation. Additionally, of course, they must have the requisite skills and resources to turn the businesses around, even if they may be in new and unfamiliar industries.

Restructuring can involve changes in assets, capital structure or management.

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1. ***Assets restructuring*** involves the sale of unproductive assets, or even whole lines of businesses, that are peripheral. In some cases, it may even involve acquisitions that strengthen the core businesses.

2. ***Capital restructuring*** involves changing the debt-equity mix or the mix between different classes of debt or equity.

3. ***Management restructuring*** involves changes in the composition of top management team, organisational structure, and reporting relationships. Tight financial control, rewards based strictly on meeting performance goals, reduction in the number of middle-level managers are common steps in management restructuring. In some cases, parental restructuring may even result in changes in strategy as well as infusion of new technologiesand processes.

7.8 Summary

- Strategy is the direction and scope of an organisation over the long-term. Strategies achieve advantages for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations.
- Strategies exist at several levels in any organisation – ranging from the overall business through to individuals working in it.
- Growth strategies are the most widely pursued corporate strategies.Without moving outside the organisation's current range of products or services, it maybe possible to attract customers by intensive advertising, and by realigning the productand market options available to the organisation. These strategies are generally referredto as intensification or concentration strategies.

- There are three important intensive strategies, viz. Market penetration, Marketdevelopment and Product development. Integration basically means combining activities relating to the present activity of a firm.Integration is basically of two types, viz. vertical integration and horizontal integration.
- Diversification is the process of adding new businesses to the existing businesses of the company.
- A company may pursue defense strategies when it has a weak competitive position insome or all of its product lines resulting in poor performance.
- Retrenchment strategies are last resort strategies. Companies can use any of the fourretrenchment strategies- turnaround, divestment, bankruptcy and liquidation.
- Firms can take the international route by exporting a part of their produce to other nationsor by outsourcing a small chunk of their work outside.
- Cooperative strategies such as strategic alliance and joint ventures are a logical and timelyresponse to intense and rapid changes in economic activity, technology and globalisation.
- Restructuring is another means by which the corporate office can add substantial value toa business. Restructuring can involve changes in assets, capital structure or management.

7.9 Key Terms

Backward Integration: Gaining ownership or increased control of a firm’s suppliers.

Corporate Strategy: primarily about the choice of direction for the corporation as a whole

Diversification: process of adding new businesses to the existing businesses of the company

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Horizontal Integration: The strategy of seeking ownership or increased control over a firm's competitors.

Integration: Integration basically means combining activities relating to the present activity of a firm.

Intensive Strategy: firms intensify their efforts to boost sales and grow market share

Market Development: seeks to increase market share by selling the present products in new markets

Market Penetration: seeks to increase market share for existing products in the existing markets through greater marketing efforts.

Vertical Integration: Expanding the firm's range of activities backward into the sources of supply and/or forward into the distribution channels.

7.10 Questions and Exercises

1. If a firm succeeds in making the customers to switch from the competitor's brands to the firm's brands, while maintaining its existing customers intact, there will be an increase in the firm's sales. Why/why not?
2. Explain the concept of product development. Under what conditions, do you think it is feasible?
3. As a manager, in which situations would you apply vertical integration and why?
4. "Horizontal integration eliminates or reduces competition". Comment
5. Discuss the concept of last resort strategies. Under what conditions should they be applied?
6. "A firm is sick!" What do you mean by this statement? How can you prevent this sickness?
7. Do you think that the turnaround process is difficult? Why/ why not?

8. Suppose you are the business head of a firm which is in deep financial trouble and is losing customers because of lack of proper services. In such a situation, what will you do and how would you justify your actions?

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Check your progress

Fill in the blanks:

1. The customer .... defines the value proposition that the organisation will apply to satisfy customers.
2. The .... focuses on all the activities and key processes required in order for the company to excel at providing the value expected by the customers.
3. The .... and .... is the foundation of any strategy and focuses on the intangible assets of an organisation.
4. .... strategy implies continuing the current activities of the firm without any significant change in direction.
5. A .... strategy is a decision to do nothing new.
6. .... strategies are the most widely pursued corporate strategies.
7. .... seeks to increase market share for existing products in the existing markets.
8. Market .... seeks to increase market share by selling the present products in new markets.
9. .... seeks to increase the market share by developing new or improved products for present markets.
10. .... increases the dependability of the supply and quality of raw materials.
11. .... involves gaining ownership or increased control over distributors or retailers.
12. .... is the process of adding new businesses to the existing businesses of the company.

NOTES

13. By expanding into ...., the company can obtain new technologies and products, which can complement its present businesses.
14. Competition as a reason of corporate .... occurs in the form of product and/or price competition.

Answers:

1. perspective 2. internal process 3. innovation, learning perspective 4. Stability 5. no change 6. Growth 7. Market penetration 8. Development 9. Product development 10. Backward integration 11. Forward integration 12. Diversification 13. industries 14. Decline.

7.11 Further Reading and References

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UNIT 8: BUSINESS LEVEL STRATEGIES

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8.0 Unit Objectives

8.1 Introduction

8.2 Industry Structure

8.3 Positioning of the Firm

8.4 Generic Strategies

8.4.1 Risks in Competitive Strategies

8.4.2 Critical Assessment of Generic Strategies

8.4.3 Comment on Porter's Generic Strategies

8.5 Business Tactics

8.6 Summary

8.7 Key Terms

8.8 Questions and Exercises

8.9 Further Reading and References

8.0 Unit Objectives

After studying this unit, you should be able to:

- Define industry structure
- Describe the positioning of firm
- Discuss the generic strategies
- Identify the business tactics

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8.1 Introduction

Each business should have its own business strategy. A business strategy is basically a competitivestrategy and is concerned more with how a business competes successfully in the chosen market.The strategic decisions at business-level revolve around choice of products and markets, meetingthe needs of customers, protecting market share, gaining advantage over competitors, exploitingor creating new opportunities and earning profit at the business unit level. In short, a businessstrategy outlines the competitive posture of its operations in the industry.Business strategy is guided by the direction set by the corporate strategy. It takes the cue fromthe priorities set by the corporate strategy. It translates the direction and intent generated at thecorporate level into objectives and strategies for individual business units.

8.2 Industry Structure

An industry is a collection of firms offering goods or services that are close substitutes of each other. Alternatively, an industry consists of firms that directly compete. For industry analysis, an industry can be defined rather broadly (the beverage industry)or more precisely (the carbonated soft drink industry). How one defines and circumscribes anindustry depends on the kinds of analysis to be performed. In "industry analysis", it is generallybetter to define an industry as precisely as possible.*Example:* In discussing companies like Coca-Cola and Pepsi, one would want to definethe boundaries of the "carbonated soft drink industry" rather than that of the "beverage industry".The term "industry structure" refers to the number and size distribution of firms in an industry.The number of firms in an industry may run into hundreds or thousands. The existence of a largenumber of firms in an industry reduces opportunities for coordination among firms in theindustry. Hence, generallyspeaking, the level of competition in an industry rises with

thenumber of firms in the industry. The size distribution of firms in an industry is important fromthe perspective of both business policy and public policy.

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Industry structure consists of four elements:

(a) Concentration

(b) Economies of scale

(c) Product differentiation

(d) Barriers to entry.

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

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

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

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

These features determine the strength of the competitive forces operating in the industry. Trendsaffecting industry structure are important considerations in strategy formulation.

Check Your Progress

Which industry is Vodafone a part of? Identify the features of that industry and comment on its status in India?

8.3 Positioning of the Firm

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When starting a new firm or launching new product, a prime strategic decision is to identify thetarget audience. But even though a useful segment has been identified, this does not in itself resolve the organisation's strategy. The competitive position within the segment then needs to be explored, because only this will show how the organisation will compete within the segment. Competitive positioning is thus the choice of differential advantage that the product or services will possess against its competitors. Competitive positioning allows an organisation to compete and survive in a market place or in a segment of a market place. To develop positioning, it is useful to follow a two-stage process- first identify the segment gaps, second identify positioning within segments.

Identification of Segment Gaps and their Competitive Positioning Implications

From a strategy viewpoint, the most useful strategy analysis often emerges by exploring where there are gaps in the segments of an industry. The starting point for such work is to map out thecurrent segmentation position and then place companies and their products into the segments;it should then become clear where segments exist that are not served or are poorly served bycurrent products.

Identifying the Positioning within the Segment

From a strategy perspective, some gaps may be more attractive than others. For example, they may have limited competition or poorly supported products. In addition, some gaps may possessa clear advantage in terms of competitive positioning. Others may not.

The process of developing positioning runs as follows:

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1. ***Perceptual mapping:*** In-depth qualitative research on actual and prospective customerson the way they make their decisions in the market place, e.g. strong versus weak, cheapversus expensive, modern versus traditional.

2. ***Positioning:*** Brands or products are then placed on the map using the research dimensions.

3. ***Options development:*** Take existing and new products and use their existing strengthsand weaknesses to devise possible new positions on the map.

4. ***Testing:*** First with simple statements with customers, then at a later stage in the marketplace.

It will be evident that this is essentially a process, involving experimentation with actual and potential customers.

8.4 Generic Strategies

Generic strategies were first outlined in two books from Michael Porter of Harvard Business School. These were “Competitive Strategy” in 1980 and “Competitive Advantage” in 1985. The second book contained a small modification of the concept. The original version is explored here. Michael Porter made the bold claim that there are only three fundamental strategies that any business can undertake. During the 1980s, they were regarded as being at the forefront of strategic thinking. Arguably, they still have a contribution to make in the new century in the development of strategic options.

Professor Porter argued that the three basic strategies open to any business are:

1. Cost leadership

2. Differentiation

3. Focus.

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Each of these generic strategies has the potential to overcome the five forces of competition and allow the firm to outperform rivals within the same industry. These are called ‘generic’ because they can be used in a variety of situations, across diverse industries at various stages of development.

Cost Leadership

Cost leadership is a strategy whereby a firm aims to deliver its product or service at a pricelower than that of its competitors. Overall cost leadership is achieved by the firm by maintaining the lowest costs of production and distribution within an industry and offering “no-frills” products. This strategy requires economies of scale in production and close attention to efficiency and operating costs. The firm places a lot of emphasis on minimizing direct input and overhead costs, by offering no-frills products.

Example: Deccan Airways, Timex, Nirma.

A cost leadership strategy is likely to work better where the product is standardized, competition is based mainly on price and consumers can switch easily between different suppliers. However, a low cost base will not in itself bring competitive advantage. The product must be perceived as comparable or acceptable by consumers. Firms pursuing this strategy must be effective in engineering, purchasing, manufacturing, and physical distribution. Marketing can be consideredas less important, as the consumer is familiar with the product attributes.

Differentiation Strategy

Differentiation consists of offering a product or service that is perceived as unique or distinctive by the customer. This allows firms to command a premium price or to retain buyer loyalty because customers will pay more for what they regard as a better product. A differentiation strategy can be more profitable than a cost leadership

strategy because of the premium price. Products can be differentiated in a number of ways so that they stand apart from standardized products:

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1. Superior quality
2. Special or unique features
3. More responsive customer service
4. New technologies
5. Dealer network.

***Example**:* Hero Honda, Nike athletic shoes, Sony, Asian Paints, Mercedes-Benz, BMW etc. Nokia achieves differentiation through the individual design of its product, while Sony achieves it by offering superior reliability, service and technology. Mercedes-Benz differentiates by stressing a distinctive product service image, while Coca Cola differentiates by building a widely recognized brand. This strategy is often supported by high spending on advertising and promotion to sustain the brand identity. McDonald's is differentiated by its brand name and its 'Big Mac' and 'Ronald McDonald' products and imagery. In order to differentiate a product, Porter argued that it is necessary for the producer to incur extra costs, for example, to advertise a brand and thus differentiate it.The form of differentiation varies from industry to industry. In construction industry, equipment durability, spare parts availability and service will feature, while in cosmetics, differentiation is based on sophistication and exclusivity. Differentiation is aimed at the broad mass market. It is a viable strategy for earning above average profits because the resulting brand loyalty lowers customers' sensitivity to price. Buyer loyalty also serves as an entry barrier because new entrants must develop their own distinctive competence to differentiate their products in some way to achieve buyer loyalty. It is essential for the success of this strategy that the premium price for the differentiated product must exceed the cost of differentiation. For successfully carrying out the differentiation

strategy, the following are required :

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1. Creative flair

2. Engineering skills

3. R&D capabilities

4. Innovative marketing capabilities

5. Motivation for innovation

6. Corporate reputation for quality or technological capabilities.

Focus Strategy

A focus strategy occurs when a firm focuses on a specific niche in the market place and develops its competitive advantage by offering products especially developed for that niche. It targets a specific consumer group (e.g. teenagers, babies, old people etc.) or a specific geographic market (urban areas, rural areas etc.).

Hence, the focus strategy selects a segment or group of segments in the industry and tailors its strategy to serve them to the exclusion of others. By optimizing its strategy, for the targets, the focuser seeks to achieve competitive advantage in its target segments, even though it does not possess a competitive advantage overall. As Porter observes, while the low cost and differentiation strategies are aimed at achieving theirobjectives industry-wide, the entire focus strategy is built around serving a particular target very well. Sometimes, according to Porter, neither a low-cost leadership strategy nor a differentiation strategy is possible for an organisation across the broad range of the market.

Example: The costs of achieving low-cost leadership may require substantial funds which are not available. Equally, the costs of differentiation, while serving the mass market of customers, may be too high. If the differentiation involves quality, it may not be credible to offer high quality and cheap products under the same brand name. So a new brand name has to be developed and supported. For these and related reasons, it may be better to adopt a focus strategy.

The focus strategy has **two variants**:

1. ***Cost focus:*** A firm seeks to achieve low cost position in its target segment only.
2. ***Differentiation focus:*** A firm seeks to differentiate its products in its target segment only.

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8.4.1 Risks in Competitive Strategies

No one competitive strategy is guaranteed for success. Some companies that have successfully implemented one of Porters' competitive strategies have found that they could not sustain the strategy. Each of these generic strategies has its own risks.

1. ***Risks of cost leadership:***

(a) Cost leadership may not be sustained

If competitors imitate

If technology changes

If other bases for cost leadership erode.

(b) Proximity in differentiation is lost.

(c) Cost focusers achieve even lower costs in segments.

Proximity in differentiation means that companies that choose cost leadership strategy must offer relatively standardized products with features or characteristics that are acceptable to customers. In other words, the company must offer a minimum level of differentiation–at the lowest competitive price. If this minimum level of differentiation is lost, then the strategy of cost leadership will fail.

2. ***Risks of differentiation:***

(a) Differentiation may not be sustained

If competitors imitate.

If features of differentiation become less important to buyers.

(b) Cost proximity is lost.

(c) Firms that follow focus strategy may achieve even greater differentiation in segments.

(d) Dilution of brand identification through product-line.

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A company following a differentiation strategy must ensure that the higher price it charges for its higher quality is not priced too far above the competition, otherwise customers will not see the extra quality as worth the extra cost.

In other words, if the price differential between the standardized and differentiated product is too high, the risk is that the company provides a greater level of uniqueness than the customers are willing to pay for.

3. ***Risks of Focus:*** The competitive risks of focus strategy are similar to those previously noted for cost leadership and differentiation strategies, with the following additions:

(a) Focus strategy is not sustained if competitors imitate it.

(b) The target segment may become structurally unattractive.

if structure erodes.

if demand disappears.

(c) Competitors may successfully focus on an even smaller segment of the market, out focusing the focuser, or focus only on the most profitable slice of the focuser'schosen segment.

(d) An industry-wide competitor may recognize the attractiveness of the segment served by the focuser and mobilize its superior resources to better serve the segment's need.

(e) Preferences and needs of the narrow segment may become more similar to the broad market, reducing or eliminating the advantage of focusing.

Check Your Progress

Illustrate how a firm can pursue both low-cost and differentiation strategies?

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8.4.2 Critical Assessment of Generic Strategies

The generic business-level strategies discussed above are useful when we view an industry as stable. However, in practice, business environment is dynamic and successful firms need toadapt their strategies to the environmental conditions. More (2001) notes that each generic strategy gives a company some kind of defence against each of the five competitive forces.

Example: Cost leadership can raise barriers to cope with cost increases form suppliers.

8.4.3 Comment on Porter's Generic Strategies

Hendry ll and others have set out the problems of the logic and the empirical evidence associated with generic strategies that limit its absolute value. We can summarize them as follows:

Low-cost Leadership

1. If the option is to seek low-cost leadership, then how can more than one company be thelow-cost leader? It may be a contradiction in terms to have an option of low-cost leadership.
2. Competitors also have the option to reduce their costs in the long-term, so how can one company hope to maintain its competitive advantage without risk?
3. Low-cost leadership should be associated with cutting costs per unit of production. However, there are limitations to the usefulness of this concept.
4. Low-cost leadership assumes that technology is relatively predictable, if changing. Radical change can so alter the cost positions of actual and potential competitors.

5. Cost reductions only lead to competitive advantage when customers are able to make comparisons. This means that the low-cost leader must also lead price reductions or competitors will be able to catch up, even if this takes some years and is at lower profit margins. But permanent price reductions by the cost leader may have a damaging impact on the market positioning of its product or service that will limit its usefulness.

Differentiation

1. Differentiated products are assumed to be higher priced. This is probably too simplistic. The form of differentiation may not lend itself to higher prices.
2. The company may have the objective of increasing its market share, in which case it mayuse differentiation for this purpose and match the lower prices of competitors.
3. Porter discusses differentiation as if the form this will take in any market will be immediately obvious. The real problem for strategy options is not to identify the need fordifferentiation but to work out what form this should take that will be attractive to thecustomer. Generic strategy options throw no light on this issue whatsoever. They simplymake the dubious assumption that once differentiation has been decided on, it is obvioushow the product should be differentiated.

Focus

1. The distinction between broad and narrow targets is sometimes unclear. Are they distinguished by size of market? Or by customer type? If the distinction between them isunclear then what benefit is served by focus?
2. For many companies, it is certainly useful to recognise that it would be more productiveto pursue a niche strategy, away from the broad markets of the market leaders. That is theeasy part of

the logic. The difficult part is to identify which niche is likely to proveworthwhile. Generic strategies provide no useful guidance on this at all.

3. As markets fragment and product life cycles become shorter, the concept of broad targetsmay become increasingly redundant.

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Fast-moving Markets

In dynamic markets such as those driven by new internet technology, the application of generic strategies will almost certainly miss major new market opportunities. They cannot be identified by the generic strategies approach. Faced with this veritable onslaught on generic strategies, it might be thought that Professor Porter would gracefully concede that there might be some weaknesses in the concept. However, Porter hit back in 1996 by drawing a distinction between basic strategy and what hecalled 'operational effectiveness' – the former is concerned with the key strategic decisionsfacing any organisation while the latter are more concerned with such issues as TQM, outsourcing,re-engineering and the like. He did not concede any ground but rather extended his approach toexplore how companies might use market positioning within the concept of generic strategies. Given these criticisms, it should not be concluded that the concept of generic strategies has no merit. As part of a broader analysis, it can be a useful tool for generating basic options in strategic analysis. It forces exploration of two important aspects of business strategy: the role ofcost reduction and the use of differentiated products in relation to customers and competitors.

But it is only a starting point in the development of such options. When the market is growing fast, it may provide no useful routes at all. More generally, the whole approach takes a highly prescriptive view of strategic action.

8.5 Business Tactics

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Tactics should work with a firm's strategy and they are the set of requirements need for the planto take place. A tactic is a device used by the firm for meeting your goals set by your strategy. Strategy and tactics should always be relative to one another because the tactics are the set of actions needed to fulfil your strategy.

1. Tactics are the tools used to achieve goals.
2. Tactics include things like advertising and marketing.
3. Tactics are the steps taken to achieve goals.

Brand Management

One tactic that almost every firm employs is strategic brand management. Firms must find a way to communicate their products and corporate philosophy to potential customers. Over time, a business can establish a reputation that gives its brand name an advantage over the lesserknown competitors. Brand management includes good advertising and public relations to present an image of that is consistent with the mission and vision of the company. A company may also conduct researchor poll the general public to learn about how it is perceived and what changes are necessary.

