Management Principles for Engineers

Lecture Notes

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4.1 Strategic management

 Strategic management is the process of formulating and implementing strategies to accomplish longterm goals and sustain competitive advantage. The essence of strategic management is looking ahead, understanding the environment and the organisation, and effectively positioning the organisation for competitive advantage in changing times.

Competitive advantage arises when an organisation acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources, such as high-grade ores or inexpensive power, or access to highly trained and skilled personnel — human resources.

Henry Mintzberg describes **organisational strategy** as 'a pattern in a stream of decisions'. This decision-based concept of strategy has two important implications. First, strategy is not necessarily apparent from the analysis of just one decision, because it must be viewed in the context of several decisions and the consistency among the decisions. Second, the organization must be aware of alternatives in all of its decisions.

4.1.1 Sustainable strategic competitiveness
Achieving and sustaining competitive advantage is a challenging task for even the largest organisations, all of which are very aware that new technologies, changes in the global economy or world geopolitics, and sudden shifts in consumer demand could lead to their demise.

Sustainable competitive advantage is the hallmark of successful companies such as Facebook, Sony and IKEA. In all these companies, technological and design leadership has been central to the strategy of sustainable competitive advantage and has been driven by senior management with almost crusading zeal and passion. Sustainable competitive advantage can also be achieved through applying technologies developed by other industries. The aim for any organisation, however, is not just to achieve competitive advantage but to make it sustainable in spite of competitors' attempts to copy or duplicate a success story.

Organisations need to be prepared for a wide range of eventualities. Importantly, a strategy provides the plan for allocating and using resources with consistent strategic intent — that is, with all organisational energies directed towards a unifying and compelling target or goal. Companies need to be aware of technological changes that alter the rules of competition. In addition, companies need to be aware of how customers may interact with these technologies and where the technologies may provide access to certain 'slack' resources, such as privately owned vehicles or vacant residential accommodation. It could be said, therefore, that these marketplace companies enable existing infrastructure to be used more efficiently.

Strategic management, however, is more than just being aware of how environmental trends interact with each other to provide new opportunities and a changed business landscape. For instance, not every company who is aware of these trends can turn the opportunity into profit. The company must be able to harness its own resources and in some cases change itself to turn opportunity into profit.

4.2 Strategic management goals

A **goal** is a desired future state that the organization attempts to realize. The term **objective** is often used interchangeably with goal but usually refers to specific targets for which measurable results can be obtained. Organizational objectives are the end points of an organization's mission.

The strategic goals are crucial to clarify its vision, which they concretize and specify outcomes. They are generally defined by the owner or top management, who is also responsible for achieving them. Strategic goals concretize the vision and help managers to manage and motivate staff at the organization, together with properly defined specific objectives.

Sound strategy starts with having the right goal, the ultimate goal for any business should be superior profitability. This creates value for investors in the form of above average returns, returns that exceed what an investor could earn by investing in alternative opportunities of equivalent risk. The nature of the competition within an organisation's environment largely determines whether above average returns are achievable. An understanding of the organisation's markets is crucial for setting strategic management goals. Good economic analysis is therefore essential. The roots of the structural and market analysis within strategic management lie within economics.

Organisations compete in environments that vary according to their market structures. Where a *monopoly environment* exists there is only one organisation and no competition. This creates absolute competitive advantage, delivering sustainable and probably excessive business profits. This absolute competitive advantage may not be in the public interest — lack of consumer choice and high prices are the likely outcomes.

An *oligopoly environment* or oligopolistic competition is a market where a small number of competitors feel themselves constrained more by the actions of their rivals than by those of their customers. Organisations within an oligopoly sustain long-term competitive advantages within defined market segments. In the absence of competition within these segments, they can reap excessive business profits. Aircraft manufacturers, major machine tool producers, defence manufacturers, national newspapers, natural resource extraction operations and segments of the food manufacturing industry are in an oligopolistic environment.

An effective understanding of the principles of game theory therefore becomes a critical skill of strategists under an oligopoly. They need to guess correctly what a rival's response to a price change will be; to understand when a new entrant to the industry should be accommodated rather than driven out; and to know when to collude with a rival, either explicitly or implicitly, rather than fighting a cut-throat action.

The global economy has helped to create for many businesses today an *environment of hypercompetition*. This is an environment in which there are at least several players who directly compete with one another. An example is the fast-food industry where McDonald's, KFC, Pizza Hut and many other restaurant chains all compete for largely the same customers. Because the competition is direct and intense, any competitive advantage that is realised is temporary. Successful strategies are often copied and organisations must be agile, in that they must continue to find new strategies that deliver new sources of competitive advantage, even while trying to defend existing ones. In hypercompetition, there are always some winners and losers. Business

profits can be attractive but intermittent. The customer generally gains in this environment through lower prices and more product/-service innovation.

4.3 The strategic management process

Strategic management is successful when organisations, even those operating in environments of hypercompetition, achieve sustainable competitive advantage and earn above-average returns. Successful strategies are crafted from insightful understandings of the competitive environment as well as intimate knowledge of the organisation. They are implemented with commitment and resolution.
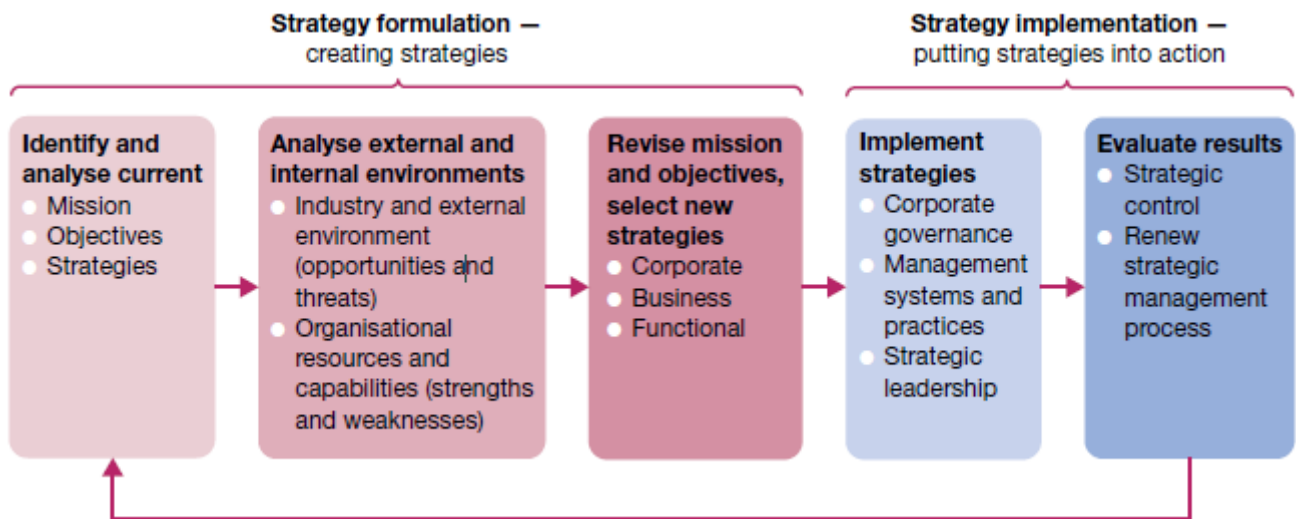

Fig 4.3.1 Strategy formulation and implementation in the strategic management process

The first strategic management responsibility is **strategy formulation**, the process of creating strategy. This involves assessing existing strategies, the organisation and your environment to develop new strategies and strategic plans capable of delivering future competitive advantage. Peter Drucker associates this process with a set of five strategic questions: *What is our business mission? Who are our customers? What do our customers consider value? What have been our results? What is our plan?*

The second strategic management responsibility is **strategy implementation**, the process of allocating resources and putting strategies into action. Once strategies are created, they must be successfully acted on to achieve the desired results. It requires decision — now. It imposes risk — now. It requires action — now. It demands allocation of resources, and above all, of human resources — now. It requires work — now.

4.3.1 Analysis of mission, values and objectives
The strategic management process begins with a careful assessment and clarification of the organisational mission, values and objectives.

Mission

The **mission** or purpose of an organisation may be described as its reason for existence in society. A mission should represent what the strategy or underlying business model is trying to accomplish. 'What are we moving to? What is our dream? What kind of a difference do we want to make in the world?' can be asked

A good mission statement identifies the domain in which the organisation intends to operate — including the customers it intends to serve, the products and/or services it intends to provide, and the location in which it intends to operate. The mission statement should also communicate the underlying philosophy that will guide employees in these operations. For example Consider the mission statement for Merck, one of the world's leading pharmaceutical companies: 'To discover, develop and provide innovative products and services that save and improve lives around the world'.

An important test of corporate purpose and mission is how well it serves the organisation's **stakeholders**. Stakeholders are individuals and groups — customers, shareholders, suppliers, creditors, community groups and others — who are directly affected by the organisation and its accomplishments.

Employees
We respect the individuality of each employee . . . creativity and productivity are encouraged, valued and rewarded.

Communities
We are committed to being caring and supportive corporate citizens within the worldwide communities in which we operate.

Mission
Create value for our stakeholders

Shareholders
We are dedicated to . . . performing in a manner that will enhance returns on investments.

Customers
We are committed to providing superior value in our products and services.

Suppliers
We think of our suppliers as partners who share our goal of . . . highest quality.

Fig 4.3.2 External stakeholders and the mission statement

In the strategic management process, the stakeholder test can be done as a constituencies analysis. Here, the specific interests of each stakeholder are assessed along with the organisation's record in responding to them. Figure above gives an example of how stakeholder interests can be reflected in a mission statement

Core values

Values are broad beliefs about what is or is not appropriate. **Organisational culture** is defined as the predominant value system of the organisation as a whole. Through organisational cultures, the values of managers and other members are shaped and pointed in common directions. In strategic management, the presence of strong core values for an organisation helps build institutional identity. It gives character to an organisation in the eyes of its employees and external stakeholders, and it backs up the mission statement. Shared values also help guide the behaviour of organisation members in meaningful and consistent ways. For example, Merck backs up its mission with a public commitment to core values that state 'our core values are driven by a desire to improve human life, achieve scientific excellence, operate with the highest standards of integrity, expand access to our products and employ a diverse workforce that values collaboration'.

Objectives

Whereas a mission statement sets forth an official purpose for the organisation and the core values describe appropriate standards of behaviour for its accomplishment, **operating objectives** direct activities towards specific performance results. These objectives are shorter term targets against which actual performance results can be measured as indicators of progress and continuous improvement. Any and all operating objectives should have clear means–ends links to the mission and purpose. Any and all strategies should, in turn, offer clear and demonstrable opportunities to accomplish operating objectives.

According to Peter Drucker, the operating objectives of a business might include:

i. *profitability* — producing at a profit in business
ii. *market share* — gaining and holding a specific market share
iii. *human talent* — recruiting and maintaining a high-quality workforce
iv. *financial health* — acquiring capital; earning positive returns
v. *cost efficiency* — using resources well to operate at low cost
vi. *product quality* — producing high-quality goods or services
vii. *innovation* — developing new products and/or processes
viii. *social responsibility* — making a positive contribution to society.

4.3.2 Analysis of organisational resources and capabilities

Second step in the strategic management process are analysis of the organisation and analysis of its environment. They may be approached by a technique known as SWOT analysis — the internal analysis of organisational Strengths and Weaknesses as well as the external analysis of environmental Opportunities and Threats. A SWOT analysis begins with a systematic evaluation of the organisation's resources and capabilities. A major goal is to identify core competencies in the form of special strengths that the organisation has or where it does exceptionally well in comparison with competitors. They are capabilities that by virtue of being rare, costly to imitate, and non-substitutable become viable sources of competitive advantage.