Diversification and Specialisation

Two different business strategies that deal with the scope of a company are diversification and specialisation. A business can diversify by simply expanding its products and services, such as adding a new division, or through merging or acquiring another business.Specialisation is the opposite of diversification. It refers to narrowing a business's products tofocus on a more specific type of product. By focusing limited resources on a smaller product line,a business may hope to improve the quality of its remaining products, or

simply divest itself ofan unprofitable product.

Research and Development

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Some firms use investments into research and development as a major tactic to get ahead of competitors. This is particularly true in the manufacturing field, where new product technologiescan save money and produce products that will excite consumers. Smaller businesses may lackthe money or in-house talent to invest directly in research and development, but for largercompanies the ability to innovate can be the difference between success and failure.

Risk Management Notes

Managing risk is a tactic that every firm employs in its own way. The simple act of founding a business is itself a risk, since market trends and customer behaviour can be difficult to predict. For an established business, managing risk means making good decisions about where to invest funds and what types of products to focus on.

8.6 Summary

- Business conditions are always changing, so it's a good practice to periodically step backand take a hard look at the business strategy and analyse its implementation.
- Business Strategy can be defined as a long-term approach to implementing a firm's businessplans to achieve its business objectives.
- A business strategy addresses how the firm competes in a market and how it attains and sustains competitive advantage.
- The term "industry structure" refers to the number and size distribution of firms in an industry.
- The competitive position within the segment then needs to be

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explored, because only thiswill show how the organisation will compete within the segment.

- Cost Leadership Strategy emphasises efficiency. By producing high volumes of standardisedproducts, the firm hopes to take advantage of economies of scale and experience curveeffects.
- The product is often a basic no-frills product that is produced at a relatively low cost andmade available to a very large customer base.
- Differentiation is aimed at the broad market that involves the creation of a product or services that is perceived throughout its industry as unique.
- Focus Strategy concentrates on a select few target markets and is also called a segmentationstrategy or niche strategy.

8.7 Key Terms

Cost Leadership: A strategy whereby a firm aims to deliver its product or service at a price lowerthan that of its competitors.

Differentiation: Offering a product or service that is perceived as unique or distinctive by the customer.

Focus Strategy: The strategy in which a firm focuses on a specific niche in the market place anddevelops its competitive advantage by offering products especially developed for that niche.

Industry: A collection of firms offering goods or services that are close substitutes of each other.

Positioning: Occupying a distinct position in the minds of consumers.

8.8 Questions and Exercises

1. Which industry is Vodafone a part of? Identify the features of that industry and comment on its status in India.
2. Critically analyse the benefits of positioning for a firm.

3. Suppose you are the CEO of a cosmetic firm. Under what situations would you choose a low-cost, differentiation, or speed-based strategy?
4. Illustrate how a firm can pursue both low-cost and differentiation strategies.
5. Identify requirements for business success at different stages of industry evolution.
6. Discuss the good business strategies in fragmented and global industries.
7. "Diversification is a double edged sword". Comment
8. There are many risks in cost leadership strategy. What are they and how would it affect you as a manager?
9. Under what condition(s) do you think would the cost leadership strategy work better?
10. In which situations do you think that the neither a low cost nor a differentiation strategy would be possible for an organisation?
11. Are tactics different from business strategies? Give reasons for your answer.
12. "Business strategy and tactics go hand in hand". Discuss

Check your progress

Fill in the blanks:

1. ....means the extent to which industry sales are dominated by only a few firms.
2. Competitive positioning gives............................advantage to the firms.
3. ....are the tools used for meeting the goals and objectives as designed by the strategy.
4. A company focuses only the production of ladies shoes. This is an example of...........................
5. Each of these generic strategies has the potential to overcome the .... of competition.

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6. A cost leadership strategy is likely to work better where the product is ....
7. Compared with the low-cost leader, competitors will have .... costs.
8. The .... strategy selects a segment or group of segments in the industry and tailors its strategy to serve them to the exclusion of others.
9. If the differentiation involves quality, it may not be credible to offer .... quality and................. products under the same brand name.
10. Hybrid strategies include a combination of .... strategies.

Answers:

1. Concentration 2. Differential 3. Tactics 4. Specialisation 5. Five forces 6. Standardised 7. Higher 8. Focus 9. High, cheap 10. Generic

8.9 Further Reading and References

Books

- Azhar Kazmi, *Strategic Management and Business Policy* - 3rd edition, Tata McGrawHill
- C Appa Rao, B Parvathiswara Rao and K Sivarama krishna, *Strategic Management and Business Policy-Text and Cases*, Excel Books
- David Fred, *Strategic Management: Concepts and Cases*-12th edition, Prentice Hall ofIndia
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UNIT 9: STRATEGIC ANALYSIS AND CHOICE

NOTES

9.0 Unit Objectives

9.1 Introduction

9.2 Process for Strategic Choice

9.2.1 Focusing on a few Alternatives

9.2.2 Considering Selection Factors

9.2.3 Evaluating the Alternatives

9.2.4 Making the Actual Choice

9.3 Industry Analysis

9.4 Corporate Portfolio Analysis

9.4.1 Display Matrices

9.4.2 Balancing the Portfolio

9.4.3 Portfolio and other Analytical Models

9.5 Contingency Strategies

9.6 Summary

9.7 Key Terms

9.8 Questions and Exercises

9.9 Further Reading and References

9.0 Unit Objectives

After studying this unit, you should be able to:

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- Describe the process for strategic choice
- Explain the concept of strategic and industry analysis
- State the concept of corporate portfolio analysis
- Discuss the contingency strategies

9.1 Introduction

Strategic analysis and choice is essentially a decision-making process. This involves generating feasible alternatives, evaluating those alternatives and choosing a specific course of action that could best enable the firm to achieve its mission and objectives. Alternative strategies do not come from a vacuum. They are derived from the firm's present strategies keeping in view the vision, mission, objectives andalso the information gathered from external and internal analysis. They are consistent with or built on past strategies that have worked well.

9.2 Process for Strategic Choice

According to Glueck and Jauch, "strategic choice is the decision to select from among the alternatives considered the strategy which will best meet the enterprise objectives. This decision-making process consists of four distinct steps:

1. Focusing on a few alternatives.
2. Considering the selection factors.
3. Evaluating the alternatives.
4. Making the actual choice.

9.2.1 Focusing on a few Alternatives

Strategists never consider all feasible options that could benefit the firm because there are innumerable options. So strategists should narrow down the choice to a reasonable number of alternatives. But it is still difficult to tell what that reasonable number is. For deciding on a reasonable number of alternatives, we can make use of the following concepts:

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Gap Analysis

In gap analysis, a company sets objectives for a future period of time, say three to five years of time, and then works backward to find out where it can reach at the present level of efforts.

Business Definition

In deciding on what would be a manageable number of alternatives, it is advisable to start with the business definition. Business definition, as discussed earlier, determines the scope of activities that can be undertaken by a firm. It tries to answer three basic questions clearly: (i) who is being satisfied? (ii) what is being satisfied? and (iii) how the need is being satisfied?

9.2.2 Considering Selection Factors

The concepts of Gap Analysis and Business definition would help the strategist to identify a few workable alternatives. These must be analysed further against a set of selection criteria. Selection factors are the criteria against which the alternative strategies are evaluated. These selection factors consist of:

Check Your Progress

Conduct an industry analysis for the Indian automobile industry?

1. ***Objective factors :*** are based on analytical techniques such as BCG matrix, GE matrix etc. and are hard facts or data used to facilitate a strategic choice. They are also called rational,

normative or prescriptive factors.

2. ***Subjective factors :*** on the other hand, are based on one's personal judgment or descriptive factors such as consistency, feasibility, etc. which are discussed in the previous unit.

9.2.3 Evaluating the Alternatives

After narrowing down the alternative strategies to a few alternatives, each alternative has to be evaluated for its suitability to achieve the organisational objectives. Evaluation of strategic alternatives basically involve bringing together the results of the analysis carried out on the basis of objective and subjective criteria.

9.2.4 Making the Actual Choice

An evaluation of alternative strategies leads to a clear assessment of which alternative is most suitable to achieve the organisational goals. The final step, therefore, is to make the actual choice. One or more strategies have to be chosen for implementation. Besides the chosen strategies, some contingency strategies should also be worked out to meet any eventualities. In both the above two steps, a number of portfolio analyses like BCG, nine–cell matrix etc., can be useful.

9.3 Industry Analysis

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

Importance of Industry Analysis

Macro environment is common to all industries. It remotely affects the industry. It is the structural realities of the specific industry and the nature and intensity of competition unique to thatindustry that are of special relevance to the firm in formulating strategy.

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The importance of industry analysis can thus be summarised as follows.

1. Industry – related factors have a more direct impact on the firm than the general environment.
2. An industry's dominant economic characteristics are important because of their implication for crafting strategy.
3. Industry analysis reveals industry attractiveness and its prospects for growth.
4. It helps the firm to identify such aspects as:
   (a) Current size of the industry
   (b) Product offerings
   (c) Relative volumes
   (d) Performance of the industry in recent years
   (e) Forces that determine competition in the industry.
5. It focuses attention on the firm's competitors.
6. It helps to determine key success factors.
7. A thorough understanding of the industry provides a basis for thinking about appropriate strategies that are open to the firm.

9.4 Corporate Portfolio Analysis

Many companies offer more than one product, and serve more than one customer. They have a portfolio (i.e. a basket) of products. This is a good strategy because a firm which is dependent on one product or customer runs immense risk. Decisions on strategy, therefore, generally involve a range of products in a range of markets.

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Portfolio analysis is an analytical tool which views a corporation as a basket or portfolio of products or business units to be managed for the best possible returns, and help a corporate to build a multi-business strategy. When an organisation has several products in its portfolio, it is quite likely that they will be in different stages of development. Some will be relatively new and some much older. Many organisations will not wish to risk having all their products at the same stage of development. It is useful to have some products with limited growth but producing profits steadily, and some products with real growth potential but may still be in the introductory stage. Indeed, the products that are earning steadily may be used to fund the development of those that will provide the growth and profits in the future.

So, the key strategy is to produce a balanced portfolio of products, some with low risk but dull growth and some with high-risk but great potential for growth and profits. This is what we call portfolio analysis.

The aim of portfolio analysis is:

1. To analyse its current business portfolio and decide which business should receive moreor less investment.
2. To develop growth strategies for adding new businesses to the portfolio.
3. To decide which business should no longer be retained.

9.4.1 Display Matrices

"Display matrices" are simple frameworks in which products or business units are displayed as a series of investments from which top management expects a profitable return. It charts and characterises different products or businesses in the organisation's portfolio of investments in such a way that top management constantly juggles to

ensure the best returns from them. As already stated, key purpose of portfolio models is to assist in achieving a balanced portfolio of businesses. This means that portfolio should consist of those businesses whose profitability, growth, cash flow and risk elements would complement each other, and add up to a satisfactory overall corporate performance. Imbalance in portfolio, for example, could be caused either by excessive cash generation with too few growth opportunities or by insufficient cash generation to fund the growth requirements of other businesses in the portfolio.

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9.4.2 Balancing the Portfolio

Balancing the portfolio means that the different products or businesses in the portfolio have to be balanced with respect to four basic aspects:

1. ***Profitability:*** The main aim of the portfolio analysis is to maintain the overall profitabilityof the corporation, even though some of the businesses are loss making. This is ensured through balancing investments.

2. ***Cash flow:*** A growing firm may be profitable, but it will also require additional cash outflows for investment requirements. Mature businesses, though less profitable, do not require much of investments though they may not be net cash generators. Thus, portfolio analysis must balance different businesses, which together must give a comfortable overallcash flow position in harmony with the desired strategy of the company.

3. ***Growth:*** All businesses or products go through the life cycle of introduction, growth, maturity and decline stages. If a company depends on one product alone, it would face problems in the declining stage of the product. It may be too late to start a new product at this stage because of the time lag involved in

waiting till it achieves its growth rate. It is therefore better to match different businesses at different stages in their life cycles, to achieve stability which is sometimes called "extended corporate immortality". Thus the balancing of the portfolio implies that though individual businesses grow, mature and decline, yet the company continues to grow.

4. ***Risk:*** Another major objective of portfolio analysis is to reduce the risk due to economic trends and market forces in a country. The aim is to put together diverse businesses with different or even opposite market forces to ensure a stable and smoother financial performance of the overall corporation.

9.4.3 Portfolio and other Analytical Models

Innumerable analytical models have been developed by several leading consulting firms. Some of the best-known models are:

1. *BCG matrix*
2. *GE Nine-cell Matrix*
3. *Hofer's Product/Market Evolution Matrix*
4. *Directional Policy Matrix*
5. *Arthur D Little's Portfolio Matrix*
6. *Profit Impact of Market Strategy (PIMS) Matrix*
7. *SPACE Matrix*
8. *Quantitative Strategic Planning Matrix (QSPM)*

BCG Matrix

The BCG matrix was developed by the Boston Consultancy group in 1970s. It is also called the "Growth share matrix". This is the most popular and the simplest matrix to describe a corporation's portfolio of businesses or products. BCG matrix is based on the premise that majority of the companies carry out multiple business activities in a number of different product-market segments.

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Together, these different businesses form the business portfolio of the company, which need to be balanced for overall profitability of the company. To ensure long-term success, a company's business portfolio should consist of both high-growth products in need of cash inputs and low-growth products that generate excess cash. The BCG matrix helps to determine priorities in a product portfolio. Its basic purpose is to invest where there is growth from which the firm can benefit, and divest those businesses that havelow market share and low growth prospects. Each of the products or business units is plotted on a two-dimensional matrix consisting of :

1. Relative market share

2. Market growth rate.

Relative Market Share: Relative market share is defined as the ratio of the market share of the concerned product or business unit in the industry divided by the share of the market leader. Bythis calculation, a relative market share of 1.0 belongs to the market leader.

For example, if market share of 3 businesses A, B, C are

Business Market share

A - 10%

B - 20%

C - 60%

A's relative market share=10/60=1/6

B's relative market share=20 /60=1/3

C's relative market share=60/20=3

The relative market share reflects the firm's capacity to generate cash. It is assumed that if a business unit enjoys high market share; its cash earnings would be correspondingly higher and vice versa.

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Market Growth Rate: It is the percentage of market growth, that is, the percentage by which sales of a product or business unit have increased. A high growth rate enables the company to expand its operations. It makes it easier for the company to increase its market share and provide the opportunities of profitable investment. The company may plough back its earnings into the business and further increase the rate of return on the investment. Additional cash will necessarily be required to avail of the investment opportunities for growth. On the other hand, low market growth rate indicates stagnation with little scope for expansion and profitable investments may be risky to undertake. Increase in market share in such a situation can be possible only by cutting into the competitor's market price.

Building the BCG Matrix

The stepwise procedure for building the BCG matrix is given below:

1. The various activities of the company are classified into different business units or SBUs.
2. The growth rate of the market is determined and plotted on the Y-axis.
3. The assets employed by the company in each of the business units are compiled to determine the relative size of the business unit in relation to the company.
4. The relative market share for different business units is estimated and plotted on the X-axis
5. The position of each business unit or product is plotted on a matrix of market growth raterelative market share. The size of the business is represented by a circle with a diameter corresponding to the assets invested in the business. The radius of the circle is given by r = p .R2 where R represents total

sales, P represents sales of the business unit as a percentage of the total sales of the company.

6. Depending on its location in the 2 × 2 matrix, a separate strategy has to be developed for each of the units. It is important not to change the criteria around in order to shift pet projects and products into more favourable groups, thereby defeating the very purpose of the exercise.

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Analysis of BCG Matrix

The BCG matrix reflects the contribution of the products or business units to its cash flow. Based on this analysis, the products or business units are classified as:

1. Stars
2. Cash cows
3. Question marks
4. Dogs

Stars (High Growth, High Market Share)

Stars are products that enjoy a relatively high market share in a strongly growing market. They are (potentially) profitable and may grow further to become an important product or category for the company. The firm should focus on and invest in these products or business units. The general features of stars are:

1. High growth rate means they need heavy investment
2. High market share means they have economies of scale and generate large Amounts .... of cash
3. But they need more cash than they generate.

Check Your Progress

Analyse the main advantages of portfolio analysis? Why it is a good option for multiproduct or ganisa-tions?

The high growth rate will mean that they will need heavy investment and will therefore be cash users. Overall, the general strategy is to take cash from the cash cows to fund stars. Cash

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may also be invested selectively in some problem children (question marks) to turn them into stars. The other problem children may be milked or even sold to provide funds elsewhere.

Cash Cows (Low Growth, High Market Share)

These are the product areas that have high relative market shares but exist in low-growth markets. The business is mature and it is assumed that lower levels of investment will be required. On this basis, it is therefore likely that they will be able to generate both cash and profits. Such profits could then be transferred to support the stars. The general features of cash cows are:

1. They generate both cash and profits
2. The business is mature and needs lower levels of investment
3. Profits are transferred to support stars/question marks
4. The danger is that cash cows may become under-supported and begin to lose their market.

Although the market is no longer growing, the cash cows may have a relatively high market share and bring in healthy profits. No efforts or investments are necessary to maintain the status quo. Cash cows may however ultimately become dogs if they lose the market share.

Question Marks (High Growth, Low Market Share)

Question marks are also called problem children or wild cats. These are products with low relative market shares in high-growth markets. The high market growth means that considerable investment may still be required and the low market share will mean that such products will have difficulty in generating substantial cash. These businesses are called' question marks because the organisation must decide whether to strengthen them

or to sell them.

The general features of question marks are:

1. Their cash needs are high
2. But their cash generation is low
3. Organisation must decide whether to strengthen them or sell them.

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Dogs (Low Growth, Low Market Share)

These are products that have low market shares in low-growth businesses. These products will need low investment but they are unlikely to be major profit earners. In practice, they may absorb cash required to hold their position. They are often regarded as unattractive for the long term and recommended for disposal. The general features of dogs are:

1. They are not profit earners
2. They absorb cash
3. They are unattractive and often recommended for disposal.

Turnaround can be one of the strategies to pursue because many dogs have bounced back and become viable and profitable after asset and cost reduction. The suggested strategy is to drop or divest the dogs when they are not profitable. If profitable, do not invest, but make the best out of its current value. This may even mean selling the division's operations.

Ge Nine Cell Matrix

This matrix was developed in 1970s by the General Electric Company with the assistance of the consulting firm, McKinsey & Co., USA. This is also called GE Multifactor Portfolio matrix. The GE matrix has been developed to overcome the obvious limitations of BCG matrix. This matrix consists of nine cells

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(3×3) based on two key variables:

1. Business strength; and
2. Industry attractiveness.

The horizontal axis represents "business strength" and the "vertical axis represents", "industry attractiveness".

The business strength is measured by considering such factors as:

1. Relative market share
2. Profit margins
3. Ability to compete on price and quality
4. Knowledge of customer and market
5. Competitive strengths and weaknesses
6. Technological capacity
7. Calibre of management

Industry attractiveness is measured considering such factors as:

1. Market size and growth rate
2. Industry profit margin
3. Competitive intensity
4. Economies of scale
5. Technology
6. Social, environmental, legal and human aspects

The individual product-lines or business units are plotted as circles. The area of each circle is proportionate to industry sales. The pie within the circles represents the market share of the product line or business unit. The nine cells of the GE matrix represent various degrees of industry attractiveness (high, medium or low) and business strength (strong, average and weak). After plotting each product line or business unit on the nine cell matrix, strategic choices are made depending on their position in the matrix.

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Directional Policy Matrix (DPM)

This matrix was developed by Shell Chemicals, UK. It uses two dimensions- viz. "business sector prospects and the "company's competitive capabilities". Business sectors prospects are divided into attractive, average and unattractive; and company's competitive capabilities into strong, average and weak, as shown in the following Figure 9.7. This gives a 9-cell matrix. Based on the two dimensions, businesses fall into Nine quadrants. The strategy to be followed for businesses in each quadrant are explained below.

Divestment

Both competitive capabilities and business prospects of the business units are weak. Loss making units with uncertain cash flows fall in this quadrant. Since the situation is not likely to improve in the near future, these businesses should be divested. The resources released could be put to an alternative use.

Phased Withdrawal

Here the SBU is in an average to weak competitive position in the low growth unattractive business, with very little chance of generating enough cash flows. Gradual withdrawal from such SBUs is the strategy to be followed. The cash released can be invested in more profitable ventures.

Double or Quit

Though business prospects look attractive here the company's competitive capabilities are weak. Either invest more to exploit the prospects or, if not possible, better "exit" from the SBU.

Phased Withdrawal

Already covered in previous page.

Custodial

Here both competitive capabilities and business prospects are unattractive or average. Bear with the situation with a little bit of help from the other product divisions or get out of the SBU so as to focus more on other attractive businesses.

Try Harder

Here business prospects are attractive, but competitive capabilities are average; strengthen their capabilities with infusion of additional resources.

Cash Generation

Here the SBU has strong competitive capabilities, but its business prospects are unattractive. Its operations can be continued at least for generating cash flows and profits. However, further investments cannot be made in view of unattractive business prospects.

Growth

Here the SBU has strong competitive capabilities, but its business prospects are average. This SBU requires additional infusion of funds. This would help the SBU to grow.

Market Leadership

Here the SBU has strong capabilities, and its business prospects are also attractive. It must receive top priority so that the SBU can retain its market leadership.

Arthur D Little Portfolio Matrix (ADL)

Arthur D Little Company's matrix links the stages of the product life cycle with the business strength. On the vertical axis, businesses are classified with respect to their business strength

as weak, tenable, favoured, strong or dominant. Along the horizontal axis, four steps in the product life cycle, i.e. embryonic, growth, mature and decline are marked.

Profit Impact of Market Strategy (PIMS)

PIMS was invented by General Electric in the 1960s to examine which strategic factors most influence cash flows and the investment needs and success. PIMS model is based on analysis of data presented by companies to derive general laws. Actually, the model uses statistical relationships derived from the past experience of companies. Typically, the Strategic Planning Institute develops an industry characteristic, using multidimensional cross sectional regression studies of the profitability of more than 2000 companies. The industry characteristic is compared with performance in the concerned company so as tofind the clue to appropriate strategic approaches. The model is characterized by scientific objectivity but it involves analysis of relationship that is based on heterogeneity of business and time periods. PIMS, of course, has certain inherent drawbacks. It assumes that short-term profitability is the primary goal of the firm. The analysis is based on the historical data and the model does not take note of further changes in the company's external environment. The model cannot take account of internal-dependencies and potential synergy within organisations. Each firm is examined in isolation.

SPACE Matrix

The Strategic Position and Action Evaluation (SPACE) matrix is another important technique. It reveals which of the following strategies is most appropriate for an organisation:

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1. Aggressive strategies
2. Conservative strategies
3. Defensive strategies
4. Competitive strategies

Aggressive Quadrant

When a firm's directional vector falls in the "aggressive quadrant" of the matrix. It is in an excellent position to use its internal strength to:

1. take advantage of external opportunities
2. overcome internal weaknesses
3. avoid or minimize external threats

The firm can adopt any of the aggressive growth strategies like market penetration, market development, product development, backward and forward integration, horizontal integration, concentric and conglomerate diversification or a combination strategy.

Conservative Quadrant

When a firm's directional vector falls in the "conservative quadrant", it means the firm should stay close to its core competencies and not take excessive risks. Conservative strategies include market penetration, market development, product development and concentric diversification.

Defensive Quadrant

When the directional vector falls in the "defensive quadrant", it suggests that the firm should focus on rectifying internal weaknesses and external threats, through defensive strategies. Defensive strategies or retrenchment strategies include

turnaround, divestiture, bankruptcy or liquidation.

Competitive Quadrant

When a directional vector falls in the "competitive quadrant", the firm should follow competitive strategies, which include backward, forward, and horizontal integration, market penetration; market development, product development, joint ventures and strategic alliances.

Quantitative Strategic Planning Matrix (QSPM)

The basic format of QSPM is as follows:

- Key external factors
- Economic
- Political, legal and governmental
- Social, cultural and demographic
- Technological
- Competitive
- Key internal factors
- Management
- Marketing
- Finance
- Production
- HR
- R&D

The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on key internal and external success factors. Like other analytical tools, QSPM requires good intuitive judgment.

The six steps required to develop a QSPM are:

Step 1: Make a list of the firm's external opportunities/threats

and internal strengths/ weaknesses.

Step 2: Assign weights to each key factor.

Step 3: Identify alternative strategies that the organisation wants to pursue.

Step 4: Determine the attractiveness scores. They are numerical values that indicate the relative attractiveness of each strategy in a given set of strategies.

Step 5: Compute the total attractiveness scores, which are obtained by multiplying the weights by the attractiveness scores in each row.

Step 6: Compute the sum total attractiveness scores in each strategy column of QPSM.

The sum attractiveness scores reveal which strategy is most attractive.

9.5 Contingency Strategies

Strategic choice is made on the basis of certain assumptions and conditions. If the conditions change drastically, the chosen strategies may have to be discarded altogether. If they are not too radical, the strategies may have to be modified suitably. But changes do not occur in a sequential order, nor do they give any impending warnings. They surface suddenly leaving deep scars on the faces of managers—if they are unprepared. To be on the safe side, strategists always keep contingency strategies ready. Such contingency strategies are formulated in advance to take care of unknown events and unexpected challengers. As rightly summarised by Peter Drucker, successful managers do not wait for future. They make the future through their proactive planning and advanced preparation. They introduce original action by removing present difficulties, anticipate future problems, change the goals to suit internal and external changes,

experiment with creative ideas and take initiative, attempt to shape the future and create a more desirable environment.

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The contingencies could come in the form of a labour strike, a downturn in the economy or an overnight change in government policy. Once such scenarios are identified managers could come out with alternative strategies for the firm. Firms using this kind of strategy identify certain trigger points to alert management that a contingency strategy should be pressed into service. When alternative plans are put in place, mid-course corrections could be carried out in a smooth way.

9.6 Summary

- Strategic choice is the decision to select from among the alternatives considered, the strategy which will best meet the enterprise objectives.
- This decision-making processconsists of four distinct steps: Focusing on a few alternatives. Considering the selection factors. Evaluating the alternatives. Making the actual choice.
- Strategic analysis framework consists of three stages: Input stage, Matching stage and Decision stage
- The basic purpose of industry analysis is to assess the strengths and weaknesses of a firm relative to its competitors in the industry.
- Portfolio analysis is an analytical tool which views a corporation as a basket or portfolio of products or business units to be managed for the best possible returns, and help a corporate to build a multi-business strategy.
- Various matrices are used under this approach.

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- Though the portfolio approaches have limitations, but all these limitations can be overcomethrough effective strategy development and meticulous planning.
- While the core competence concept appealed powerfully to companies disillusioned withdiversification, it did not offer any practical guidelines for developing corporate-levelstrategy.
- Contingency plans are organised and coordinated set of steps to be taken if an emergencyor disaster (fire, hurricane, injury, robbery, etc.) strikes.

9.7 Key Terms

BCG Matrix: Most popular and the simplest matrix to describe a corporation's portfolio of businesses or products.

Display Matrices: Frameworks in which products or business units are displayed as a series of investments from which top management expects a profitable return.

Market Growth Rate: The percentage of market growth, that is, the percentage by which sales of a particular product or business unit have increased.

Portfolio strategy approach: A method of analysing an organisation's mix of business in terms of both individual and collective contributions to strategic goals.

Relative Market Share: The ratio of the market share of the concerned product or business unit in the industry divided by the share of the market leader.

Strategic Choice: Selection of a strategy that will best meet the firm's objectives.

9.8 Questions and Exercises

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1. Suppose you are the head of a garments making firm that has just started its operations in India. Discuss the process of strategic choice that you are most likely to follow.
2. Conduct an industry analysis for the Indian automobile industry.
3. Analyse the main advantages of portfolio analysis? Why it is a good option for multiproduct organisations?
4. Through examples, prove that some of the underlying assumptions of the BCG matrix may not hold good for some businesses.
5. Compare and contrast the General Electric Grid and the BCG Matrix?
6. Do you think, BCG Matrix has limited application? Justify your answer.
7. Though BCG matrix can be very helpful in forcing decisions in managing a portfolio of products, it cannot be employed as the sole means of determining strategies for a portfolio of products. Do you agree with this statement or not? Why?
8. On the basis of GE Matrix, make an analysis of banking company of your choice.
9. Analyse the main issues which have to be taken care of while formulating a multi business strategy.
10. Do you think it is possible to sustain over a long run without formulating multi business strategy? Why/ why not?

Check your progress

Fill in the blanks:

1. The balancing of the portfolio implies that though individual businesses grow, mature and decline, yet the company continues to ....

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2. The GE matrix has been developed to overcome the obvious limitations of ....
3. In GE Matrix, the horizontal axis represents .... and the vertical axis represents ....
4. GE matrix is also called .... strategy matrix.
5. Directional Policy Matrix (DPM) was developed by ....
6. Arthur D Little Company's matrix links the stages of the product life cycle with the ....
7. On the vertical axis in Arthur D Little Company's matrix, businesses are classified with respect to their business strength as ...., ..., ..., ... or ....
8. The axes of the space matrix represent two internal dimensions, namely, ... and ....
9. The axes of the space matrix represent two external dimensions, namely, ... and ....
10. BCG matrix is also called the ....
11. The BCG matrix helps to determine .... in a product portfolio.
12. A high growth rate enables the company to .... its operations.

Answers:

1. grow 2. BCG matrix 3. business strength, industry attractiveness 4. Stoplight 5. Shell Chemicals, UK 6. business strength 7. weak, tenable, favoured, strong, dominant 8. financial strength, competitive advantage 9. environmental stability, industry strengths 10. Growth share matrix 11. Priorities 12. Expand

9.9 Further Reading and References

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Books

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UNIT 10: STRATEGY IMPLEMENTATION

NOTES

10.0 Unit Objectives

10.1 Introduction

10.2 Activating Strategies

10.3 Nature of Strategy Implementation

10.4 Barriers and Issues in Strategy Implementation

10.5 Model for Strategy Implementation

10.6 Resource Allocation

- 10.6.1 Importance of Resource Allocation
- 10.6.2 Managing Resource Conflict
- 10.6.3 Criteria for Resource Allocation Process
- 10.6.4 Factors affecting Resource Allocation
- 10.6.5 Difficulties in Resource Allocation

10.7 Summary

10.8 Key Terms

10.9 Questions and Exercises

10.10 Further Reading and References

10.0 Unit Objectives

After studying this unit, you should be able to:

- Explain how strategies are activated
- State the nature and barriers in strategy implementation
- Discuss the model of strategy implementation
- Describe the concept of resource allocation

NOTES

10.1 Introduction

Strategy implementation is the process of putting organisation's various strategies into action by setting annual or short-term objectives, allocating resources, developing programmes, policies, structures, functional strategies etc. Even the best strategic plan will be useless unless it is implemented properly. The strategy implementation is, therefore, the most difficult element of the strategic management process. This is so because there has to be a "fit" between the strategy and the organisation.

10.2 Activating Strategies

There is no guarantee that a well designed strategy is likely to be approved and implemented automatically. The strategic leader must, therefore, defend the strategy from every angle, communicate how the strategy when implemented would benefit the whole organisation and secure the wholehearted support of employees working at various levels. To keep things on track, he can list out priorities, programme implementation process, budgets, etc. on paper so that nothing is left to chance. While giving a concrete shape to the strategy, he should also take note of regulatory mechanisms that govern business activity and see that everything is in order. Some of the important things to be kept in mind are listed below:

1. ***Formation of a company:*** This must be in line with provisions of the Companies Act, 1956, covering issues such as formation of a company, its registration, obtaining suitable licenses before commencing operations, raising funds from various sources in accordance with the provisions of SEBI Act, 1992.

2. ***Operations of a company:*** The company must compete in a fair way and earn the profits through legally blessed routes only observing the (a) provisions of competition law; (b)Import/ export restrictions, (c) FERA regulations (FEMA regulations, 2000); (d) Patent, trademark, copyright (Indian Patents Act 1995, The Trade and Merchandise Marks Act 1958, The Copyrights Act 1957 etc.) stipulations; (e) Labour Laws (regarding employment of women, children, payment of wages, providing welfare amenities, keeping healthy industrial relations etc.); (f) environmental protection (The Environment Protection Act 1986), (g) pollution control requirements; (h) consumer protection measures etc.

3. ***Winding up operations:*** Even when the company decides to get out of a venture/business, the rules of the game need to be followed scrupulously (whether in offering golden handshake to employees or asking all the employees to quit in one go). After the institutionalisation of strategy in the above manner, action plans could be formulated. These are basically functional level strategies undertaken at the departmental level and usually deal with operational aspects of a strategy. The action plans, however, must try to translate the overall strategic plan in letter and spirit without any deviations. Issues like who will do what, what kind of support is required at various stages, what kind of privities have to be fixed while implementing active plans, how does a particular active plan contribute to the broad objectives of the strategy etc. must also be carefully looked into. Once the

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Check Your Progress

"Strategic decisions to be communicated and understood throughout the organisation". Elucidate?

action plans are ready, the strategist must resolve issues relating to allocation of scarce resources over the entire organisation.

10.3 Nature of Strategy Implementation

A successful strategy formulation does not guarantee successful strategy implementation. It affects an organisation from top to bottom; it affects all divisional and functional areas of business. It requires the right alignment between the strategy and various activities, processes within the organisation. The complexities in the task of implementation arise from a number of organisational adjustments that are required over an extended period of time and the need to match them all to the strategy. Key people need to be added or reassigned, resources have to be mobilised and allocated, functional strategies and policies are to be designed, organisational structure may have to be changed, a strategy- supportive culture may have to be developed, reward and incentive plans are to be revised and if necessary, restructuring, re-engineering and redesigning becomes imperative. In short, the difficulties in affecting the organisational adjustments arise from the tasks associated with change. The success of strategy implementation, to a large extent, therefore, depends on the way the task of change management is carried out.

10.4 Barriers and Issues in Strategy Implementation

Management must keep in mind the following key issues that arise in implementing strategy and how empowering systems might relate to such issues.

1. ***Time Horizon:*** Such systems have both long-term and short-term dimensions. For example, rewards like productivity bonus should be based on quantitative measures of performance related

to the short-term. On the other hand, it is appropriate to link long-term rewards with qualitative measures and a few relevant quantitative measures.

2. ***Risk Considerations:*** When risk-prone behaviour is desired, qualitative measures of performance may be more beneficial, for example, rewards like bonus or stock options. This is because quantitative measures may lead to risk-averse behaviour to avoid failure rather than risk prone behaviour to achieve results.

3. ***Bases of Individual Rewards:*** Reward systems should be linked to an individual's capability,effort and job satisfaction. If rewards are geared to only one aspect, it may have a negativeeffect on performance in other aspects.

4. ***Bases of Group Rewards:*** An important issue in reward systems is whether to haveindividual rewards or group rewards. Rewarding individuals for effort and performance may be difficult unless the organisational structure permits individual performance to be isolated from that of others. Thus, for example, with respect to managerial contribution to corporate performance, individual rewards may be beneficial and appropriate because individual's contribution is relatively independent of others. On the other hand, if individual's contributions are relatively interdependent, it would be appropriate to adopt schemes based on group performance. Again, rewarding individuals may be necessary where entrepreneurial or creative behaviours are sought to be encouraged. On the contrary, if greater co-operation and team work is sought to be rewarded, group reward schemes would be more desirable.

5. ***Corporate and SBU Perspectives:*** In multi-divisional organisations, reward systems with a balanced approach towards corporate interests and the interests of the Strategic

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Business Units (SBUs) should be designed, where business units have greater autonomy and independence. Likewise, if the SBUs are not likely to influence corporate performance, unit-based reward schemes would be more beneficial. But in the case of directors andgeneral managers, placed in the units, who have dual responsibility of achieving unit aswell as corporate objectives, due care must be taken to design balanced empoweringenvironment.

10.5 Model for Strategy Implementation

According to Steiner and Miner, "the implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organisational purposes". Implementation of strategy therefore involves a number of interrelated decisions, choices, and a broad range of activities. It requires an integration of people, structures, processes etc. Mc Kinsey's 7-S model is good at capturing the importance of all these elements in the implementation of strategy. The 7-S framework was developed in 1970s by the well-known consultancy firm, the Mc Kinsey Company of the United States. The 7-S framework is illustrated :

- ***Strategy***
- ***Shared***
- ***Values***
- ***Structure***
- ***Systems***
- ***Staff***
- ***Skills Style***

The purpose of the model is to show the *interrelationship* between different elements of an organisation, and the need to bring them together.

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7-S Framework

This framework basically deals with organisational change. The main thrust of change is not connected only with the organisation's strategy. It has to be understood by the complex relationships that exist between ***strategy, structure, systems, style, staff, skills*** and ***super-ordinategoals***. These are called the 7-S of the organisation.

The 7-S framework suggests that there are several factors that influence an organisation's ability to change. The variables involved are interconnected so that altering one element may wellimpact other connected elements. Hence, significant changes cannot be achieved in any variablewithout making changes in all the variables. There is no starting point or implied hierarchy inthe shape of the diagram, so it is not obvious which of the 7 factors would be the driving forcein changing a particular organisation at a particular point of time. All the elements are equallyimportant. The critical variables of change could be different across organisations. They couldalso be different in the same organisation. Fundamentally, the framework makes the point that effective strategy implementation is more than an individual subject, but is coupled with skills, styles, structures, systems, staff and super-ordinate goals.

Super-ordinate Goals: "Super-ordinate goals" mean the "goals of a higher order which express the values, vision and mission that senior management brings to the organisation". These can be considered as the fundamental ideas around which a business is built. Hence, theyrepresent the main values and aspirations of an organisation. They are the broad notions offuture direction. They can be considered to be equivalent to "organisational purposes".

Structure: "Structure" means the organisational structure of the

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company. The design of organisational structure is a critical task of top management. Organisational structure refers tothe relatively more durable organisational arrangements and relationships. It prescribes the formal relationships among various positions and activities, communication channels, roles to be performed by various members of an organisation.

Organisational structure performs four major functions:

1. It reduces external uncertainty.
2. It reduces internal uncertainty due to variable, unpredictable and random human behaviour.
3. It provides a wide variety of devices like departm-entalization, specialization, division oflabour, delegation of authority etc.
4. It helps in coordinating various activities of the organisation and focus on its objectives.

Organisational structure must be designed in accordance with the needs of the strategy. According to Chandler, structure must follow strategy. In other words, changes in strategy must be followed by changes in organisational structure. According to McKinsey, the relationship between strategy and structure, though important, rarely provides unique structural solutions. Quite often the main problem in strategy relates to its execution.

Systems: "Systems" mean the procedures that make the organisation work. They include the rules, regulations and procedures, both formal and informal, that complement the organisational structure. Systems include production planning and control systems, cost accounting procedures, capital budgeting systems, performance evaluation systems etc. Often, changes in strategy require changes in systems.

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Style: "Style" means the way the company conducts its business. Top managers in organisations can use style to bring about change. Organisations differ from each other in their "styles" of working. The style of an organisation, according to the McKinsey framework, becomes evident through the patterns of actions taken by the top management team over a period of time. Thus, an important part of managing change is establishing and nurturing a good 'fit' between culture and strategy.

Staff: "Staff" refers to the pool of people who need to be developed, challenged and encouraged. It should be ensured that the staff has the potential to contribute to the achievement of goals.

Three important aspects about staff are:

1. Selecting meritorious people for specific organisational positions.
2. Developing abilities and skills in them, to take up challenging assignments.
3. Motivating them to give their best to achieve strategic goals.

Skills: "Skills" are the most crucial attributes or capabilities of an organisation. Skills in the 7-S framework can be considered as an equivalent of "distinctive competencies".

For example : Hindustan Lever is known for its marketing skills, TELCO for its engineering skills, IBM for its customer service, Du Pont for its research and development skills and Sony for its new product development skills. Skills are developed over a period of time and are a result of a number offactors. Hence, to implement a new strategy, it is necessary to build new skills.

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Strategy: "Strategy" is the long-term direction and scope of an organisation. It is the route that the company has chosen to achieve competitive success.

Alignment of the Framework

Successful implementation of strategy requires the right alignment of different elements within the organisation. The Mc Kinsey consultants call *strategy*, *structure*, *and systems* as the *"hard elements*" of the organisation and the other 4 Ss i.e. *style, skills, staff and super-ordinate goals* as the *"soft elements"* of the organisation. The hard elements are more tangible and definite, and so they are often the ones that gain the greater attention, however, the soft elements are equally important, even if they are less easy to measure, assess and plan.