Core competencies may be found in special knowledge or expertise, superior technologies, efficient manufacturing technologies or unique product distribution systems, among many other possibilities. Organisations need more competencies that do important things better than the competition and that are very difficult for competitors to duplicate.
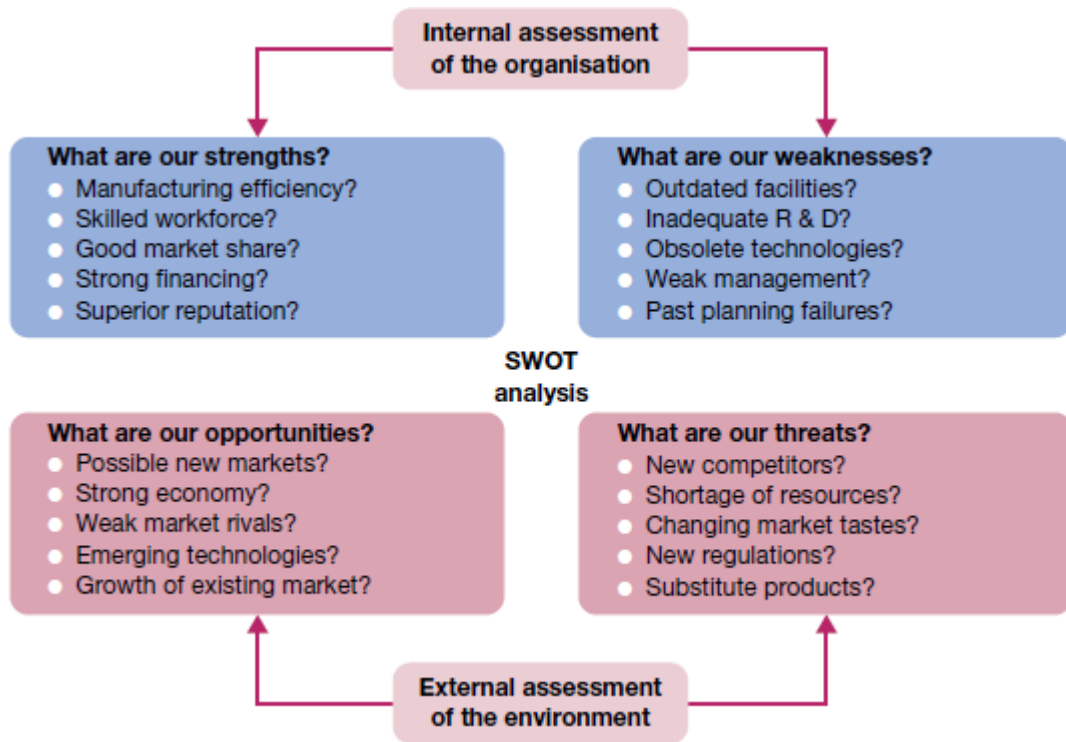
Fig 4.3.3 SWOT analysis of strengths, weaknesses, opportunities and threats

Analysis of industry and environment

A SWOT analysis is not complete until opportunities and threats in the external environment are also analysed. They can be found among *macroenvironment factors* such as technology, government, social structures and population demographics, the global economy and the natural environment. They can also include developments in the *industry environment* of resource suppliers, competitors and customers. Opportunities may exist as possible new markets or a strong economy; threats may be identified in such things as the emergence of new competitors or technologies, resource scarcities, changing customer tastes and new government regulations, among other possibilities.

In respect to the external environment as a whole, the more stable and predictable it is, the more likely that a good strategy can be implemented with success for a longer period of time, but when the environment is composed of many dynamic elements that create uncertainties, more flexible strategies that change with time are needed. Given the nature of competitive environments today, strategic management must be considered an ongoing process in which strategies are formulated, implemented, revised and implemented again in a continuous manner.

Michael Porter offers the five forces model as a way of adding sophistication to this analysis of the environment
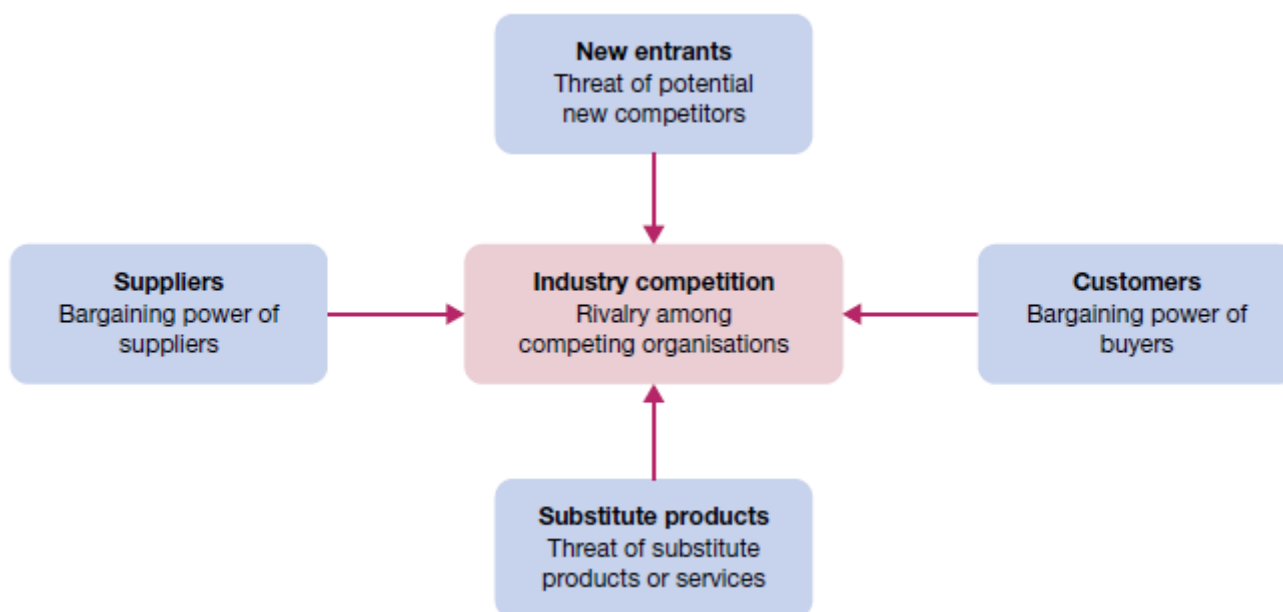

Fig 4.3.4 Porter's model of five strategic forces affecting industry competition
Porter's framework for competitive industry analysis directs attention towards understanding the following forces:
1. *industry competitors* — intensity of rivalry among firms in the industry
2. *new entrants* — threats of new competitors entering the market
3. *suppliers* — bargaining power of suppliers
4. *customers* — bargaining power of buyers
5. *substitutes* — threats of substitute products or services.