10.6 Resource Allocation

Most strategies need resources to be allocated to them if they are to be implemented successfully. Let us examine some special circumstances that may affect the allocation of resources. Resource allocation deals with the procurement and commitment of financial, physical and human resources to strategic tasks for achievement of organisational objectives. This involves the process of providing resources to particular business units, divisions, functions etc for the purpose of implementing strategies. All organisations have at least five types of resources:

1. Physical Resources
2. Financial Resources
3. Human Resources
4. Technological Resources
5. Intellectual Resources

These resources may already exist in the organisation or may have to be acquired. Resource allocation decisions are very critical in that they set the operative strategy for the firm. Resource allocation decisions about how much to invest in which areas of business reinforce the strategy and commit the organisation to the chosen strategy.

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10.6.1 Importance of Resource Allocation

A company's ability to acquire sufficient resources needed to support new strategic initiatives and steer them to the appropriate organisational units has a major impact on the strategy implementation process. Too little funding arising from constrained financial resources or from sluggish management action slows progress and impedes the efforts of organisational units to execute their part of the strategic plan effectively. At the same time, too much funding wastes organisational resources and reduces financialperformance. Both these extremes emphasize the need for managers to be careful about resource allocation. Resource allocation becomes a critically important exercise when there are majorshifts from the past strategies in terms of product/ market scope. For example, if the firm'sstrategy is expansion in one line, withdrawal from another and stability in the rest of theproducts, then greater resources will have to flow to the first and lesser to the second and thethird. Similarly, if the strategy is to develop competitive edge through product development, greater resources will have to be committed to R&D. Resource allocation is a powerful means of communicating the strategy in the organisation as itgives the signals to all concerned. It will demonstrate what strategy is really in operation.Resource allocation decisions should be taken judiciously because using a formula approach (i.e. allocating funds as a percentage of sales or profits), may be inappropriate and counterproductive.Care should be taken to see that the resources are not allocated or withdrawn because of easy availability or paucity.

Check Your Progress

Why is it said that using a formula approach in resource allocation may be counterproductive. Discuss with reasons accompanied with examples?

10.6.2 Managing Resource Conflict

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The common approach to resource allocation is through budgetary system. There are however, many other tools, which can be used for this purpose. Some of the important tools used for resource allocation are discussed below:

BCG Matrix

The BCG matrix, which is generally used for portfolio analysis, can also be used as a guideline for resource allocation. The surplus resources from "cash cows" can be reallocated to "stars" or "question marks". In so far as businesses categorized as "dogs" are concerned, with low growth and low market share, they may not need any thrust, and resources can be gradually withdrawnfrom such businesses and invested in other promising businesses. The BCG matrix is a useful tool because it impresses upon a portfolio approach to resourceallocation. It helps in averting over-investment in any particular type of business and underinvestmentin promising businesses from the long-term perspective. Despite the utility of theBCG matrix, however, it should be used with care and only as a guideline. It does not provide aconcrete measure for making a finer choice, particularly among the businesses of the samenature.

PLC-based Budgeting

Resource allocation can also be linked to different stages of a Product Life Cycle (PLC). A product in introductory and growth stages may require more resources than a product in mature and decline stages.

Zero-based Budgeting (ZBB)

The key differences between ZBB and traditional budgeting is that ZBB requires managers to justify their budget requests in detail from the scratch, without relying on the previous budget allocations.

Therefore, instead of taking the last year's budget as the base for projecting the future allocations, ZBB forces the managers to review the objectives and operations afresh and justify the budget requests. ZBB is, therefore, a type of budget that requires managers to rejustify the past objectives, projects and budgets and set priorities for the future. It amounts to recalculationof all organisational activities to see which should be eliminated or funded at a reduced orincreased level.

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Capital Budgeting

Capital Budgeting techniques can be used for long-term commitment of resources, such as capital investments in mergers, acquisitions, joint ventures, and setting up of new plants etc. Various techniques like payback period, net present value, internal rate of return, etc. can be used to find which investments would earn maximum returns.

Operating Budgets

Operating budgets are necessary for more routine resource allocation for conducting operations. There are two types of systems:

1. ***Fixed budgeting system:*** This system commits resources based on activity levels. In this type of budgeting, there may be a tendency to retain the committed resources even if the activity levels are not being achieved, thus depriving other divisions of the resources, which have a better potential.
2. ***Flexible budgeting system:*** This system provides for transfer of funds from one unit to another if a fall is expected in actual activity level in a particular unit, thus ensuring better resource utilization. But this system has the disadvantage of encouraging non-seriousness about budgetary allocations.

10.6.3 Criteria for Resource Allocation Process

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In large, diversified companies, the corporate office plays a major role in allocating resources among various strategies proposed by its operating units or divisions. In many cases, product groups, business units or functional areas may bid for funds to support their strategic proposals.

There are three criteria which can be used when allocating resources.

1. ***Contribution towards fulfillment of organisational objectives:*** At the centre of the organisation, the resource allocation task is to steer resources away from areas that are poor at delivering the organisation's objectives and towards those that are good at delivering the organisation's objectives.

2. ***Support of key strategies :*** In many cases, the problem with resource allocation is that the requests for funds usually exceed the funds normally available. Thus, there needs to be some further selection mechanism beyond the delivery of the organisation's mission and objectives. This second criterion relates to two aspects of resource analysis:

   (a) Support of core competencies : Resources should develop and enhance core competencieswhich, in turn, help achieve competitive advantage.

   (b) Enhancement of value chain activities : Resources should assist particularly those activities of the value chain which help the organisation to achieve low cost or differentiation and thereby enhance and sustain competitive advantage of the firm.

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(c) ***Risk-acceptance level of the organisation:*** Clearly, if the risk is higher, there is a lower likelihood that the strategy will be successful. Some organisations will be more comfortable with accepting higher levels of risk than others. So, the criterion in this case needs to be considered in relation to the risk-acceptance level of the organisation.

10.6.4 Factors affecting Resource Allocation

Resource allocation may not necessarily be a purely 'rational' decision-making process. It is also a behavioural and political process involving people who may be motivated by different objectives. Some of the major factors affecting resource allocation are discussed below:

1. ***Objectives of the organisation:*** People motivated by different objectives exercise theirinfluence over the funding of projects. There are two types of objectives. Official (explicit) objectives and operative (implicit) objectives. Allocations of resources are more guided by implicit objectives than explicit objectives. The formal and informal organisations also influence the perception of which projects should be chosen for funding.
2. ***Powerful units:*** Sometimes, powerful SBU heads secure larger allocation of funds than their 'fair share'.
3. ***Dominant strategists:*** The preferences of dominant strategists like the CEO, Directors, SBU heads, etc. are reflected in the way resources are allocated. The divisional and departmental heads know that such preferences matter and try to present their demands in line with them.

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4. ***Internal politics:*** Resources are often construed as power, and those units, which manage to secure substantial resources, are perceived as more powerful than others. Internal politics within the organisation to secure more and more resources, affect the process of resource allocation.
5. ***External influences:*** Apart from internal politics, external influences like government policy, demands of shareholders, financial institutions, community and others, also affect resource allocation. For example, legal requirements may require additional finances in labour welfare and social security, pollution control, safety equipments and energy conservation. The shareholders may expect higher dividends, and resources have to be directed to them. Financial institutions may impose restrictions or require companies to invest in technology up-gradation and R&D. Similarly, the discharge of social responsibilities by the firm requires allocation of sufficient funds. Thus, external influence affect the process of resource allocation.

10.6.5 Difficulties in Resource Allocation

The resource allocation process can sometimes become fairly complex, and may even create several difficulties to the strategists. Some of the difficulties that can create problems are:

1. ***Scarcity of Resources:*** Resources are hard to find. Even if finance is available, the cost ofcapital could be a constraint. Non-availability of highly skilled people could be another problem.

2. ***Restrictions on Generating Resources:*** Within organisations, the new units which have greater potential

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for growth in the future, may not be able to generate resources in the short run. Allocation of resources on par with existing SBUs, divisions and departments through the usual budgeting process, will put them at a disadvantage.

3. ***Bloated Demands:*** Unit managers may sometimes submit inflated or overstated demands for funds to guard against any budget-cuts. This subverts the decision process.

4. ***Negative Attitude:*** Units, which do not get the desired allocations, may develop a negative attitude towards the corporate managers. They may work at cross purposes, which may obstruct the implementation of the intended strategy.

5. ***Budget Battles:*** The actual allocation of funds to any unit has a major effect on the work environment of the unit and the career of the manager concerned. If a manager loses the 'budget battle', his subordinates feel that the manager has failed them, and may not cooperate with him.

6. ***Budgetary Process:*** The budgetary process itself can lead to problems if it is not tied to the strategic plans of the firm. If top management fails to communicate the shifts in the strategic plans and the lower levels are unaware of the shifts, any intended strategy is unlikely to succeed.

7. ***New SBUs:*** The budgetary process is tied to the way units and divisions are arranged organisationally. New SBUs can be at a disadvantage if they are unaware of the intricacies of the budget procedures used in their organisations.

To avoid the above difficulties, strategists should pay maximum attention to resource allocation, and 'prioritize' budgeting allocations in the initial stages taking overall objectives into account.

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10.7 Summary

- Most strategies need resources to be allocated to them if they are to be implemented successfully.
- A successful strategy formulation does not guarantee successful strategy implementation.
- It affects an organisation from top to bottom; it affects all divisional and functional areas of business.
- Implementation of strategy involves a number of interrelated decisions, choices, and a broad range of activities. It requires an integration of people, structures, processes etc.
- Mc Kinsey's 7-S model is good at capturing the importance of all these elements in the implementation of strategy.
- A company's ability to acquire sufficient resources needed to support new strategic initiatives and steer them to the appropriate organisational units has a major impact on the strategy implementation process.

10.8 Key Terms

Bottom-up Approach: In this approach, resources are distributed through a process of aggregation from the operating level. The operating levels work out the requirements of each subunit and the resources are allocated accordingly.

Capital Budgeting: used for long-term commitment of resources, such as capital investments in mergers, acquisitions, joint ventures etc.

McKinsey 7-S Model: A model of organisational effectiveness that postulates that there areseven internal factors of an organisation that needs to be aligned and reinforced in order for it to be successful.

Operating Budget: Necessary for more routine resource allocation for conducting operations.

Top-down Approach: In this approach, resources are allocated through a process of segregation down to the operating levels. The Board of Directors, the Managing Director or members of top management typically decide the requirements of each subunit and distribute resources accordingly,.

Zero Based Budgeting: Budget requests in detail from the scratch, without relying on the previous budget allocations.

10.9 Questions and Exercises

1. Does a successful strategy formulation guarantee a successful implementation? Why/ why not?
2. "Strategic decisions to be communicated and understood throughout the organisation". Elucidate.
3. Why is it said that using a formula approach in resource allocation may be counterproductive. Discuss with reasons accompanied with examples.
4. "There has to be a "fit" between the strategy and the organisation." Substantiate
5. "Formulation and implementation are inextricably linked". Discuss
6. Bring out the differences between formulation and implementation of strategy.
7. Discuss the relevance of McKinsey's 7-S model in modern business organisations.
8. Critically evaluate the McKinsey's 7-S Model.
9. "Resource allocation is a powerful tool to communicate the strategies of the organisation". Justify.

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Check your progress

Fill in the blanks:

1. ....are the core values of the company that are evidenced in the corporate culture and the general work ethic.
2. ....represents the competencies of the employees working for the company.
3. Resource allocation deals with the ....and .... of financial, physical and human resources to strategic tasks.
4. .... budget specifies materials, labour, overheads and other costs.
5. .... and 'political' considerations are inevitable in a typical organisation.
6. The common approach to resource allocation is through .... system.
7. In BCG Matrix, the .... represent low growth and low market share.
8. .... budgeting system provides for transfer of funds from one unit to another if a fall is expected in actual activity level in a particular unit.
9. .... budgeting techniques can be used for long-term commitment of resources.
10. The problem with resource allocation is that the requests for funds usually .... the funds normally available.

Answers:

1. Super ordinate goals 2. Skills 3. Procurement, commitment 4. Operating 5. 'Behavioural' 6. Budgetary 7. "Dogs" 8. Flexible 9. Capital 10. Exceed

10.10 Further Reading and References

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UNIT 11: STRUCTURAL IMPLEMENTATION

11.0 Unit Objectives

11.1 Introduction

11.2 Basic Principles of Organisational Structure

11.3 Relation between Strategy and Structure

11.4 Improving Effectiveness of Traditional Organisational Structures

11.5 Types of Organisational Structures

11.6 Modular Organisation

11.7 Towards Boundary less Structures

11.8 Structures for Strategies

11.9 Summary

11.10 Key Terms

11.11 Questions and Exercises

11.12 Further Reading and References

11.0 Unit Objectives

After studying this unit, you should be able to:

- Describe the types of organisational structures
- Define organisational design and change
- Explain the structures for strategies

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11.1 Introduction

To implement its strategy successfully a firm must have an appropriate organisational structure. An organisational structure is a set of formal tasks and reporting relationships which provide a framework for control and coordination within the organisation. The visual representation of an organisational structure is called organisational chart. The purpose of an organisational structure is to coordinate and integrate the efforts of employees at all levels – corporate, business and functional levels – so that they work together to achieve the specific set of strategies. Organisational structure is a tool that managers use to harness resources for getting things done.It is defined as:

1. The set of formal tasks assigned to individuals and departments.
2. Formal reporting relationships, including lines of authority, responsibility, number of hierarchical levels and span of manager's control.
3. The design of systems to ensure effective coordination of employees across departments. The set of formal tasks and formal relationships provides a framework for vertical control of the organisation.

There are two different aspects of the organisational structure:

1. ***Superstructure :*** This is the highly visible part of the organisational structure. This depicts how people are grouped into different divisions, departments and sections and how they are related to each other. The superstructure also indicates the principal ways in which the organisational operations are integrated and coordinated. By showing their levels, it indicates which groups have relatively more strategic importance.

2. ***Infrastructure:*** This is comparatively less visible part of the organisational structure. It is concerned with issues like delegation of authority, specialization, communication, information systems and procedures. The infrastructure enables the organisation to engagein a number ofdisparate activities and still keep them coordinated. The design of organisational structure is a critical task of the top management of an organisation. It is the skeleton of the whole organisation. It provides relatively more durable organisational arrangements and relationships.

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Thus, an organisational structure fulfils two fundamental and opposing requirements:

1. Division of labour into various tasks
2. Coordination of these tasks to accomplish effective control of an organisation.

However, as an organisation grows and becomes more complex, it needs appropriate changes in its design.

11.2 Basic Principles of Organisational Structure

There are several important principles of organisation, which need to be understood before building an organisation's structure. They are:

Check Your Progress

Do you agree with the statement that work can be performed more efficiently if employees are allowed to specialize? Why/why not?

1. ***Hierarchy:*** Hierarchy defines who reports to whom and the span of control. Span of control is the number of people reporting to a supervisor. It determines how closely a supervisor can monitor subordinates. Tall structures have many levels in the hierarchyand a narrow span. Communication up and down the hierarchy becomes difficult. Flatstructures are horizontally

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dispersed having fewer levels in the hierarchy. The trend inrecent years has been towards flat structures allowing for wider spans of control as a wayto facilitate better communication and co-ordination.

2. ***Chain of Command:*** The chain of command is an unbroken line of authority that links all persons in an organisation and shows who reports to whom. It has two underlying principles. Unity of command means that each employee is held accountable to only onesupervisor. The scalar principle means a clearly defined line of authority in the organisation.Authority and responsibility for different tasks should be distinct. All persons in the organisation should know to whom they report as well as the successive management levels all the way to the top.

3. ***Specialization :*** Specialization, sometimes called division of labour, is the degree to which organisational tasks are subdivided into separate jobs. Work can be performed more efficiently if employees are allowed to specialize. This is because an employee in each department performs only the tasks relevant to his specialized function. Despite the apparent advantages of specialization, many organisations are moving away from this principle. With too much specialization, employees are isolated performing only a single, boring job. Many companies are, therefore, enlarging jobs to provide greater challenges or assigning tasks to teams so that employees can rotate among several jobs performed by the team.

4. ***Authority, Responsibility and Delegation:*** Authority is the formal and legitimate right of a manager to make decisions, issue orders, allocate resources and command obedience. Responsibility is the duty to perform the task or activity an employee has been assigned. Accountability means that the people with authority and responsibility are subject to reporting and justifying task outcomes to those above them in the chain of command.

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Delegation is the process managers use to transfer authority and responsibility to positions below them in the hierarchy. The principle is that there must be parity between authority and responsibility. It means managers can be made accountable for results only when they are delegated with sufficient authority commensurate with the responsibility. Most organisations today encourage managers to delegate authority to the lowest possible level to provide maximum flexibility to meet customer needs and adapt to the environment. Managers are encouraged to delegate authority, although they often find it difficult.

5. ***Centralization and Decentralization:*** Centralization and decentralization refer to the level at which decisions are made. Centralization means that decision-making is done atthe top levels of the organisation. Decentralization means that decision making is pushed down to the lower levels in the organisation. Centralization helps in better coordination, but too much centralization results in slow response and demotivates people at lower levels. Decentralization relieves the burden on top managers, makes greater use of worker's skills, ensures decision making by well-informed people and permits rapid response to external changes. But it does not mean that every organisation should decentralize. Managers should diagnose the organisational situation and select the decision-making level.

6. ***Formalization:*** Formalization is the extent to which written documentation is used to direct and control employees. Written documentation includes rules, regulations, policies, procedures, job descriptions etc. They are inexpensive ways to coordinate activities. These documents complement the organisational structure by providing descriptions of tasks, responsibilities

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and authority. The use of rules and regulations is a part of bureaucratic model of organisation.

7. ***Departmentalization:*** Another fundamental characteristic of organisational structure is departmentalization, which means grouping positions into departments and departments into the total organisation.

11.3 Relation between Strategy and Structure

Strategic management posits that the strategy and the organisation structure of the firm must match. In a classic study of large U.S. corporations such as DuPont, General Motors, Sears, and Standard Oil, Alfred Chandler concluded that structure follows strategy. This means that changes in corporate strategy lead to changes in organisational structure. He also concluded that organisations follow a pattern of development from one kind of structural arrangement to another as they expand. According to Chandler, these structural changes occur because the old structure was not suitable. Chandler therefore proposed the following as the sequence of what occurs:

1. New strategy is created
2. New administrative problems emerge
3. Economic performance declines
4. New appropriate structure is invented
5. Profit returns to its previous level

Chandler found that in their early years, corporations such as DuPont and General Motors had a centralized functional structure, which was suitable for a limited range of products. As they added new product lines and created their own distribution networks, the old structure became too complex. Therefore, they shifted to a decentralized structure with several autonomous divisions.

11.4 Improving Effectiveness of Traditional Organisational Structures

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In the changed times and situations, traditional organisational structure is crumbling under the weight of ever-increasing regulations that drive greater accountability and transparency. Smart companies are on the forefront of building new and improved structures that support and enhance this new compliance environment, and best practices are emerging. The best structure for an organisation is determined by many aspects of its situation – the technology, size, environment and strategy. Frequently, structures evolve as the organisation moves from one stage of growth to the next. The external and internal environments affectstructural design in different ways.

Rate of Change : When the organisation operates in a more dynamic environment, it needs to be able to respond quickly to the rapid changes that occur. In static environments, change is slow and predictable and does not require great sensitivity on the part of the organisation. In dynamic environments, the organisation structure and its people need to be flexible, well co-ordinated and able to respond quickly to outside influences. The dynamic environment implies a more flexible, organic structure.

Degree of Complexity : Some environments can be easily monitored from a few key data movements. Others are highly complex, with many influences that interact in complex ways. One method of simplifying the complexity is to decentralize decisions in that particular area. The complex environment will usually benefit from a decentralized structure.

Market Complexity : Some organisations sell a single product or variations on one product. Others sell ranges of products that are essentially diverse. As markets become more diverse, there

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is usually a need to divisional the organisation as long as synergy or economies of scale are unaffected.