Michael Porter's Five Forces is a powerful competitive analysis tool to determine the principal competitive influence in a market. It is a broadly used model in business that refers to the five important factors that drive a firm's competitive position within an industry. By thinking through how each force affects you, and by identifying the strength and direction of each force, you can quickly assess the strength of the position and your ability to make a sustained profit in the industry. Thus Five Forces analysis helps the firm stay competitive by:
- Knowing the strength of these five forces, you can develop strategies that help their businesses be more competitive and profitable.
- Looking at opportunities, you can to strengthen their organization's position compared to the other players for reducing the competitive pressure as well as generate competitive advantage.

Step-by-Step Five Forces Analysis
Porter's Five Forces Analysis is an important tool in the project planning stage. Porter's Five Forces Analysis makes a strong assumption that there are only five important forces that could determine the competitive power in a business situation. Using the following three steps:
1. Identify the different factors that bring about the competitive pressures for each of the five forces:
    - Who are the suppliers?
    - Who are the customers?
    - What are the substitute products?

o Is it difficult to enter this industry?
o Who are the major competitors in this industry?
2. Based on the factors identified, determine if the pressures are:
o Strong
o Moderate
o Weak
3. Determine whether the strength of the five forces is favorable to earning attractive profits in the industry. Using the Five Forces model can help answer the following questions:
o Is the state of competition in the industry stronger than "normal"?
o Can companies in this industry expect to earn decent profits in light of the competitive forces?
o Are the competitive forces sufficiently powerful enough to undermine industry profitability?

Components of Porter's Five Forces
The Porter's five forces analysis include the following components:

The bargaining power of suppliers: it represents the extent to which the suppliers can influence the prices. When there are a lot of suppliers, buyers can easily switch to competition because no supplier can, actually, influence the prices and exercise control in the industry. On the contrary, when the number of suppliers is relatively small, they can push the prices up and be powerful. Thus, supplier bargaining power is high when:
- The market is conquered by a few big suppliers.
- There are no alternative products available.
- The supplier customer base is fragmented, making their bargaining power low.
- High switching costs from one to another supplier.
Possibility of supplier integration forward, to obtain higher profits and margins.

The bargaining power of Customers: The bargaining power of customers looks at customers' ability to affect the pricing and quality of products and services. When the number of consumers of a particular product or service is low, they have much more power to affect pricing and quality. The same holds true when a large proportion of buyers can easily switch to a different product or service. When consumers buy products in low quantities, the bargaining power is low. Factors affecting this force are buyer concentration, the degree of dependency on the product, overall bargaining leverage, readily available purchasing information, substitute products, price sensitivity, and total volume of trade. Thus, customer bargaining power is high when:
- Customers procure large volumes.
- The supplying industry consists of several small operators.
- The supplying industry is controlled with high fixed costs.
- The product has substitutes. Switching products is easy and simple.
- Switching products does not incur high costs.
- Customers are price responsive. Customers could manufacture the product themselves.

The threat of new entrants: when the barriers to entry into an industry are high, new businesses can hardly enter the market due to high costs and strong competition. Highly concentrated industries, like the automobile or the health insurance, can claim a competitive advantage because their products are not homogeneous, and they can sustain a favorable position. On the other hand, when the barriers to entry into an industry are low, new businesses can take

advantage of the economies of scale or key technologies. Possible barriers to entry could include:

- Economies of scale. High initial investment costs or fixed costs
- Cost advantage of existing players.
- Brand loyalty.
- Intellectual property like licenses, etc.
- Shortage of important resources.
- Access to raw materials is controlled by existing players.
- Distribution means are controlled by existing players.
- Existing players have secure customer relations. Elevated switching costs for customers.
- Legislation and government acts.

The threat of substitutes: when customers can choose between a lot of substitute products or services, businesses are price takers, i.e. buyers determine the prices, thereby lessening the power of businesses. On the contrary, when a business follows a product differentiation strategy, it can determine the ability of buyers to switch to the competition. This threat is determined by things such as:

- Brand dependability of customers.
- Secure customer relationships.
- Switching costs for customers.
- The relative price for performance of substitutes.
- Up-to-date trends.

Competitive rivalry: in highly competitive industries, firms can exercise little or no control on the prices of the goods and services. In contrast, when the industry is a monopolistic competition or monopoly, businesses can fully control the prices of goods and services. Rivalry between existing players is likely to be high when:

- Players are the same size.
- Players have comparable strategies.
- Little or no differentiation between players and their products leading to price competition.
- Low market growth rates.
- Barriers for exit are high.

Porter's Five Forces Example - Footwear Company

NiceWare is a leading Footwear company that operates in the athletic apparel industry.

Based on Porter's Five Forces model the threat of new entrants is moderate as there are high capital costs, mostly related to advertising and promotion, especially when a new product line is launched. On the other hand, company A can expand in the performance apparel industry and cross-sell its products.

The bargaining power of suppliers is relatively low because the company has many different suppliers both in the US and abroad.
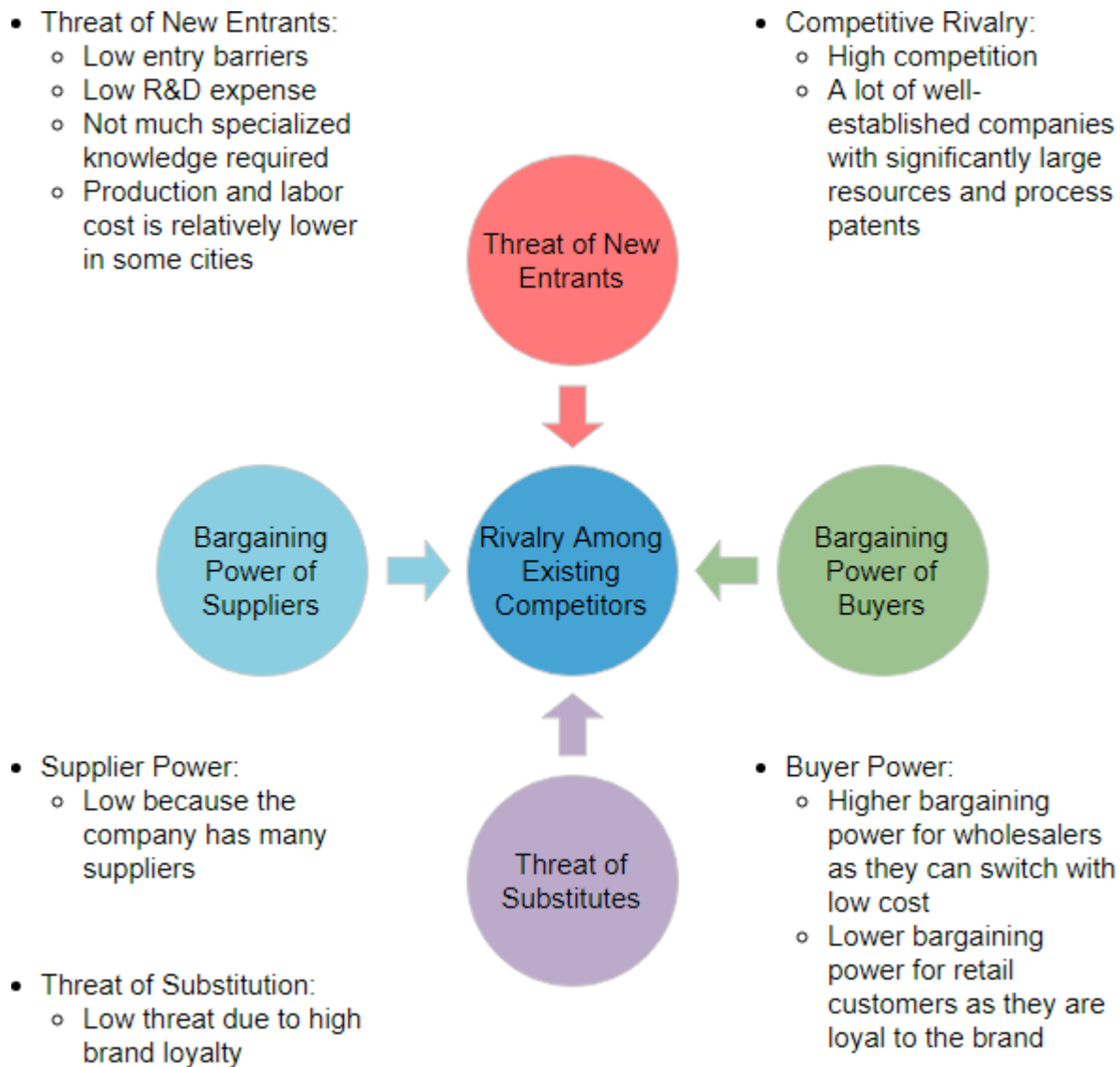
The bargaining power of customers is higher in the wholesale customers as they can switch at a low cost to the competition, thereby gaining a higher margin. With respect to the retail customers, the bargaining power is lower as customers are loyal to the brand.

The threat of new entrants is high as the entry barriers are low - low R & D expense, not much specialized knowledge is required in operating the business, low production and labour cost in some cities.

The threat of substitute products is relatively low because brand loyalty is high. Hence, the demand for the company's products is expected to continue in the long-term.

The competitive rivalry in the industry is high as there are a lot of well-established companies with significantly larger resources and process patents.

These forces are brought together in a diagram below:

- Threat of New Entrants:
  - Low entry barriers
  - Low R&D expense
  - Not much specialized knowledge required
  - Production and labor cost is relatively lower in some cities

- Competitive Rivalry:
  - High competition
  - A lot of well-established companies with significantly large resources and process patents

Threat of New Entrants

Bargaining Power of Suppliers

Rivalry Among Existing Competitors

Bargaining Power of Buyers

Threat of Substitutes

- Supplier Power:
  - Low because the company has many suppliers

- Threat of Substitution:
  - Low threat due to high brand loyalty

- Buyer Power:
  - Higher bargaining power for wholesalers as they can switch with low cost
  - Lower bargaining power for retail customers as they are loyal to the brand

The effect on Internet on Porter's 5 forces model

The entry of new competitors

Today, it's not just traditional industry competitors the firm needs to worry about, but new entrants from outside the industry, equipped with new digitally based business models and value propositions. This is often tech giants and startups that have envisioned and built a new business model from the ground up, powered by a new platform ecosystem for digital business. They're leveraging the familiar social, mobile, analytics and cloud technologies, but are often adding in

personas and context, intelligent automation, the Internet of Things, and cybersecurity to further enhance the value proposition of their platform.

Why can new entrants move in so easily? Digital business changes the rules by lowering the traditional barriers to entry. A digitally based business model requires far less capital and can bring large economies of scale for example.

The threat of substitutes

The threat of substitutes has to do with the threat of substitute products or services. In terms of internet based business, this can come from a purely digital substitute or a hybrid digital/physical substitute. Taxi services, such as Uber and EasyTaxi for example, provide a hybrid model via a digital app for consumers and taxi drivers, coupled with the physical taxis.

Digital services wrapped around a physical product are another example and can range from one extreme such as the industrial Internet to another such as home automation technologies or personal fitness products. In addition, the long-term revenue stream from the digital services may be worth far more than the one time sale of the physical product.

The threat of substitutes is high in many industries since switching costs are low and buyer propensity to substitute is high. In the taxi services example, customers can easily switch from traditional models to the new model simply by installing an app on their smartphone. Propensity to switch from the traditional model is high due to consumer wait times for taxis, lack of visibility into taxi location and so on.

The bargaining power of buyers

Perhaps the strongest of the five forces impacting industry competition is the bargaining power of buyers since the biggest driver of digital business comes from the needs and expectations of consumers and customers themselves.

This bargaining power lays out a new set of expectations for the digital customer experience and necessitates continual corporate innovation across business models, processes, operations, products and services.