Competitive Situations : With friendly rivals, there is no great need to seek the protection of the centre. In deeply hostile environments, however, extra resources and even legal protection may be needed; these are usually more readily provided by central headquarters. As markets become more hostile, the organisation usually needs to be more centralized.

11.5 Types of Organisational Structures

There are seven basic types of organisational structures:

1. Simple structure
2. Functional structure
3. Divisional structure
4. SBU structure
5. Matrix structure
6. Network structure
7. Virtual structure

Let us understand each of them briefly.

1. ***Simple Structure:*** In this structure, the owner-manager controls all activities and makes all the decisions. This structure may be appropriate for small and young organisations. Coordination of tasks is done through direct supervision. There is little specialization of tasks, few rules and regulations and communication is informal.
2. ***Functional Structure:*** Functional structures are grouped based on major functions performed. Each function is led by a functional specialist. Functional structures are formed in organisations in which there is a single or closely related products or services.

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3. ***Divisional Structure :*** Divisional structures are used by diversified organisations. In a divisional structure, divisions are created as self-contained units with separate functional departments for each division. A division may be organised around geographic area, products, customers etc. The head office determines corporate strategy, allocates resources among divisions and appoints and rewards the heads of these divisions. Each division is responsible for product, market and financial objectives for the division as well as their division's contribution to overall corporate performance.
4. ***Matrix Structure :*** The matrix structure is, in effect, a combination of functional and divisional structures. In this structure, there are functional managers and product or project managers. Employees report to one functional manager and to one or more project managers. For example, a product group wants to develop a new product. For this project it obtains personnel from functional departments like Finance, Production, Marketing, HR, Engineering etc. These personnel work under the product manager for the duration of the project. Thus, they are responsible for two managers – the product manager and the manager of their functional area. While functional heads have vertical control over the functional managers, the product or project heads have horizontal control over them. Thus, matrix structure provides a dual reporting. The dual lines of authority makes the matrix structure unique. The matrix structure has been used successfully by companies such as IBM, Unilever, Ford Motor Company etc.
5. ***Network Structure:*** A network organisation outsources or subcontracts many of its major functions to separate companies and coordinates their activities from a small headquarters. Rather than being housed under one roof,

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activities like design, manufacturing, marketing, distribution etc. are outsourced to separate organisations that are connected electronically to the central office.

6. ***Virtual Organisation:*** This is an extension of the network structure. In this approach, independent organisations form temporary alliances to exploit specific opportunities, then disband when their objectives are met. The term virtual means "being in effect but not actually so". The virtual organisations consist of a network of independent companies – suppliers, customers or even competitors – linked together to share skills, costs, markets and rewards. The members of a virtual organisation pool and share the knowledge and expertise of each other.

11.6 Modular Organisation

The organisational capabilities to interact with others have been greatly improved as a result of modern information and communications technologies: Nowadays a company can maintain more relationships with more companies at much lower costs than before. The increased business networks require modularization of the products, the processes and the firm in order to be effective. Modular products tend to favour a modular organisation form, as the various units involved in the design process of products with interchangeable components are loosely coupled,operate autonomously, and can be easily reconfigured. The concept of modularity can be applied not only to complex product system design, but also to business system interpretation and design. A modular organisation is one in which different functional components are separated from one another, a technique adopted from software engineering. A modular organisation is in contrast to a composite organisation in which there is no separation between functions. Modular organisation is also distinct from hierarchical organisation. Modular

organisation is chiefly concerned with the horizontal design of a system. Modularity allows components to be produced separately and used interchangeably in different configurations without compromising system integrity. In modular organisations, coordination tasks are delegated to individual modules (functions, teams, etc.) and coherence is achieved easily through fully specified interfaces. In addition to the reduction of managerial complexity, this structural, hierarchical function-based decomposition results in the localization of the impacts of environmental disturbances within specific modules, increasing the immunity and adaptability of the overall organisation in a turbulent environment.

11.7 Towards Boundary less Structures

Traditional companies with boundaries, rules, and extensive plans are at a supreme disadvantage in today' globalized world, where technology changes daily and the value chain commands changes of its own. In a traditional company where people are categorized into neatly defined positions with their job descriptions filed in triplicate in the Human Resources department, the way a company plans its business can cause it to sink despite planning because the boundaries can mean lost opportunities, being overtaken by the competition, loss of revenues, or watching its niche slip away because of a new technology, an alteration in the global marketplace, or simply a failure to market its product effectively. When changes occur, they happen too quickly for its organisational processes to meet them; as a result, opportunities are quickly lost, problem situations take over rapidly, and before the company can respond appropriately, it has lost customers, opportunities, and market share. Although that company likely has more than enough talent within its walls to offset all of those disasters, the talent is never put to use, because employees are constrained to operate within the confines of their job descriptions,

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where only the prescribed talents can be put to good use. The answer to this dilemma lies in boundary less organisations. A boundary less organisation is a contemporary approach to organisational design. It is an organisation that is not defined by, or limited to, the horizontal, vertical, or external boundaries imposed by a predefined structure. This term was coined by former GE chairman Jack Welch because he wanted to eliminate vertical and horizontal boundaries within GE and break down external barriers between the company and its customers and suppliers.

11.8 Structures for Strategies

To understand the logic behind this approach to the development of organisational structures, it is helpful to look at the historical background. As already mentioned, prior to the early 1960s, the US strategist Alfred Chandler studied how some leading US corporations had developed their strategies in the first half of the twentieth century. He then drew some major conclusions from this empirical evidence, the foremost one being that the organisation first needed to develop its strategy and, after this, to devise the organisation structure that delivered that strategy. Chandler drew a clear distinction between devising a strategy and implementing it. He defined strategy as: "The determination of the basic long-term goals and objective of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals". The task of developing the strategy took place at the corporate and business levels of the organisation. The job of implementing it then fell to the various functional areas. Chandler's research suggested that, once a strategy had been developed, it was necessary to consider the structure needed to carry it out. A new strategy might require extra resources, or new personnel or equipment which would alter the work of the enterprise.

Check Your Progress

In your opinion, which aspects of an organisation determine the best design for it?

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Strategy and Structure are Interlinked

According to modern strategists, strategy and structure are interlinked. It may not be optimal for an organisation to develop its structure after it has developed its strategy. The relationship is more complex in two respects:

1. *Strategy and the structure associated with it may need to develop at the same time in an experimental way* : As the strategy develops, so does the structure. The organisation learns to adapt to itschanging environment and to its changing resources, especially if such change is radical.
2. *If the strategy process is emergent, then learning and experimentation involved may need a more open and less formal organisation structure.*

Managing the Complexity of Strategic Change

Quinn suggests that strategic change may need to proceed incrementally, i.e. in small stages. Hecalled the process "logical incrementalism". The clear implication is that it may not be possible to define the final organisation structure, which may also need to evolve as the strategy moves forward incrementally. He recognizes the importance of informal organisation structures in achieving agreement to strategy shifts. If the argument is correct, it will be evident that any idea of a single, final organisation structure – after deciding on a defined strategy – is dubious.

Criticism of the Strategy – First, Structure- Afterwards Process

1. Structures may be too rigid, hierarchical and bureaucratic to cope with the newer social values and rapidly changing environment.
2. The type of structure is just as important as the business area

in developing the organisation's strategy. It is the structure that will restrict, guide and form the strategy.

3. Value chain configurations that favour cost cutting or, alternatively, new market opportunities may also alter the organisation required.
4. The complexity of strategic change needs to be managed, implying that more complex organisational considerations will be involved. Simple configurations such as a move from a functional to a divisional structure are only a starting point in the process.
5. The role of top and middle management in the formulation of strategy may also need to be reassessed: Chandler's view that strategy is decided by the top leadership alone has been challenged. Particularly for new, innovative strategies, middle management and the organisation's culture and structure may be important. The work of the leader in empowering middle management may require a new approach – the organic style of leadership.

The Concept of 'Strategic Fit'

Although it may not be possible to define which comes first, there is a need to ensure that strategy and structure are consistent with each other. For example, Pepsi Co reorganised its North American business to ensure that its strengths in the growing non-carbonated drinks market could be exploited across its full range of drinks. For an organisation to be economically effective, there needs to be a matching process between the organisation's strategy and its structure. This is the concept of strategic fit. In essence, organisations need to adopt an internally consistent set of practices in order to undertake the proposed strategy effectively. It should be said that such practices will involve more than the organisation's structure. They will also cover such areas as reward systems, information systems and

processes, culture, leadership styles, etc. There is strong empirical evidence, both from Chandler and Senge, that there does need to be a degree of strategic fit between the strategy and the organisation structure. Although the environment is changing all the time, organisations may only change slowly and not keep pace with external change, which can often be much faster – for example, the introduction of digital technology. It follows that it is unlikely that there will be a perfect fit between the organisation's strategy and its structure. There is some evidence that a minimal degree of fit is needed for an organisation to survive. It has also been suggested that, if the fit is ensured early during the strategic development process, then higher economic performance may result. However, as the environment changes, the strategic fit will also need to change.

11.9 Summary

Organisations are structured in a variety of ways, dependant on their objectives and culture. The structure of an organisation will determine the manner in which it operates and it's performance. Structure allows the responsibilities for different functions and processes to be clearly allocated to different departments and employees. The wrong organisation structure will hinder the success of the business. Organisational structures should aim to maximize the efficiency and success of theorganisation.An effective organisational structure will facilitate working relationships between various sections of the organisation. It will retain order and command whilst promoting flexibility and creativity. Internal factors such as size, product and skills of the workforce influence the organisational structure. As a business expands the chain of command will lengthen and the spans of control will widen. The higher the level of skill each employee has the more the business will make use of the matrix structure to maximize these skills across the organisation.

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11.10 Key Terms

Agile Organisation: A firm that identifies a set of business capabilities central to high profitability operations and then build a virtual organisation around those capabilities.

Chain of Command: an unbroken line of authority that links all persons in an organisation and shows who reports to whom

Formalization: extent to which written documentation is used to direct and control employees.

Hierarchy: defines who reports to whom and the span of control

Infrastructure: concerned with issues like delegation of authority, specialization, communication, information systems and procedures

Modular Organisation: An organisation in which different functional components are separated from one another.

Outsourcing: subcontracting a service with another company or person to do a particular function.

Span of Control: The number of employees that each manager/ supervisor is responsible for. ***Superstructure:*** depicts how people are grouped into different divisions, departments and sections and how they are related to each other.

Virtual Organisations: consist of a network of independent companies - suppliers, customers or even competitors linked together to share skills, costs, markets and rewards.

11.11 Questions and Exercises

1. In your opinion, what fundamental requirements does an organisational structure fulfill?
2. Do you agree with the statement that work can be performed more efficiently if employees are allowed to specialize? Why/ why not?

3. What do you see as the reason behind the recent trend of most organisations encouraging managers to delegate authority to the lowest possible level?
4. In your opinion, which aspects of an organisation determine the best design for it?
5. Compare and contrast the functional and divisional structures?
6. Give example of an organisation that has successfully employed the matrix structure. Analyse its success mantra.
7. Prove that network structure can weaken the employee loyalty.
8. Illustrate the advantages due to which some organisations sell a single product or variations on one product.
9. "Being boundary-less can be the disadvantages for an organisation". Explain
10. Suggest any three advantages of modular organisations.

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Check your progress

Fill in the blanks:

1. The .... indicates the principal ways in which the organisational operations are integrated and coordinated.
2. The .... enables the organisation to engage in a number of disparate activities.
3. .... means that each employee is held accountable to only one supervisor.
4. .... means that decision-making is done at the top levels of the organisation.
5. The .... principle means a clearly defined line of authority in the organisation.
6. .... is the process managers use to transfer authority and responsibility to positions below them in the hierarchy.
7. The process of designing an organisation's structure to match with its situation is called ....

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8. Divisional structures are used by .... organisations.
9. The .... structure is, in effect, a combination of functional and divisional structures.
10. A .... organisation outsources or subcontracts many of its major functions to separate companies.
11. The complex environment will usually benefit from a .... structure.
12. As markets become more hostile, the organisation usually needs to be .... centralized.
13. A .... organisation is an organisation that is not defined by, or limited to, the horizontal, vertical, or external boundaries imposed by a predefined structure.
14. The biggest advantage of an agile virtual organisation is it can draw on .... worldwide.
15. A modular organisation is in contrast to a .... organisation.

Answers:

1. superstructure 2. Infrastructure 3. Unity of command 4. Centralization 5. scalar 6. Delegation 7. organisational design 8. Diversified 9. matrix 10. Network 11. decentralized 12. More 13. boundaryless 14. Expertise 15. Composite

11.12 Further Reading and References

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UNIT 12: BEHAVIOURAL IMPLEMENTATION

12.0 Unit Objectives

12.1 Introduction

12.2 Stakeholders and Strategy

12.3 Strategic Leadership

    12.3.1 Leadership Approaches

12.4 Corporate Culture and Strategic Management

    12.4.1 Influence of Culture on Behaviour

    12.4.2 Creating Strategy Supportive Culture

12.5 Personal Values and Ethics

    12.5.1 Importance of Ethics

    12.5.2 Approaches to Ethics

    12.5.3 Building an Ethical Organisation

12.6 Social Responsibility and Strategic Management

    12.6.1 Responsibilities of Business

    12.6.2 Need for CSR: The Strategy

12.7 Summary

12.8 Key Terms

12.9 Questions and Exercises

12.10 Further Reading and References

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12.0 Unit Objectives

After studying this unit, you should be able to:

- Explain the concept of stakeholder management
- Describe the concept of strategic leadership
- Discuss the corporate culture and strategic management
- Identify the role of personal values and ethics
- Realise the concept between social responsibility and strategic management

12.1 Introduction

Successful strategy formulation does not at all guarantee successful strategy implementation. It is always more difficult to actually carry out something than to say you are going to do it. Strategy implementation requires support, discipline, motivation and hard work from all managers and employees. Managers should pay careful attention to a number of key issues while executing the strategies. Chief among them are how the organisation should be structured to put its strategy into effect and how such variables as leadership, power and organisational culture should be managed to enable employees to work together while implementing the firm's strategic plans. Organisations in stable, predictable environments often become relatively tall, with many hierarchical levels and narrow spans of control. On the other hand, companies in dynamic, rapidly changing environments usually adopt flat structures with few hierarchical levels and wide spans of control.

12.2 Stakeholders and Strategy

A firm's stakeholders are the individuals, groups, or other organisations that are affected by and affect the firm's decisions and actions. Depending on the specific firm, stakeholders mayinclude

government, employees, shareholders, suppliers, distributors, the media and even the community in which the firm is located among many others.

1. When it comes to corporate mission values stakeholders will maximise the value for allstakeholders, as opposed to shareholders who only maximise the value for themselves.
2. Stakeholders also play a role in the decision making process in a business. Although since employees and customers are included in being stakeholders they too are considered when it comes to decision making.
3. When it comes to accountability it does not just come down to being accountable to themselves. Accountability lies with the customer, suppliers, government, community and employee stakeholders.

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Stakeholder Management

An organisation needs to have an effective stakeholder management system in place, which provides a great support in achieving its strategic objectives. It interprets and influences both the external and internal environments and creates positive relationships with stakeholders through the appropriate management of their expectations and agreed objectives. Stakeholder Management is a process and control that must be planned and guided by underlying principles. Stakeholder Management, within business or projects, prepares a strategy that utilises informationor intelligence collected during the following common processes:

Check Your Progress

Assess the value of stakeholders in an organsiation. Why is it important to manage the stakeholders well?

1. ***Stakeholder Identification:*** identify the parties, either internal or external to organisation, that are affected by the business. For this purpose, a stakeholder map can be used.

2. ***Stakeholder Analysis:*** identify and acknowledge stakeholder's needs, concerns, wants, authority, common relationships, interfaces, and put this information in line

NOTES

within the Stakeholder Matrix.

3. ***Stakeholder Matrix:*** position the stakeholders on a matrix based on their level of influence, impact or enhancement they may provide to the business or its projects.
4. ***Stakeholder engagement:*** engaging stakeholders does not seek to develop the project/ business requirements, solution or problem creation, or establishing roles and responsibilities. The process focuses on knowing and understanding each other, at the Executive level. It gives an opportunity to discuss and agree expectations of communication and, primarily, agree a set of Values and Principles that all stakeholders will abide by.
5. ***Communicating Information:*** expectations are established and agreed for the manner in which communications are managed between stakeholders - who receives communications, when, how and to what level of detail. Protocols may be established including security and confidentiality classifications.

12.3 Strategic Leadership

Leadership is the art and process of influencing people so that they will strive willingly and enthusiastically towards achievement of the organisation's purpose. Specific styles of leadership are often associated with specific approaches to the crafting and execution of strategies. The organisation's purpose and strategy do not just drop out of a process of discussion, but are actively directed by an individual with strategic vision, whom we call "strategic leader". Strategic leadership establishes the firm's direction by developing and communicating a vision of the future and inspiring organisation members to move in that direction. Unlike managerial leadership which is generally concerned with the short-term day-to-day activities, strategic leadership is concerned with determining the firm's strategy, direction, aligning the firm'smstrategy with its culture,

modeling and communicating high ethical standards, and initiatingmchanges in the firm's strategy when necessary. The most successful leadership is not just tom define the vision and mission of an organisation in a cold, abstract manner but to communicate trust, enthusiasm and commitment to strategy.

Leaders play a central role in performing six critical and interdependent activities in implementation of strategies:

1. ***Clarifying strategic intent:*** Leaders motivate employees to embrace change by setting forth a clear vision of where the business's strategy needs to take the organisation.

2. ***Setting the Direction:*** Leaders set the direction and scope of the organisation through formulating appropriate corporate and business strategies.

3. ***Building the organisation:*** Since leaders are attempting to embrace change, they are often required to rebuild their organisation to align it with the ever – changing environment and needs of the strategy. And such an effort often involves overcoming resistance to change and addressing problems like the following:

(a) Ensuring a common understanding about organisational priorities

(b) Clarifying responsibilities among managers and organisational units

(c) Empowering managers and pushing authority lower in the organisation

(d) Uncovering and remedying problems in coordination and communication across the organisation

(e) Gaining personal commitment from managers to a shared vision

(f) Keeping closely connected with "what's going on in the organisation".

4. ***Shaping organisational culture:*** Leaders play a key role in developing and sustaining a strategy supportive culture. Leaders know well that the values and beliefs shared throughout their organisation will shape how the work of the organisation is done. And when attempting to embrace accelerated change, reshaping their organisation's culture is an activity that occupies considerable time for most leaders.
5. ***Creating a learning organisation:*** Leaders must also play a central role in creating a learning organisation. Learning organisation is one that quickly adapts to change. The five elements central to a learning organisation are:
   (a) Inspiring and motivating people with a mission or purpose
   (b) Empowering people at all levels throughout the organisation
   (c) Accumulating and sharing internal knowledge
   (d) Gathering external information
   (e) Challenging the status quo to stimulate creativity
6. ***Instilling ethical behaviour:*** Ethics may be defined as a system of right and wrong. Business ethics is the application of general ethical standards to commercial enterprises. A leader plays a central role in instilling ethical behaviour in the organisation. The ethical orientation of a leader is generally considered to be a key factor in promoting methical behaviour among employees. Leaders who exhibit high ethical standards become role models for others in the organisation and raise its overall level of ethical behaviour. In essence, ethical behaviour must start with the leader before the employees can be expected to perform accordingly.

12.3.1 Leadership Approaches

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Research has found that some leadership approaches are more effective than others for bringing about change in organisation. Three types of leadership that can have a substantial impact are transactional, transformational and charismatic leadership. These types of leadership are briefly explained below:

1. ***Transactional Leadership:*** Transactional leaders clarify the role and task requirements ofsubordinates, initiate structure, provide appropriate rewards, and try to be considerate to and meet the social needs of subordinates. The transactional leader's ability to satisfy subordinates may improve productivity. Transactional leaders excel at management functions. They are hardworking, tolerant, and fair minded. They take pride in keeping things running smoothly and efficiently. Transactional leaders often stress the impersonal aspects of performance, such as plans, schedules and budgets. They have a sense of commitment to the organisation and conform to organisational norms and values. In short, transactional leaders use the authority of their office to exchange rewards such as pay and status for employees and generally seek to enhance an organisation's performance steadily, but not dramatically. In other words, transactional leadership is important to all organisations, but leading change requires a different approach, viz. transformational leadership.
2. ***Transformational Leadership:*** Transformational leaders have a special ability to bring about *innovation* and *change*. They encourage the followers to question the status quo. They have the ability to lead change in the organisation's mission, strategy, structure and culture as well as promote innovation in products and technologies. Transformational leaders do

NOTES

not rely solely on tangible rules and incentives to control specific transactions with followers. They focus on intangible qualities such as vision, shared values, and ideas to build relationships and find common ground to enlist in the change process.