Customers and consumers have amassed far more bargaining power today due to instant access to information, insights from social media including access to reviews and feedback, low switching costs via digital channels, price sensitivity, access to substitute products and services with greater ease of use and convenience, as well as increased industry competitiveness as a result of the other forces.

The bargaining power of suppliers

Suppliers can accelerate or slow down the adoption of a digitally based business model based upon how it impacts their own situation. Those pursuing digital models themselves, such as the use of APIs to streamline their ability to form new partnerships and manage existing ones, may help accelerate your own model.

Those who are suppliers to the traditional models, and who question or are still determining their new role in the digital equivalent, may use their bargaining power to slow down or dispute the validity or legality of the new model.

Good examples are the legal and business issues surfacing around the digital-sharing economy (i.e. ride-sharing, room-sharing etc.) where suppliers and other constituents work to ensure the business model and process innovations still adhere to established rules, regulations, privacy, security and safety. This is a positive and needed development since, coupled with bargaining power of buyers, it can help to keep new models "honest" in terms of how they operate.

The rivalry among the existing competitors

Finally, existing competitors are all looking at internet-based business, trying to understand the disruptions occurring, and prepare their response. The responses can range all the way from defensive to offensive measures, and even a first-mover attack. This rivalry among competitors is always in play, but in recent years digital business has added fuel to the fire, just as the e-business era did many years ago.

The rivalry is heating up because entry and exit barriers are going down due to the comparative low-cost of internet business models, and in many cases new entrants do not even need to own physical assets or infrastructure. In particular, the "platform" model is seeing considerable success in the marketplace by simply connecting stakeholders and applying a set of peripheral services to enhance the customer experience.

By doing so, platform operators are moving to the forefront of service delivery and getting closer to the customer without even owning assets or employees working in that particular industry. Today, any service provider, and even content provider, risks becoming hostage to the platform operator, which, by aggregating all those peripherals and streamlining the experience of using them, suddenly moves from the periphery to the centre.

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4.4 Strategies used by organisations

The strategic management process encompasses the three levels of strategy shown in figure. Strategies are formulated and implemented at the organisational or corporate level, business level and functional level. All should be integrated in means–ends fashion to accomplish objectives and create sustainable competitive advantage.
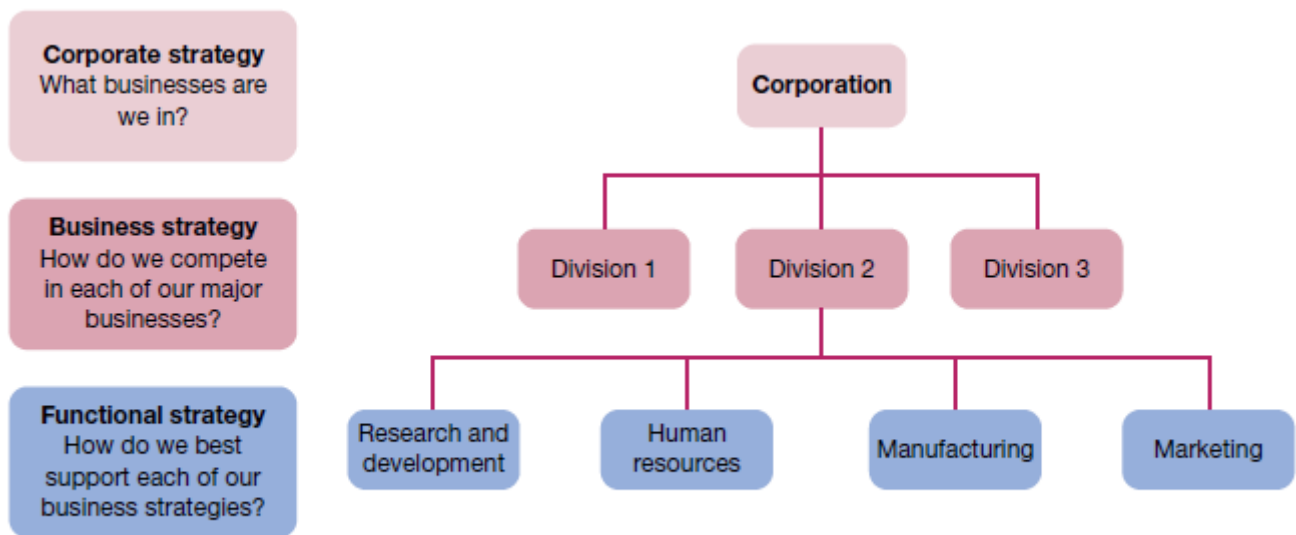
Fig 4.4.1 Levels of strategy in organisations

Levels of strategy

The level of **corporate strategy** directs the organisation as a whole towards sustainable competitive advantage. For a business it describes the scope of operations by answering the following question: In what industries and markets should we compete? The purpose of corporate strategy is to set direction and guide resource allocations for the entire enterprise. In large, complex organisations like General Electric (GE), corporate strategy identifies the different areas of business in which a company intends to compete. The organisation presently pursues business interests in aviation, home and businesses solutions, financial (capital) services, healthcare, energy and transportation, for example. Typical strategic decisions at the corporate level relate to the allocation of resources for acquisitions, new business development, divestitures and so on across the business portfolio. Increasingly, corporate strategies for many businesses include an important role for global operations such as international joint ventures and strategic alliances.

Business strategy is the strategy for a single business unit or product line. It describes intent to compete within a specific industry or market. Large conglomerates such as GE, are composed of many businesses, with many differences among them in product lines and even industries. The term **strategic business unit (SBU)** is often used to describe a single business or a component that operates with a separate mission within a larger enterprise. The selection of strategy at the business level involves answering the question: How are we going to compete for customers in this industry and market? Typical business strategy decisions include choices about product/service mix, the location of facilities and new technologies.

Functional strategy guides the use of organisational resources to implement business strategy. This level of strategy focuses on activities within a specific functional area of operations. The standard business functions of marketing, manufacturing, human resources, and research and development illustrate this level of strategy. The question to be answered in selecting functional strategies becomes: How can we best use resources to implement our business strategy? Answers to this question typically involve the choice of progressive management and organizational practices that improve operating efficiency, product or service quality, customer service or innovativeness.