3. ***Charismatic and Visionary Leadership:*** Charismatic leadership goes beyond transactional and transformational leadership. Charisma is a "fire that ignites followers' energy and commitment, producing results above and beyond the call of duty". The charismatic leader has the ability to inspire and motivate people to do more than what they would normally do, despite obstacles and personal sacrifice. Followers transcend their own self interestsfor the sake of the leader. Charismatic leaders are often skilled in the art of visionary leadership. A vision is an attractive, ideal future that is credible yet not readily attainable. Visionary leaders see beyond current realities and help followers believe in a brighter future. They speak to the hearts of their followers, letting them be part of something bigger than themselves. Thus, visionary leaders have a strong vision for the future and can motivate others to help realise it. They have an emotional impact on subordinates because they strongly believe in the vision and can communicate it to others in a way that makes the vision real, personal and meaningful to others.

When charismatic and visionary leaders respond to organisational problems, they can have a powerful, positive influence on organisational performance.

12.4 Corporate Culture and Strategic Management

A company's culture is manifested in the values and business principles that management preaches and practices.

Example: Culture is manifested in:

1. Corporate stories
2. Attitudes and behaviours of employees
3. Core values
4. Organisation's politics
5. Approaches to people management and problem solving
6. Relationships with stakeholders; and
7. Atmosphere that permeates its work environment

An organisation's culture is similar to an individual's personality. Just as an individual's personality influences the behaviour of an individual, the shared assumptions (beliefs and values) among a firm's members influence the opinions and actions within that firm. Quite often, the elements of company culture originate with a founder or other early influential leader who articulates the values, beliefs and principles to which the company should adhere.These elements then get incorporated into company policies, a creed or value statement, strategies and operating practices. Over time, these values and practices become shared by company employees and managers. Culture is thus perpetuated as:

1. New leaders act to reinforce them
2. New employees are encouraged to adopt and follow them
3. Stories of people and events told and retold
4. Organisation members are honoured and rewarded for displaying cultural norms.

12.4.1 Influence of Culture on Behaviour

An organisation's culture can exert a powerful influence on the behaviour of all employees. It can, therefore, strongly affect a company's ability to adopt new strategies. A problem for a strong culture is that a change in mission, objectives, strategies or policies is not likely to be

successful if it is in opposition to the culture of the company. Corporate culture has a strong tendency to resist change because its very existence often rests on preserving stable relationships and patterns of behaviour.

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12.4.2 Creating Strategy Supportive Culture

Once a strategy is established, it is difficult to change. It is the strategy-maker's responsibility to select a strategy compatible with the organisation's prevailing corporate culture. If it is not possible, once a strategy is chosen, it is the strategy implementer's responsibility to change the corporate culture that hinders effective execution of a chosen strategy.

Changing a Problem Culture

Changing a company's culture to align it with strategy is one of the toughest management tasks. This is because the deeply held values and habits are heavily anchored, and people cling emotionally to the old and familiar. It takes concerted management action over a period of time to root out certain unwanted behaviours and instill behaviours that are more strategy-supportive. Changing culture requires competent leadership at the top. Great power is needed to force major cultural change, to overcome the spring back resistance of entrenched cultures, and great power normally resides only at the top. Changing a problem culture involves the following four steps:

Step 1: Identify facts of present culture that are strategy – supportive and those that are not.

Step 2: Clearly define desired new behaviours and specify key features of "new" culture.

Step 3*:* Talk openly about problems of present culture, and how new behaviours will improve performance.

Step 4*:* Follow with visible, aggressive actions to modify culture.

NOTES

Managing Culture Change

As already explained in earlier sections, the culture that an organisation wishes to develop is conveyed through rites, rituals, myths, legends, actions etc. Only with bold leadership and concerted action on many fronts can a company succeed in tackling a major cultural change. Top leadership should play a key role in communicating the need for a cultural change and personally launching actions to prod the culture into better alignment with strategy. Changing culture requires both (a) Symbolic actions and (b) Substantive actions. They require serious commitment on the part of the top management. The following measures are helpful in building a strategy supportive culture:

1. ***Emphasise key themes or dominant values:*** Leaders must emphasise dominant values through internal company communications. They must repeat at every opportunity the messages of why cultural change is good for the company.
2. ***Stories and legends:*** Leaders must tell stories, anecdotes and legends in support of basic beliefs. Organisational members must identify with them, and share those beliefs and values.
3. ***Rewards:*** Visibly praising and generously rewarding people who display new culturalnorms will slowly change the culture.
4. ***Recruiting and hiring :*** New managers and employees are to be recruited who have the desired cultural values.
5. ***Revising policies and procedures*** in ways that will help the new culture.
6. ***Leading by example:*** If the organisation's strategy involves low-cost leadership, senior management must display in their own actions and decisions, inexpensive decorations in the executive suites, conservative expense accounts and

NOTES

entertainment allowances, lean corporate allowances, few executive perks, and so on.

7. ***Ceremonial events:*** In ceremonial functions, companies must honour individuals and groups who exhibit cultural norms and reward those who achieve strategic milestones.
8. ***Group gatherings:*** Top management must participate in employee training programmes etc. to stress strategic priorities, values, ethical principles and cultural norms. Every group gathering must be seen as an opportunity to repeat and ingrain values, praise good deeds, reinforce cultural norms and promote changes that assist strategy implementation. Thus, best companies and best executives expertly use symbols, role models, and ceremonial occasions to achieve the strategy-culture fit.

Managing Culture Clash

When merging or acquiring another company, top management must give some consideration to a potential clash of corporate cultures. Integrating cultures is a top challenge to a majority ofcompanies. It is dangerous to assume that the firms can simply be integrated into the same reporting structures. The greater the gap between the cultures of the two firms, the faster executives in the acquired firm quit their jobs, and valuable talent is lost.

Value Preservation of Their Own Culture

There are four general methods of managing two different cultures. They are:-

1. ***Integration*** involves merging the two cultures in such a way that separate cultures of both firms are preserved in the resulting culture.
2. ***Assimilation:*** Here, the acquired firm willingly surrenders

its culture and adopts the culture of the acquiring company.

3. ***Separation :*** Here there is a separation of the two companies' cultures. They are structurally separated, without cultural exchange.

4. ***Deculturation:*** This involves imposition of the acquiring firm's culture forcefully on the acquired firm. This often results in much confusion, conflict, resentment and stress.

12.5 Personal Values and Ethics

Values, personal values, and core values all refer to the same thing. They are desirable qualities, standards, or principles. Values are a person's driving force and influence their actions and reactions. **Ethics** is defined as "the discipline dealing with what is good and bad, and right and wrong, or with moral duty and obligation." Ethics refers to the moral principles and values that govern the behaviour of a person or group. Ethics helps us in deciding what is good or bad, moral or immoral, fair or unfair in conduct and decision-making. In other words, ethics serve as a **"moral compass"** to guide our actions. There are many sources for an individual's ethics. These include family background, religious beliefs, community standards and expectations etc.

12.5.1 Importance of Ethics

There has been a growing interest in corporate ethics over the past several years. This is perhaps because of a spate of recent corporate scandals at such firms as Enron, Tyco, Texaco etc. Withouta strong ethical culture, the chances of ethical crises occurring in companies cannot be ruled out.Due to this, companies face enormous costs in terms of financial and reputational loss as well as erosion of human capital and relationships with suppliers, customers, society at large and governmental agencies. An ethical organisation is driven by ethical

NOTES

values and integrity. Such values shape the search for opportunities, the design of systems and the decision-making processes of the organisation. They provide a common frame of reference that serves as a unifying force across different functions and employee groups. Organisational ethics define what a company is and what it stands for. The potential benefits of an ethical organisation are many. A strong ethical orientation can have a positive effect on employee commitment and motivation to excel. This is particularly important in today's knowledge-intensive organisations, where human capital is critical in creating value and competitive advantage. An ethically sound organisation can also strengthen its bonds among its suppliers, customers and governmental agencies. The ethical orientation of a leader is generally considered to be a key factor in promoting ethical behaviour among employees. Leaders who exhibit high ethical standards become role models for others in the organisation and raise its overall ethical behaviour. In essence, ethical behaviour must start with the leader, who plays a central role in instilling ethical behaviour in the organisation.

12.5.2 Approaches to Ethics

When an ethical dilemma arises, there are four approaches to guide our action. These four approaches are: -

Check Your Progress

Critically analyse the role of strategic leader vis-à-vis managerial leaders.

Utilitarian Approach

According to this approach, moral behaviour is one that produces the greatest good for the greatest number.

Individualism Approach

According to this approach, acts are moral when they promote the individual's best long-term interests, which ultimately lead to the greater good.

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Moral – Rights Approach

According to this approach, the fundamental rights and liberties should be respected in all decisions. Thus, an ethically correct decision is one that best maintains the rights of those people affected by it. Six moral rights should be considered during decision-making:

1. Right of free consent
2. Right of privacy
3. Right of freedom of conscience
4. Right of free speech
5. Right to due process
6. Right to life and safety

To make ethical decisions, managers need to avoid interfering with the rights of others.

Justice Approach

According to this approach, moral decisions must be based on equity, fairness and impartiality.

Four types of justices are of concern to managers:

1. ***Distributive justice*** requires that individuals should not be treated differently on the basis of race, sex, religion or national origin. Individuals who are similar should be treated similarly. Thus, men and women should not receive different salaries if they are performing the same job.
2. ***Procedural justice*** requires that rules be administered fairly. Rules should be clearly stated and be consistently and impartially administered.
3. ***Compensatory justice*** requires that individuals should be compensated for the cost of their injuries by the party responsible. Moreover, individuals should not be held responsible for matters over which they have no control.

NOTES

4. ***Natural duty principle:*** This principle reflects a duty to help others who are in need or danger; duty not to cause unnecessary suffering; and the duty to comply with the just rules of an institution.

12.5.3 Building an Ethical Organisation

A firm must have several key elements before it can become a highly ethical organisation. These elements must be constantly reinforced in order for the firm to be successful:

Role Models

For good or bad, leaders are role models in their organisation. The values as well as the character of leaders become transparent to an organisation's employees through their behaviour. Leaders must take responsibility for ethical lapses within the organisation, which enhances the loyalty and commitment of employees through the organisation.

Code of Ethics

They are another important element of an ethical organisation. Such mechanisms provide a statement and guidelines for norms and beliefs as well as decision–making. They provide employees with a clear understanding of the ethical standards of the organisation. Many large companies have developed such codes code of conduct.

1. ***Reward and Evaluation Systems :*** An appropriate reward and evaluation system should consider both the outcomes and the means adopted to achieve the organisational goals and objectives. Inappropriate reward systems may cause individuals to commit unethical acts.
2. ***Policies and Procedures :*** Most of the unethical behaviours in organisations could be traced to the absence of policies

NOTES

and procedures to guide behaviour. It is important to carefully develop policies and procedures to guide behaviour so that all employees are encouraged to behave in an ethical manner. However, it is not enough merely to have policies "on the books". Rather, they must be effectively communicated, enforced and monitored. The company should also follow sound corporate governance practices.

Ethics Training

The purpose of ethic training is to encourage ethical behaviour. Companies should provide appropriate training in ethical standards. It enables managers to align ethical behaviour with organisational goals.

Ethics Audit

Companies should undertake periodic audits to ensure that proper ethical standards are being followed by all deportments of the organisation.

Chief Ethics Officer

Some large corporations appoint a senior officer with the exclusive responsibility of overseeing the ethical conduct of employees. He functions like a watchdog on ethics.

Ethics Committee : An ethics committee establishes polices regarding ethical conduct and resolves major ethical dilemmas faced by the employees of an organisation. Ethics committee performs such functions as organisation of regular meetings to discuss ethical issues, identifying possible violations of the code, enforcing the code, rewarding ethical behaviour etc.

Ethics Hotline : This is a special telephone line that enables

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employees to bypass the proper channel for reportingtheir ethical dilemmas and problems. The line is usually handled by an executive also investigatesthe matter and helps resolve the problems of the concerned employees.

12.6 Social Responsibility and Strategic Management

Corporate social responsibility (CSR) consists of "actions that appear to further some social good, beyond the interests of the firm" It includes such topics as environmental 'green' issues, treatment of employees and suppliers, charitable work and other matters related to the community. It is important to note that CSR requires firms to go beyond what the law requires – just doingthe minimum required by the law is not sufficient. "Corporate social responsibility is concernedwith the ways in which an organisation exceeds the minimum obligations to the stakeholders"(Johnson and Sholes, 2002).Corporate Social Responsibility is therefore a company's duty to operate its business by meansthat *avoid harm to other stakeholders and the environment,* and also to consider *overall betterment ofsociety* in its decisions and actions. The essence of socially responsible behaviour is that a companyshould strive to *balance* its actions to benefit its shareholders without any adverse impact onother stakeholders like employees, suppliers, customers, local communities and society at large,and, further, to proactively mitigate any harmful effects on the environment its actions andbusiness may have.

12.6.1 Responsibilities of Business

A business organisation has four responsibilities:

1. ***Economic responsibilities:*** are the most basic responsi-bilities of a business firm. This involves the essential

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responsibility of business to provide goods and services to society at a reasonable cost. In discharging that economic responsibility, the company provides productive jobs to its workforce, pays taxes to central, state and local governments.

2. ***Legal responsibilities :*** reflect the firm's obligation to comply with the laws that regulate business activities, especially in the areas of consumer safety and pollution control.

3. ***Ethical responsibilities:*** reflect the company's notion of right or proper business behaviour. Ethical responsibilities go beyond legal requirements. Firms are expected, though not legally bound, to behave ethically.

4. ***Discretionary responsibilities:*** are those that are voluntarily assumed by business organisations that adopt the citizenship approach. They support ongoing charities, publicservice advertisement campaigns, donations, medical camps, public welfare activities etc. A commitment to full corporate responsibility requires strategic managers to attack social problems with the same zeal in which they tackle business problems. Business managers should keep in mind that economic and legal responsibilities are mandatory, ethical responsibilities are expected, and discretionary responsibilities are desirable. The above four responsibilities are listed in order of priority. A business firm must first make a profit to satisfy its economic responsibilities. A firm must also follow the laws as a good corporate citizen. Carrol, however, argues that business firms have obligations beyond the economic and legal responsibilities; that firms must also fulfil its social responsibilities. Social responsibility includes both ethical and discretionary responsibilities, but not economic and legal responsibilities.

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12.6.2 Need for CSR: The Strategy

After considering the arguments for and against CSR, it becomes evident that it is in the enlightened self-interest of companies to be good corporate citizens and devote some of their resources and energies to employees, the communities in which they operate, and society in general. There are five important reasons why companies should undertake social responsibilities.

Self-interest of the Organisation : Every organisation obtains critical inputs from the environment and converts them into goods and services to be used by society at large. In this process they help shareholders to get appropriate returns on their investment. It is expected that organisations acknowledge and act upon theinterests and demands of other stakeholders such as citizens and society in general that are beyond its immediate constituencies – owners, customers, suppliers and employees. That is, they must consider the needs of the broader community at large, and act in a socially responsible way.

It generates Internal Benefits : CSR generates internal benefits like employee recruitment, workforce retention and training. Companies with good CSR reputation are better able to attract and retain employees compared to companies with tarnished reputations. Some employees just feel better about working for a company committed to improving society. This can contribute to lower turnover and better worker productivity. This also benefits the firm by way of lower costs for staff recruitment and training. Provision of good working conditions results in greater employee commitment.

It Reduces Risks : CSR reduces the risk of damage to reputation and increases buyer patronage. Consumer,

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environmental and human rights activist groups are quick to criticise businesses that are not socially responsive. Pressure groups can generate adverse publicity, organise boycotts, and influence buyers to avoid an offender's products. Research has shown that adverse publicity is likely to cause a decline in a company's stock price.

In the Best Interest of Shareholders : CSR is in the best interest of shareholders. Well-conceived social responsibility strategies work to the advantage of shareholders in several ways. Socially responsible behaviour can help avoid or prevent legal and regulatory actions that could prove costly or burdensome. A study of leading companies found that environmental compliance and developing eco-friendly products an enhance earnings per share, profitability, and the likelihood of winning contracts.

It gives Competitive Advantage : Being known as a socially responsible firm may provide a firm a competitive advantage. *Example:* Firms that are eco-friendly enhance their corporate image. In western countries, many consumers boycott products that are not "green". Companies that take the lead in being environmentally friendly, such as by using recycled materials, producing 'green' products, and helping social welfare programmes, enhance their corporate image. In sum, companies that take social responsibility seriously can improve their business reputation and operational efficiency while reducing their risk of exposure and encouraging loyalty and innovation. Overall, companies that take special pains to protect the environment (beyond what is required by law), are active in community affairs, and are generous supporters of charitable causes are more likely to be seen as good

companies to work for or do business with. It will also benefit the shareholders.

NOTES

12.7 Summary

- A firm's stakeholders are the individuals, groups, or other organisations that are affectedby and also affect the firm's decisions and actions.
- An organisation needs to have an effective stakeholder management system in place,which provides a great support in achieving its strategic objectives.
- Strategic leadership establishes the firm's direction by developing and communicating avision of the future and inspiring organisation members to move in that direction.
- A company's culture is manifested in the values and business principles that managementpreaches and practices. An organisation's culture can exert a powerful influence on thebehaviour of all employees.
- Ethics refers to the moral principles and values that govern the behaviour of a person orgroup. Ethics helps us in deciding what is good or bad, moral or immoral, fair or unfair inconduct and decision-making.
- Corporate social responsibility (CSR) consists of "actions that appear to further somesocial good, beyond the interests of the firm" It includes such topics as environmental'green' issues, treatment of employees and suppliers, charitable work and other mattersrelated to the community.
- Corporate Social Responsibility is a company's duty to operate its business by means that*avoid harm to other stakeholders and the environment,* and also to consider *overall betterment ofsociety* in its decisions and actions.

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12.8 Key Terms

Culture: The beliefs and behaviors that determine how a company's employees and management interact and handle outside business transactions.

Corporate Social Responsibility: A company's sense of responsibility towards the community and environment (both ecological and social) in which it operates.

Deculturation: The removing or abandoning of one's own culture and replaces it with another.

Ethics: Motivation based on ideas of right and wrong.

Stakeholders: A person, group, or organisation that has direct or indirect stake in an organisation.

Strategic leadership: A manger's potential to express a strategic vision for the organisation, or a part of the organisation, and to motivate and persuade others to acquire that vision.

12.9 Questions and Exercises

1. Assess the value of stakeholders in an organsiation. Why is it important to manage the stakeholders well?
2. Critically analyse the role of strategic leader vis-à-vis managerial leaders.
3. "Visionary leadership inspires the impossible: fiction becomes truth". Substantiate
4. Discuss the three approaches to leadership. Assess the importance of each of them.
5. "An organisation's culture is similar to an individual's personality." Comment
6. "There is no best or worst culture". Elucidate

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7. Suppose you are the manager of a firm that has just acquired another firm. How will you ensure that there is good 'fit' between the culture and startegy of the new firm?
8. What do you mean by problem culture? How will deal with such a culture?
9. Is it necessary for an organisation to be ethical? Give your viewpoint and justify.
10. CSR is not an obligation, then why most of the successful companies engage in it?

Check your progress

Fill in the blanks:

1. The company must place its stakeholders on a ……………………..based on their level of influence or impact.
2. A manager is concerned with short term activities of the organisation, while a ………………..is concerned with the long term aspects.
3. Strategic leaders must also play a central role in creating a ………………. organisation.
4. In general, …………………may be defined as a system of right and wrong.
5. …………………leaders have a special ability to bring about innovation and change.
6. Charismatic leaders are often skilled in the art of ………………. leadership.
7. An organisation's culture is similar to an individual's …………………..
8. When the acquired firm willingly surrenders its culture and adopts the culture of the acquiring company, it is called…………………of culture.
9. An ethical organisation is driven by ethical ……………….and …………………...