Growth and diversification strategies

Traditionally one of the most common and popular of the grand or master strategies pursued by organizations at the corporate or business levels is growth. **Growth strategies** pursue an increase in size and the expansion of current operations. They are popular in part because growth is viewed as necessary for long-term survival in some industries.

One approach to growth is through **concentration**, where expansion is within the same business area. Another approach to growth is through **diversification**, where expansion takes place through the acquisition of, or investment in, new and sometimes different business areas. A strategy of *related diversification* involves growth by acquiring new businesses or entering business areas that are related to what the organisation already does. This strategy seeks the advantages of growth in areas that use core competencies and existing skills. A corporate strategy of *unrelated diversification* involves growth by acquiring businesses or entering business areas that are different from what the organisation already does. Occasionally, a company will invest in a market that is completely unrelated to its current operations.

Diversification can also take the form of **vertical integration**, where a business seeks added value creation by acquiring suppliers (*backwards vertical integration*) or distributors (*forwards vertical integration*). In the car making industry, backwards vertical integration has been common as firms purchased suppliers of key parts to ensure quality and control over their availability. In beverages, both Coca Cola and PepsiCo have pursued forward vertical integration by purchasing some of their major bottlers.

There is a tendency to equate growth with effectiveness, but that is not necessarily true. Any growth strategy, whether by concentration or some form of diversification, must be well planned and well managed to achieve the desired results. Increased size of operation in any form adds challenge to the management process. Diversification, in particular, brings the difficulties of complexity and the need to manage and integrate very dissimilar operations. Research indicates that business performance may decline with too much unrelated diversification.

Restructuring and divestiture strategies

When organisations experience performance problems, perhaps due to unsuccessful diversification, retrenchment of some sort often takes place. The most extreme **retrenchment strategy** is *liquidation*, when operations cease, owing to the complete sale of assets or the declaration of bankruptcy. Less extreme but still of potential dramatic performance impact is **restructuring**. This changes the scale and/ or mix of operations in order to gain efficiency and improve performance. The decision to restructure can be difficult for managers to make because, at least on the surface, it seems to be an admission of failure. But in today's era of challenging economic conditions and environmental uncertainty, restructuring is used frequently and with new respect.

Restructuring is sometimes accomplished by **downsizing**, which decreases the size of operations with the intention of becoming more streamlined. The expected benefits are reduced costs and improved operating efficiency. A common way to downsize is to cut the size of the workforce. Research has shown that such downsizing is most successful when the workforce is reduced in a way that allows for better focusing of resources on key performance objectives. Retrenchment with a strategic focus is sometimes referred to as *rightsizing*. This contrasts with the less well regarded approach of simply cutting staff 'across the board'.

Restructuring by **divestiture** involves selling off parts of the organisation to refocus on core competencies, cut costs and improve operating efficiency. This is a common strategy for organisations that find they have become overdiversified and are encountering problems managing the complexity of diverse operations. It is also a way for organisations to take advantage of the value of internal assets by 'spinning off' or selling to shareholders a component that can stand on its own as an independent business.

Cooperation in business strategies
In recent years increasing globalisation and regionalisation of markets has led to the dramatic growth of cross border cooperation between companies. The steady reduction of trade barriers has been accompanied by considerable economic turbulence and uncertainty in world markets, and the spread of a high degree of trade liberalisation in most countries of the world. A major response to this has been the growth of **strategic alliances** and other forms of cooperative strategy between companies, particularly in technology and marketing. For Porter and Fuller, the basic motivation for an alliance is that: 'Coalitions that arise when performing a value chain activity with a partner are superior to any other way . . . Coalitions can be a valuable tool in many aspects of global strategy, and the ability to exploit them will be an important source of international advantage.'

International joint ventures are common form of international business; they constitute one among many forms of strategic alliance. For example, in the airline industry most companies have entered into some form of strategic marketing alliance. (Airvistara).

Another way to cooperate strategically is through outsourcing alliances — contracting to purchase important services from another organisation. Many organisations are outsourcing their payroll, recruitment, information technology and security functions to specialised companies. This is often driven by a combination of motives — the desire to reduce costs and to gain access to expertise that does not exist within the company. Supplier alliances, in which preferred supplier relationships ensure a smooth and timely flow of supplies among alliance partners, stem from cooperation in the supply chain. For example, car manufacturers such as General Motors and Ford relied on multisourcing during much of the 20th century, but in the 1980s began to develop supplier alliances which were necessary for their just-in-time (JIT) production systems and to guarantee improved component quality. Distribution alliances are another cooperative approach. These involve organisations joining together to accomplish product or service sales and distribution. For example, Telstra in Australia and Cisco Systems in the United States have an alliance to jointly market internet services to business customers.

E‑business strategies
e‑business strategy is the strategic use of the internet to gain competitive advantage. Popular e-business strategies involve B2B (business-to-business) and B2C (business-to-customer) applications. *B2B business strategies* involve the use of IT and the internet to vertically link organisations with members of their supply chains. One of the interesting developments in this area involves the use of online auctions as a replacement for preferred supplier relationships and outsourcing alliances. Organisations can now go to the internet to participate in auction bidding for supplies of many types. Whether small or large in size they immediately have access to potential suppliers competing for their attention from around the world.

B2C business strategies use IT and the internet to link organisations with their customers. A common B2C strategy is e-tailing; that is, the sale of goods directly to customers via the internet.

For some organisations, e-tailing is all that they do; these are 'new economy' organisations and the business strategy is focused entirely on internet sales — examples include Amazon.com, priceline. com and Dell.com. For others who are part of the traditional or 'old economy', e-tailing has been added as a component in their business strategy mix.

4.5 Strategy formulation

Michael Porter says: 'The company without a strategy is willing to try anything'. With a good strategy in place, the resources of the entire organisation can be focused on the overall goal — superior profitability or above-average returns. Whether building e-business strategies for the new economy or crafting strategies for more traditional operations, it is always important to remember this goal and the need for **sustainable competitive advantage**. The major *opportunities for competitive advantage* are found in the following areas:

i. *cost and quality* — where strategy drives an emphasis on operating efficiency and/or product or service quality
ii. *knowledge and speed* — where strategy drives an emphasis on innovation and speed of delivery to market for new ideas
iii. *barriers to entry* — where strategy drives an emphasis on creating a market stronghold that is protected from entry by others
iv. *financial resources* — where strategy drives an emphasis on investments and/or loss sustainment that competitors can't match.