10. It is a…………………responsibility of a business to adopt the citizenship approach.

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Answers:

1. stakeholder matrix 2. strategic leader 3. learning 4. Ethics 5. Transformational 6. Visionary 7. personality 8. Assimilation 9. values, integrity 10. discretionary

12.10 Further Reading and References

Books

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NOTES

UNIT 13: FUNCTIONAL AND OPERATIONAL IMPLEMENTATION

13.0 Unit Objectives

13.1 Introduction

13.2 Functional Strategies

13.2.1 Nature of Functional Strategies

13.2.2 Need for Functional Strategies

13.3 Functional Plans and Policies

13.4 Operational Plans and Policies

13.4.1 Importance of Operational Strategy

13.4.2 Components of Operational Plan and Policies

13.5 Personnel (HR) Plans and Strategies

13.5.1 HR Planning

13.5.2 Staffing

13.5.3 Training and Development

13.5.4 Performance Management

13.5.5 Compensation and Rewards

13.5.6 Industrial Relations

13.6 Summary

13.7 Key Terms

13.8 Questions and Exercises

13.9 Further Reading and References

13.0 Unit Objectives

NOTES

After studying this unit, you should be able to:

- Describe functional strategies
- Explain the functional plans and policies
- State the operational plans and policies
- Discuss personnel plans and policies

13.1 Introduction

Once corporate level and business level strategies are developed, management must turn itsattention to formulating strategies for each functional area of the business unit. For effectiveimplementation of strategies, functional strategies provide direction to functional managersregarding the plans and policies to be adopted in each functional area.

13.2 Functional Strategies

Functional Strategy is the approach taken by a functional area to achieve corporate and business unit objectives and strategies by maximising resource productivity. It is concerned withdeveloping and nurturing a distinctive competence to provide a company or business unit with a competitive advantage.

Just as a multi-divisional corporation has several business units, each with its own business strategy, each business unit has its own set of departments, each with its own functional strategy.

13.2.1 Nature of Functional Strategies

Functional strategies are essential to implement business strategy. In fact, the effectiveness of acorporate or business strategy execution

depends critically on the manner in which strategies are implemented at the functional level. The corporate strategy provides the long-term direction and scope of a firm. The business strategy outlines the competitive posture of its operations in an industry. The functional strategy clarifies the business strategy, giving specific short-term guidance to operating managers in the areas of operations, marketing, finance, HR, R&D etc., and increases the likelihood of their success.

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13.2.2 Need for Functional Strategies

Functional managers need guidance from the corporate and business strategies in order to make decisions. In simple terms, functional strategies tell the functional manager what to do in hisarea to achieve business objectives. Glueck and Jauch have suggested five reasons to show why functional strategies are needed. Functional strategies are developed to ensure that :

1. The strategic decisions are implemented by all the parts of an organisation.
2. There is a basis available for controlling activities in different functional areas of a business.
3. The time spent by functional managers on decision-making may be reduced.
4. Similar situations occurring in different functional areas are handled by the functional managers in a consistent manner.
5. Coordination across different functions takes place where necessary.

Check Your Progress

Analyse the importance of functional strategies. Are they more important than businessstrategy?

13.3 Functional Plans and Policies

The process of developing functional plans and policies is quite similar to that of strategyformulation, with the difference that functional heads are responsible for their formulation and implementation.

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Environmental factors relevant to each functional area will have an impact on the choice of strategies. Finally, the actual process of choice involves a negotiation betweenfunctional managers and business unit managers. Thus, functional strategies are generallyformulated in all key functional areas.For each of the functional strategies, a set of policies will have to establish for appropriate areasof the business. The policies will ensure that the strategies are carried out as intended and thatthe different functional areas are working towards the same ends. Companies have plans andpolicies that cover nearly every major aspect of the firm. The firm should have strategies inevery major aspect of business, at least in key functional areas. We will highlight some of themore important issues for each functional area that need to be addressed in their respectivefunctional strategies.

The functional strategies required in key functional areas are outlined below:

Financial Strategy : In the financial management area, the major concern of the strategy relates to the acquisition and utilisation of funds. Major issues involved are the sources from where the funds will come, from equity or by borrowing. How much of the borrowing will be short-term and how muchlong-term. In terms of usage of funds, the policy decisions would relate to whether and to what extent funds have to be deployed in fixed assets and current assets. The long-term or capitalinvestment decisions relate to buying or leasing the fixed assets. A retrenchment strategy orpaucity of funds may compel the organisation to lease rather than buy. In case of an organisationwhere capital investment decisions are decentralised, a “hurdle rate” may be fixed so as to avoid investment in weaker projects by one division and non-investment by another division.

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Cash Flow : Apart from capital budgeting, another consideration in financial strategy which influencesother functional areas is the cash flow. A company may frame bonus and dividend policiesbased on availability of cash. In case a company proposes expansion through internally generatedfunds, it may reduce bonus and dividend. This is particularly so when it has formulated ambitiousgrowth strategies which require large cash. Similarly, if the firm has high risk business, itshould have a conservative debt/equity ratio to guard against heavy interest burden.The funds position and optimisation orientation of top management also determines the accountsreceivable and payable policies. Financial strategies and policies may even determine theaccounting policies as these affect the profitability, balance-sheet and hence cash flow throughtaxes, dividend, bonus etc.

Marketing Strategy : Functional strategies in marketing area are required for marketing – mix decisions, i.e. the four Ps of marketing, viz. Product design, Product distribution, Pricing and Promotion aspects ofmarketing. In terms of specifics, the product decisions relate to such issues as the variety ofproduct (shape, size, model etc.), quality requirements, introduction/ withdrawal of products, nature of customers etc. Specific policies are also required regarding distribution channels i.e. through retailers or direct selling? What would be the spread of distribution network? Whether new dealers will be established or old ones developed? The promotion strategies will relate to mode of promotion, coverage and nature (corporate, product or brand promotion). Again, very clear and specific strategies will have to be made about pricing, etc., full cost or standard cost based pricing. Offensive vs. defensive postures also influence pricing policies.

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HR Strategy : HR strategy deals with matters like HR planning, recruitment and selection, training anddevelopment, compensation management, performance management, rewards and incentivesetc. What compensation/reward system will be able to attract people of the desired type to join the organisation so as to meet the task requirements demanded by the strategy? What strategies are necessary to groom internal people for new positions? The problem becomes acute in thecontext of turnaround strategies. On the one hand, the most competent people leave and the firmfinds it difficult to attract suitable replacements. On the other hand, it faces the problem ofsurplus staff. HR strategies for retrenchment, though painful, are quite necessary but difficult todevelop.

Production Strategy : The functions relating to production need strategies relating to quality assurance, machineutilisation, location of facilities, balancing the line, scheduling of production, and materialsmanagement. The strategy for entering into export market will dictate a different policy regardingquality of products and maintenance. Location of facilities may be determined by closeness tomarket or input supply points. Decisions must be made to determine whether and how much tomake or buy, on the basis of cost differential, availability, criticality of the item, capacity ifexpansion becomes necessary. In case of bought out items, policies regarding number of suppliersand the criteria for selecting them are necessary.

R&D Strategy : In the area of research and development, functional strategies regarding the nature of research are necessary. In case of expansion through new product development, heavy emphasis has to be laid on basic and applied research.

13.4 Operational Plans and Policies

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Operations management is the core function of any organisation. This function converts inputs (raw materials, supplies, machines and people) into value added outputs. Operations managementcovers all manufacturing processes in an organisation and includes raw material sourcing,purchasing, production, distribution and logistics. This function contributes to the organisation'sability to add value to the goods and services.

13.4.1 Importance of Operational Strategy

The key to successful survival of an enterprise is how efficiently the production activity is managed. The two major factors that contribute to business failures are: obsolescence of theproduct line and excessive production costs. These factors themselves have been the outcome ofineffective production Planning.Operations strategy plays a crucial role in shaping the ultimate success of a firm. It enables anorganisation to make optimal decisions regarding product, production capacity, plant location,choice of machinery and equipment, maintenance of existing facilities and host of other aspectsof production. Constant review of production plan aids in maintaining proper balance of capitalinvestment in plant, equipment and inventory; efficient operation of the production system,product mix, Quality control; and ensures effective material handling and Planning of facilities.Within the broad framework of corporate and business strategies, production strategy helps in maintaining full co-ordination with marketing and engineering functions to formulate plans toimprove products and services. It calls upon management to keep in constant touch with financeand personnel to achieve the optimal use of assets, cost control, recruitment of suitable personneland management of labour disputes and negotiations.

13.4.2 Components of Operational Plan and Policies

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The different components of a production strategy should ideally consist of the following:

Product Mix : A firm should decide about the product mix (how many and what kind of products to beproduced) keeping in view Objectives such as productivity, cost efficiency, Quality, reliability, flexibility etc.

Capacity Planning : Capacity Planning is the process of forecasting demand and deciding what Resources will berequired to meet that demand. Meclain and Thomas suggested that capacity Planning involves the following five sequential steps.

1. ***Predict future demand and competitive reactions:*** The firm should forecast the demand for various products/services as also estimate customer reaction to the products offeredby it. It should also take care of potential countermoves by competitors.
2. ***Translate above estimates into capacity needs:*** Based on forecasts, the firm must decidethe quantity that can be manufactured keeping input limitations, such as plant equipment,manpower etc in mind.
3. ***Create alternative capacity plans:*** Depending on what the market might absorb and whatthe organisation can produce, management should create alternative capacity plans forvarious products/services that are offered to customers.
4. ***Evaluate each alternative:*** The firm should identify the opportunities and Threats associated with each alternative, and carefully evaluate in terms of additional costs involved,

payoffsetc.

5. ***Select and implement a particular capacity plan :*** The capacity plan that best servesorganisational Objectives should be selected and implemented.

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Technology and Facilities Planning

1. ***Choosing Machines and Equipments :*** A strategic decision to be made by a production manager is what type of equipments the organisation will require for production purposes, how much it will cost, what will be itsoperating cost and what services it will render to the organisation and for how long.Choice of equipment for making a particular product essentially depends on the basicmanufacturing process. The decision-maker must, therefore, familiarise himself with theproduction process to be adopted.Another consideration in the choice of new equipment for a plant is the type and degree ofoperating skill required and presently available skills within the organisation. Other factorsworth consideration are the ease with which the equipment can be operated and the safetyfeatures of the equipment.
2. ***Equipment Investment :*** Acquisition of equipment involves capital expenditure which will have long-term effects on thefinancial position of the company. Hence, before taking a final decision regarding investment ina machine, detailed analysis of such investment in terms of cost-benefits must be made and itsdesirability and worthwhileness should be evaluated with the help of internal rate of return ornet present value method.The decision to replace the existing machine is equally important to the enterprise. In thisregard the management has to decide when the replacement should be made and the bestreplacement policy that must be

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considered while making comparisons between an existingunit of equipment and its possible replacement. In order to make a sound economic comparison,all the factors must be converted into cost considerations. The rate of return so obtained iscompared with the cut-off rate to ascertain whether the replacement is economically viable.

3. ***Physical Facilities Decision :*** Facilities strategy covers plans for location analysis and selection, design and specificationsincluding layout of equipment, plant, warehouses and related services. Facilities Planning deals with the separate but interrelated costs of material, supplies, manpower, services and facilities. Its Mission is to find ways to minimise the aggregate of such costs in making and distributing the products at the proper time.
4. ***Plant Location :*** Plant location is essentially an investment decision having long-term significance. Once a plant is acquired, it is a permanent asset that cannot readily be sold. The management may alsocontemplate relocation of the plant when business expansion and advanced technology require additional facilities to serve new market areas, to produce new products, or simply to replacethe old, obsolete plants to increase the company's production capacity.The selection of an appropriate plant site calls for location study of the region in which thefactory is to be situated, the community in which it should be placed and finally, the exact site inthe city or countryside.
5. ***Plant Building :*** Once the company has chosen the plant site, due consideration must be given to providingphysical facilities. A company requiring extensive space will always construct new buildings.On planning a building for the manufacturing facilities, a number of factors will have to be keptin mind such as nature of the manufacturing process, plant layout and space

requirements, lighting, ventilating, air-conditioning, service facilities and future expansion.

6. ***Plant Layout :*** Plant layout involves the arrangement and location of production machinery, work centres and auxiliary facilities and activities (inspection, handling of material storage and shipping) for the purpose of achieving efficiency in manufacturing products or supplying consumer services.

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Maintenance of Equipment

Maintenance of equipment is an important component of planning consideration. It is intimatelylinked with replacement policies. Every manufacturing enterprise follows some maintenanceroutine in order to avoid unexpected breakdowns and thus minimise costs associated withmachine down time, possible loss of potential sales, idle direct and indirect labour delays,customer dissatisfaction from possible delays in deliveries and the actual cost of repairing themachine.

1. ***Excess Capacity :*** In carrying excess capacity method an organisation carries stand-by capacity, which is used if trouble occurs. This excess capacity can be whole machines or it can be major parts or componentswhich ordinarily take time to obtain. Carrying excess capacity involves cost which must becompared with costs arising out of a slow-down or a shut-down of a whole series of dependentoperations. Therefore, the decision in this regard is cost trade-offs.

2. ***Preventive Maintenance :*** Preventive maintenance is based on the premise that good maintenance prevents breakdowns. Preventive maintenance means preventing breakdowns by replacing worn-out machines ortheir parts before their breakdown. It anticipates likely difficulties and does the expected neededrepairs at a convenient time before

Check Your Progress

Discuss the functional strategies required in key functional areas of business?

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the repairs are actually needed. Preventive maintenancedepends upon the past knowledge that certain wearing parts will need replacement after anormal interval of use.

Inventory Management

This is concerned with management of inventory consisting of raw materials, work-in-process, goods in transit, finished goods etc. Inventory management is a critical function becausesubstantial money can be locked up in inventory, which can be put to productive use. There arevarious techniques that can be used for effective inventory management.

1. Economic Order Quantity
2. ABC analysis
3. Just-in-time (JIT) Inventory systems etc.

Quality Management

Quality is a major consideration in Production/Operations strategy. By using techniques likeTotal quality management (TQM), Six Sigma etc, organisations strive to produce 'Zero defectproducts' Operations strategy should consist of appropriate Quality improvement programmes to achieve total Quality in products and services of the organisation.*Task* Find out about the quality management practices at McDonalds.

13.5 Personnel (HR) Plans and Strategies

Personnel policies are guides to action. Brewster and Ricbell defined HR policies as "a set ofproposals and actions that act as a reference point for managers in their dealings with employees".Management should pay attention to the following aspects of HR policies:

1. HR policies must be related to the strategic objectives of the firm.
2. They should be stated in definite, clear and understandable language.
3. They should be sufficiently comprehensive and provide yardsticks for future action.
4. They should be stable enough to assure people that there will not be drastic overnight changes.
5. They should be built on the basis of facts and sound judgment.
6. They should be just, fair and equitable.
7. They must be reasonable and capable of being accomplished.
8. Periodic review of HR policies is essential to keep in tune with changing circumstances.

13.5.1 HR Planning

HR planning is the first key component for developing a human resource strategy. It involvestranslating corporate – wide strategic objectives into a workable plan and serves as a blue-print for all specific HR programmes and policies. It is the process of analysing and identifying theneed for and availability of human resources so that the organisation can meet its objectives. It helps determine the manpower needs of firms and develop strategies for meting those needs. According to Jeffrey Mello, key objectives of HR planning are:

1. Prevents overstaffing and understaffing.
2. Ensures the organisation has the right number of employees with the right skills in the right places and at the right time.
3. Ensures the organisation is responsive to changes in its environment.
4. Provides direction and coherence to all HR activities and systems.

5. Unites the perspectives of line and staff managers.
6. Facilitates leadership continuity through succession planning.

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Although HR planning follows from the strategic plan, the information collected in the HRplanning process contributes to the assessment of internal organisation's environment done in strategic planning.

13.5.2 Staffing

Staffing, the process of recruiting applicants and selecting prospective employees, remains akey strategic area for human resource strategy. Given that an organisation's performance is adirect result of the individuals it employs, the specific strategies used and decisions made in thestaffing process will directly impact the success of the strategic plan.

Recruitment : Recruitment means attracting people to apply for jobs in the organisation. The strategic issues inrecruitment are:

1. Temporary versus permanent employees
2. Internal versus external recruiting
3. When and how extensively to recruit
4. Methods of recruiting

Selection : Once a sufficient pool of applicants has been received, critical decisions need to be made regardingapplicant screening, methods of selection and placement. The selection methods should bereliable and valid.

Placement : After selecting a candidate, he should be placed on a suitable job. Placement is an importanthuman resource

activity. If neglected, it may create employee adjustment problems. An employeeplaced in a wrong job may quit the organisation in frustration.

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13.5.3 Training and Development

Training and development of employees is a key strategic issue for organisations. It is themeans by which organisations determine the extent to which their human assets are viableinvestments. Training involves employees acquiring knowledge and skills that they will beable to use on the job. There are two key factors to develop successful training programmes in organisations.

The first is planning and strategising the training. This involves four distinct steps:

1. Needs assessment
2. The establishment of objectives and measures
3. Delivery of the training
4. Evaluation

The second key factor is to ensure that desired results are achieved or accomplished. Training needs are to be integrated with performance management systems and compensation.

13.5.4 Performance Management

An organisation's long-term success in meeting its strategic objectives rests on managingemployee performance and ensuring that performance measures are consistent with the strategicneeds. One purpose of performance management systems is to facilitate employee development.A second purpose is to determine appropriate rewards and compensation, which must be clearlylinked to achievement of strategic goals.

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13.5.5 Compensation and Rewards

Organisations face a number of key strategic issues in setting their compensation and reward policies and programmes. These include:

1. Compensation relative to the market
2. Balance between fixed and variable compensation
3. Appropriate mix of financial and non financial compensation
4. Developing an overall cost-effective compensation programme that results in high performance.

In addition to these strategic issues, the fast pace of change and the need for organisations torespond in order to remain competitive create challenges for all HR programmes, but particularlyfor compensation. Organisations should revaluate their compensation programmes within thecontext of their corporate strategy and specific HR strategy to ensure that they are consistentwith the necessary performance measures required by the organisation. Overly rigid compensation systems inhibit the flexibility needed by the company's competitive strategies.HR strategy must encourage creativity to meet strategic objectives. Therefore, compensationsystems must ensure that behaviours that help achieve strategic objectives are appropriatelyrewarded.

13.5.6 Industrial Relations

Industrial relations is a key strategic issue for organisations because the nature of the relationshipbetween employees can have a significant impact on morale, motivation and productivity.Consequently, how organisations manage the day- to-day aspects of the employment relationshipcan be a key variable affecting their ability to achieve strategic objectives.Through appropriate collective bargaining and participative management

practices, industrialrelations can be managed effectively. HR strategy must incorporate long-term plans andprogrammes to maintain industrial peace for effective implementation of the business strategy.

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13.6 Summary

- Functional Strategy is concerned with developing and nurturing a distinctive competenceto provides a company or business unit with a competitive advantage.
- Functional strategies are essential to implement business strategy.
- Functional policies will ensure that the strategies are carried out as intended and that thedifferent functional areas are working towards the same ends. Companies have plans andpolicies that cover nearly every major aspect of the firm.
- Operations strategy plays a crucial role in shaping the ultimate success of a firm. It enablesan organisation to make optimal decisions regarding product, production capacity, plantlocation, choice of machinery and equipment, maintenance of existing facilities and hostof other aspects of production.
- Personnel policies are guides to action. Brewster and Ricbell defined HR policies as "a setof proposals and actions that act as a reference point for managers in their dealings withEmployees."

13.7 Key Terms

Capacity Planning: Process of forecasting demand and deciding what Resources will be requiredto meet that demand.

Cash flow: The excess of cash revenues over cash outlays in a given period of time (not includingnon-cash expenses)

Functional Strategy: Approach taken by a functional area to achieve

corporate and businessunit objectives and strategies by maximising resource productivity.

Human Resource Planning: The ongoing process of systematic planning to achieve optimum use of an organisation's most valuable asset - its human resources.

Industrial Relations: Interaction between employers, employees, and the government; and the institutions and associations through which such interactions are mediated.

Inventory Management: Management of inventory consisting of raw materials, work-in-process,goods in transit, finished goods etc.

Operations Management: Design, execution, and control of a firm's operations that convert its resources into desired goods and services, and implement its business strategy.

13.8 Questions and Exercises

1. Analyse the importance of functional strategies. Are they more important than businessstrategy?
2. Suppose you are the manager of a newly established garments company. You have abusiness strategy ready for you that stresses on competitive positioning and properstakeholder management. Draft out a proper functional strategy for your company, if theobjective is to establish a brand name in the long run.
3. Discuss the functional strategies required in key functional areas of business.
4. "Operations management is the core function of any organisation". Justify
5. Why is choice of equipments to be used in business a major strategic decision?
6. "It is necessary to have personnel strategies in place in order to make other strategiessuccessful." Comment

7. Critically analyse staffing and training as strategies decisions.
8. Evaluate the importance of effective marketing and R&D strategies.
9. "The key to successful survival of an enterprise is how efficiently the production activity is managed." Discuss
10. How does obsolescence of the product line affect the organisation?

Check your progress

Fill in the blanks:

1. ……………….. strategy outlines the competitive posture of its operations in an industry.
2. ………………….. will ensure that the strategies are carried out as intended.
3. A company often frames bonus and dividend policies based on availability of ……………………….
4. Marketing strategy includes the decision regarding the four Ps referred to as the…………………….
5. Decision related to logistics comes under the purview of……………………..strategy.
6. Some organisations that prefer to build smaller capacity to take care of normal requirements, meet peak demand by way of imports or …………………………
7. Plant location is essentially ……………………….. decision that has a long-term significance.
8. ABC Analysis is a technique used for…………………….
9. ………………is the process of recruiting applicants and selecting prospective employees.
10. The main purpose of performance management systems is to facilitate …………………….

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Answers:

1. Business 2. Policies 3. cash 4. marketing mix 5. operation 6. Subcontracting 7. investment 8. inventory management 9. Staffing 10. employee development

13.9 Further Reading and References

Books

- Azhar Kazmi, *Strategic Management and Business Policy,* 3rd Edition, Tata McGraw Hill.
- C Appa Rao, B Parvathiswara Rao and K Sivaramakrishna, *Strategic Management and Business Policy*, Excel Books
- Hill and Jones, *Strategic Management: An Integrated Approach*, 6th Edition, Biztanatra/ Cengage

UNIT 14: STRATEGIC EVALUATION AND CONTROL

14.0 Unit Objectives

14.1 Introduction

14.2 Nature of Strategic Evaluation and Control

14.2.1 Types of General Control Systems

14.2.2 Basic Characteristics of Effective Evaluation and Control System

14.3 Strategic Control

14.3.1 Types of Strategic Control

14.3.2 Approaches to Strategic Control

14.4 Operational Control

14.4.1 Setting of Standards

14.4.2 Measurement of Performance

14.4.3 Identifying Deviations

14.4.4 Taking Corrective Action

14.5 Techniques of Strategic Control

14.6 Summary

14.7 Key Terms

14.8 Questions and Exercises

14.9 Further Reading and References

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14.0 Unit Objectives

After studying this unit, you should be able to:

- State the nature of strategic evaluation and control
- Discuss the concept of strategic control and operational control
- Explain the techniques for strategic control
- Identify the role of organisational systems in evaluation

14.1 Introduction

Strategic evaluation and control is the final phase in the process of strategic management. Its basic purpose is to ensure that the strategy is achieving the goals and objectives set for thestrategy. It compares performance with the desired results and provides the feedback necessaryfor management to take corrective action.According to Fred R. David, strategy evaluation includes three basic activities :

1) Examining theunderlying bases of a firm's strategy

2) Comparing expected results with actual results

3) Taking corrective action to ensure that performance conforms to plans.

Sometime, the bestformulated strategies become obsolete as a firm's external and internal environments change.Managers should, therefore, identify important milestones and set strategic thresholds to assistthem in knowing the changes in the underlying assumptions of a strategy and, if necessary alterthe basic strategic direction. The evaluation process thus works as an early warning system forthe organisation.Strategic evaluation generally operates at two levels – strategic and operational level. At thestrategic level, managers try to examine the consistency of strategy with environment. At theoperational level, the focus is on finding how a given strategy is effectively pursued by theorganisation. For this purpose, different control systems are used both at strategic and operationallevels.

14.2 Nature of Strategic Evaluation and Control

Strategic evaluation and control is defined as the process of determining the effectiveness of a given strategy in achieving the organisational objectives and taking corrective actions wherever required. According to Pearce and Robinson, strategic control ***is concerned with tracking a strategyas it is being implemented, detecting problems or changes in its underlying premises, and making necessaryadjustments.*** In contrast to post-action control, strategic control seeks to guide action on behalf ofthe strategies,. as they are taking place and when the end result is still several years off .Strategic control in an organisation is similar to what the "steering control" is in a ship. Steeringkeeps a ship, for instance, stable on its course. Similarly, strategic control systems sense to whatextent the strategies are successful in attaining goals and objectives, and this information is fedto the decision-makers for taking corrective action in time. Strategic managers can steer theorganisation by instituting minor modifications or resort to more drastic changes such as alteringthe strategic direction altogether. Strategic control systems thus offer a framework for tracking,evaluating or reorienting the functioning of the firm's strategy.

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Check Your Progress

Comment on the nature of strategic control and evaluation?

14.2.1 Types of General Control Systems

Basically, there are three types of general control systems:

1. Output control (i.e. control on actual performance results)
2. Behaviour control (i.e. control on activities that generate the performance)
3. Input control (i.e. control on resources that are used in performance)

Output Control : Output controls specify *what* is to be accomplished by focusing on the end result. This control isdone

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through setting objectives, targets or milestones for each division, department, section and executives, and measuring actual performance. These controls are appropriate when specificoutput measures haven't been agreed on. Often rewards and incentives are linked to performancegoals.

Behaviour Control : Behaviour controls specify *how* something is to be done. This control is done through policies, rules, standard operating practices and orders from superiors. These controls are the mostappropriate when performance results are hard to measure. Rules standardise the behaviourand make outcomes predictable. If employees follow rules, then actions are performed anddecisions handled the same way time and again. The result is predictability and accuracy, which is the aim of all control systems. The main mechanisms of behaviour control are:

1. Operating budgets
2. Standard operating practices
3. Rules and procedures

Input Control : Input controls specify the amount of resources, such as knowledge, skills, abilities, of employeesto be used in performance. These controls are most appropriate when output is difficult tomeasures.

14.2.2 Basic Characteristics of Effective Evaluation and Control System

Effective strategy evaluation systems must meet several basic requirements. They must be :

1. ***Simple:*** Strategy evaluation must be simple, not too comprehensive and not too restrictive.Complex systems often confuse people and accomplish little. The test of an effectiveevaluation system is its simplicity not its complexity.

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2. ***Economical:*** Strategy evaluation activities must be economical. Too many controls can domore harm than good.
3. ***Meaningful:*** Strategy evaluation activities should be meaningful. They should specificallyrelate to a firm's objectives. They should provide managers with useful information abouttasks over which they have control and influence.
4. ***Timely:*** Strategy evaluation activities should provide timely information. For example,when a firm has diversified into a new business by acquiring another firm, evaluativeinformation may be needed at frequent intervals. Time dimension of control must coincidewith the time span of the event being measured.
5. ***Truthful:*** Strategy evaluation should be designed to provide a true picture of what ishappening. Information should facilitate action and should be directed to those individualswho need to take action based on it.
6. ***Selective:*** The control systems should focus on selective criteria like key important factorswhich are critical to performance. Insignificant deviations need not be focused.
7. ***Flexible:*** They must be flexible to take care of changing circumstances.
8. ***Suitable:*** Control systems should be suitable to the needs of the organisation. They mustconform to the nature and needs of the job and area to be controlled.
9. ***Reasonable:*** Control standards must be reasonable. Frequent measurement and rapidreporting may frustrate control.
10. ***Objective:*** A control system would be effective only if it is unbiased and impersonal. Itshould not be subjective and arbitrary. Otherwise, people may resent them.

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11. ***Acceptable:*** Controls will not work unless they are acceptable to those who apply them.
12. ***Foster Understanding and Trust:*** Control systems should not dominate decisions. Ratherthey should foster mutual understanding, trust and common sense. No department shouldfail to cooperate with another in evaluating and control of strategies.
13. ***Fix Responsibility for Failure:*** An effective control system must fix responsibility forfailure. Detecting deviations would be meaningless unless one knows where they areoccurring and who is responsible for them. Control system should also pinpoint whatcorrective actions are needed.There is no ideal strategy evaluation and control system. The final design depends on the uniquecharacteristics of an organisation's size, management style, purpose, problems and strengths.

14.3 Strategic Control

Strategic control is a type of *"steering control"*. We have to track the strategy as it is beingimplemented, detect any problems or changes in the predictions made, and make necessaryadjustments. This is especially important because the implementation process itself takes a long time before we can achieve the results. Strategic controls are, therefore, necessary to steer the firm through these events.

14.3.1 Types of Strategic Control

There are four types of strategic controls:

1. Premise control
2. Strategic surveillance
3. Special alert control
4. Implementation control

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Premise Control : Strategy is built around several assumptions or predictions, which are called *planning premises.* Premise control checks systematically and continuously whether the assumptions on which the strategy is based are still valid. If a vital premise is no longer valid, the strategy may have to bechanged. The sooner these invalid assumptions are detected and rejected, the better are the chances of changing the strategy.

Strategic Surveillance : Strategic surveillance is a broad-based vigilance activity in all daily operations both inside and outside the organisation. With such vigilance, the events that are likely to threaten the course ofa firm's strategy can be tracked. Business journals, trade conferences, conversations, observationsetc. are some of the information sources for strategic surveillance.

Special Alert Control : Sudden, unexpected events can drastically alter the course of the firm's strategy. Such events trigger an immediate and intense reconsideration of the firm's strategy.

Implementation Control : Strategy implementation takes place as a series of steps, programmes, investments and moves that occur over an extended period of time. Resources are allocated, essential people are put in place, special programmes are undertaken and functional areas initiate strategy related activities.Implementation control is aimed at assessing whether the plans, programmes and policies areactually guiding the organisation towards the predetermined objectives or not. Implementationcontrol assesses whether the overall strategy should be changed in the light of the results ofspecific units and individuals involved in implementation of the strategy. Two important methodsto achieve implementation control are:

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A. ***Monitoring Strategic Thrusts****:* Strategic thrusts are small critical projects that need to bedone if the overall strategy is to be accomplished. They are critical factors in the success ofstrategy.One approach is to agree early in the planning process on which thrusts are critical factorsin the success of the strategy. Managers responsible for these - implementation controls will single them out from other activities and observe them frequently. Another approachis to use stop/go assessments that are- linked to a series of these thresholds (time, costs,success etc.) associated with a particular thrust.

B*. *Milestone Reviews: Milestones are critical events that should be reached during strategyimplementation. These milestones may be fixed on the basis of.

(a) Critical events

(b) Major resource allocations

(c) Time frames etc.

14.3.2 Approaches to Strategic Control Notes

According to Dess, Lumpkin and Taylor, there are two approaches to strategic control.

Traditional Approach : Traditional approach to strategic control is sequential:

1. Strategies are formulated and top management sets goals
2. Strategies are implemented
3. Performance is measured against goals
4. Corrective measures are taken, if there are deviations.

Control is based on a feedback loop from performance measurement to strategy formulation.This process typically involves lengthy time lags and often tied to a firm's annual

planningcycle. This reactive measure is not sufficient to control a strategy. As already explained, this isbecause a strategy takes a long period for implementation and to produce results. The uncertainfuture requires continuous evaluation of the planning premises and strategy implementation.There is a better contemporary approach for strategic control.

Contemporary Approach : Under this approach, adapting to and anticipating both internal and external environmentchange is an integral part of strategic control.This approach addresses the assumptions and premises that provide the foundation for thestrategy. The key question addressed here is: do the organisation's goals and strategies still fitwithin the context of the current environment? This involves two key actions:

1. Managers must continuously scan and monitor the external and internal environment
2. Managers must continuously update and challenge the assumptions underlying the strategy. This may even need changes in the strategic direction of the firm.

While strategic control requires the contemporary approach, operational control is generallydone through traditional approach.

14.4 Operational Control

Operational control provides post-action evaluation and control over short periods.They involve systematic evaluation of performance against predetermined objectives.

14.4.1 Setting of Standards

The first step in the control process is setting of standards. Standards are the targets againstwhich the actual performance will be measured. They are broadly classified into quantitativestandards and

qualitative standards.

Quantitative

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These are expressed in physical or monetary terms in respect of production, marketing, finance etc. They may relate to:

1. Time standards
2. Cost standards
3. Productivity standards
4. Revenue standards

Qualitative

Qualitative criteria are also important in setting standards. Human factors such as highabsenteeism and turnover rates, poor production quality or low employee satisfaction can bethe underlying causes of declining performance. So, qualitative standards also need to beestablished to measure performance.

14.4.2 Measurement of Performance

The second step in operational control is the measurement of actual performance. Here, theactual performance is measured against the standards fixed. Standards of performance act as thebenchmark against which the actual performance is to be compared. It is important, however, tounderstand how the measurement of performance actually takes place. Operationally measuringis done through accounting, reporting and communication systems. A variety of evaluationtechniques are used for this purpose, which are explained in the next section. The other importantaspects of measurement relates to:

Check Your Progress

"Strategic control is a type of steering control". Discuss

Difficulties in Measurement : There are several activities for which it is difficult to set standards and measure performance.

Example : Performance of a worker in terms of units produced

in a day, week or monthcan easily be measured. On the other hand, it is not easy to measure the contribution of amanager or to assess departmental performance. The solution lays in developing verifiableobjectives, stated in quantitative and qualitative terms, against which performance can bemeasured.

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Timing of Measurement : Timing refers to the point of time at which measurement should take place. Delay in measurementor measuring before time can defeat the very purpose of measurement. So measurement shouldtake place at critical points in a task schedule, which could be at the end of a definable activity orthe conclusion of a task.

Example: In a project implementation schedule, there could be several critical points at which measurement would take place.

Periodicity in Measurement : Another important issue in measurement is "how often to measure", Generally, financialstatements like budgets, balance-sheets, and profit and loss accounts are prepared every year.But there are certain reports like production reports, sales reports etc. which are done on a daily, weekly, monthly basis.

14.4.3 Identifying Deviations

The third step in the control process is identifying deviations.The measurement of actual performance and its comparison with standards of performancedetermines the degree of deviation or variation between actual performance and the standard.

Broadly, the following three situations may arise:

- The actual performance matches the standards

- The actual performance exceeds the standards
- The actual performance falls short of the standards

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The first situation is ideal, but sometimes may not be realistic. Generally, a range of tolerancelimits within which the results may be accepted satisfactorily, are fixed and deviations from it are considered as variance. The second situation is an indication of superior performance. If exceeding the standards isconsidered unusual, a check needs to be made to test the validity of tests and the measurement system. The third type of situation, which indicates shortfall in performance, should be taken seriously and strategists need to pinpoint the areas where the performance is below standard and go into the causes of deviation. The analysis of variance is generally presented in a format called 'variance chart' and submitted to the top management for their evaluation. After noting the deviations, it is necessary to find the causes of deviation, which can be ascertained through the following questions: (Thomas)

1. Is the cause of deviation internal or external?
2. Is the cause random or expected?
3. Is the deviation temporary or permanent?

Analysis of variance leads to a plan for corrective action.

14.4.4 Taking Corrective Action

The last and final step in the operational control process is taking corrective action. Corrective action is initiated by the management to rectify the shortfall in performance. If the performance is consistently low, the strategists have to do an in depth analysis and diagnosis to isolate the factors responsible for such low performance and take appropriate corrective actions.

There are three courses for corrective action:

1. Checking performance
2. Checking standards
3. Reformulating strategies, plans and objectives.

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14.5 Techniques of Strategic Control

Organisations use many techniques or mechanisms for strategic control. Some of the important mechanisms are:

1. ***Management Information systems:*** Appropriate information systems act as an effective control system. Management will come to know the latest performance in key areas and take appropriate corrective measures.

2. ***Benchmarking:*** It is a comparative method where a firm finds the best practices in an area and then attempts to bring its own performance in that area in line with the best practice. Best practices are the benchmarks that should be adopted by a firm as the standards to exercise operational control. Through this method, performance can be evaluated continually till it reaches the best practice level. In order to excel, a firm shall have to exceed the benchmarks. In this manner, benchmarking offers firms a tangible method toevaluate performance.

3. ***Balanced scorecard:*** It is a method based on the identification of four key performance measures i.e. customer perspective, internal business perspective, innovation and learning perspective, and the financial perspective. This method is a balanced approach to performance measurement as a range of financial and non-financial parameters are taken into account for evaluation.

NOTES

14.6 Summary

- Strategic evaluation generally operates at two levels – strategic and operational level. Atthe strategic level, managers try to examine the consistency of strategy with environment.At the operational level, the focus is on finding how a given strategy is effectively pursuedby the organisation.
- Strategic control is a type of "steering control". We have to track the strategy as it is beingimplemented, detect any problems or changes in the predictions made, and make necessaryadjustments.
- Operational control provides post-action evaluation and control over short periods.
- They involve systematic evaluation of performance against predetermined objectives.
- Organisations use many techniques or mechanisms for strategic control. Some of theimportant mechanisms are management Information systems, bench marking, balanced scorecard, key factor rating, responsibility centres, network technique, Management by Objectives (MBO), Memorandum of Understanding.

14.7 Key Terms

Balanced Scorecard: Strategic performance management tool - a semi-standard structured report supported by proven design methods and automation tools.

Benchmarking: Comparative method where a firm finds the best practices in an area and then attempts to bring its own performance in that area in line with the best practice.

Management by Objectives: Process of agreeing upon objectives within an organisation so that management and employees agree to

the objectives and understand what they are in the organisation.

Operational control: ensures that day-to-day actions are consistent with established plans and objectives.

Responsibility centre: A segment of a business or other organisation, in which costs can be segregated, with the head of that segment being held accountable for expenses.

Strategic evaluation and control: Process of determining the effectiveness of a given strategy in achieving the organisational objectives and taking corrective actions wherever required.

Strategic surveillance: Broad-based vigilance activity in all daily operations both inside and outside the organisation.

NOTES

14.8 Questions and Exercises

1. Comment on the nature of strategic control and evaluation.
2. According to you, what should be the criteria for an effective evaluation system?
3. In evaluating a strategy, it is important to examine whether an organisation has the abilities, competencies, skills and talents needed to carry out a given strategy. Why?
4. If you were a strategist making evaluation, what would you do if you find something wrong though nothing is wrong with the performance?
5. Suggest some corrective actions that you would undertake if the performance is being affected adversely by inadequate resource allocation and ineffective systems.
6. How would you check whether a strategy can be implemented within the resources of an enterprise?
7. “Strategic control is a type of steering control”. Discuss
8. Discuss the general approaches to strategic control.

9. Discuss the steps in implementing effective operational control system.
10. Analyse the role of organisational systems in evaluation.

NOTES

Check your progress

Fill in the blanks:

1. ……………………control focuses on finding how a given strategy is effectively pursued by the organisation.
2. ………………………..control is concerned with tracking a strategy as it is being implemented.
3. ……………………control is done through policies, rules, standard operating practices and orders from superiors.
4. Assumptions or predictions around which a strategy is built is referred to as…………………………
5. PERT and CPM are techniques of ....control.
6. Control is based on a ……………………..from performance measurement to strategy formulation.
7. The analysis of variance in performance is generally presented in a format called ……………………
8. Best practices serve as……………………..against which actual performance is evaluated. Notes
9. ……………………………… are used to isolate a unit so that it can be evaluated separately from the rest of the corporation.
10. Management by Objectives method was proposed by…………………….

Answers:

1. Operational 2. Strategic 3. Behaviour 4. planning premises 5. network 6. feedback loop 7. variance chart 8. Benchmarks 9. Responsibility centres 10. Peter F Drucker.

14.9 Further Reading and References

NOTES

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