Importantly, any advantage gained in today's global and information-age economy of intense competition must always be considered temporary, at best. Things change too fast. Any advantage of the moment will sooner or later be eroded as new market demands, copycat strategies and innovations by rivals take their competitive toll over time. The challenge of achieving sustainable competitive advantage is thus a dynamic one. Strategies must be continually revisited, modified and changed if the organisation is to keep pace with changing circumstances. Formulating strategy to provide overall direction for the organisation thus becomes an on-going leadership responsibility. Fortunately, a number of strategic planning models or approaches are available to help executives in the strategy formulation process. At the business level, one should understand Porter's generic strategies model and product lifecycle planning. At the corporate level, it is helpful to understand portfolio planning, adaptive strategies and incrementalism and emergent strategies.

Porters generic strategies
Michael Porter's five forces model for industry analysis was introduced earlier. Use of the model helps answer the question: Is this an attractive industry for us to compete in? Within an industry, however, the initial strategic challenge becomes positioning your organisation and products relative to competitors. The strategic question becomes: How can we best compete for customers in this industry? Porter advises managers to answer this question by using his generic strategies framework shown in figure.
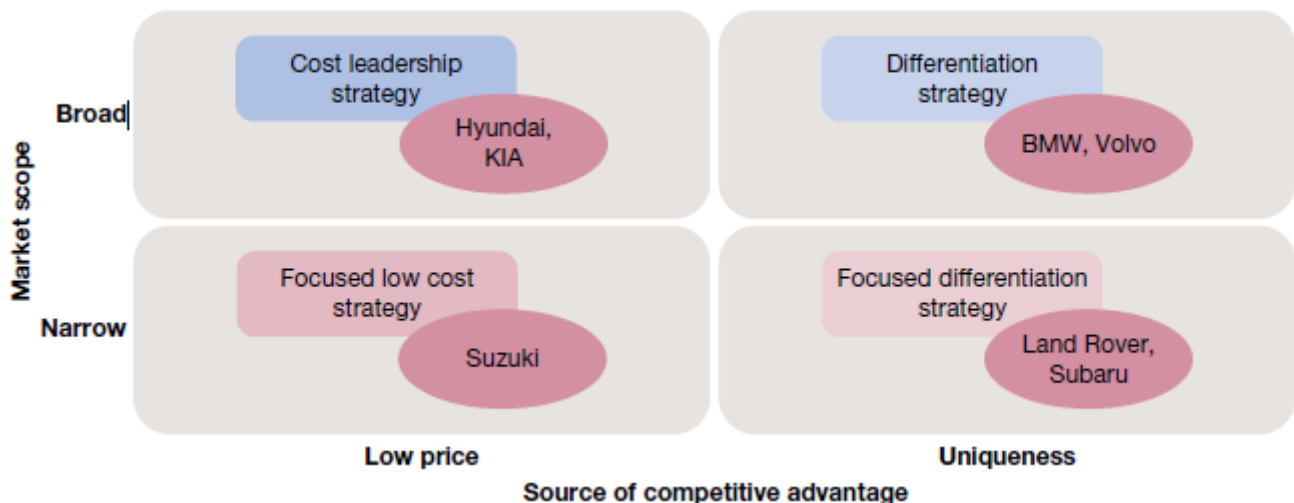
Fig 4.5.1 Porter's generic strategies framework: motor vehicle industry examples

According to Porter, business-level strategic decisions are driven by two basic factors: (1) *market scope* and (2) *source of competitive advantage* — ask: 'How will you compete for competitive advantage, by lower price or product uniqueness?' . These factors combine to create the following four generic strategies that organisations can pursue. The examples in the figure are of competitive positions within the motor vehicle industry:

i. *differentiation* — where the organisation's resources and attention are directed towards distinguishing its products from those of the competition (e.g. BMW, Volvo)

ii. *cost leadership* — where the organisation's resources and attention are directed towards minimising costs to operate more efficiently than the competition (e.g. Hyundai, KIA)

iii. *focused differentiation* — where the organisation concentrates on one special market segment and tries to offer customers in that segment a unique product (e.g. Land Rover, Subaru)

iv. *focused cost leadership* — where the organisation concentrates on one special market segment and tries in that segment to be the provider with lowest costs (e.g. Suzuki)

Organisations pursuing a **differentiation strategy** seek competitive advantage through uniqueness. They try to develop goods and services that are clearly different from those made available by the competition. The objective is to attract customers who become loyal to the organisation's products and lose interest in those of competitors. This strategy requires organisational strengths in marketing, research and development, technological leadership and creativity. It is highly dependent for its success on continuing customer perceptions of product quality and uniqueness.

Organisations pursuing a **cost leadership strategy** try to continuously improve the operating efficiencies of production, distribution and other organisational systems. The objective is to have lower costs than competitors and therefore achieve higher profits. This requires tight cost and managerial controls as well as products that are easy to manufacture and distribute. Of course, quality must not be sacrificed in the process. In fast food, McDonald's remains the most cost-effective operation of its type through preferential bulk-purchasing agreements with suppliers, de-skilled and often automated in-house operations, and large customer volume providing economies of scale. It also uses one of the youngest and least expensive labour forces. It pays the minimum wage and keeps most staff on part-time or casual employment, thereby escaping government requirements to pay superannuation and other statutory fulltime entitlements.

Organisations pursuing a **focused differentiation strategy** or a **focused cost leadership strategy** concentrate attention on a special market segment with the objective of serving its needs better than anyone else. The strategies focus organisational resources and expertise on a particular customer group, geographical region or product or service line. They seek to gain competitive advantage in product differentiation or cost leadership. Importantly, focused strategies require willingness to concentrate and the ability to use resources to special advantage in a single area.

Product life cycle planning
Another way to consider the dynamic nature of business strategy formulation is in terms of **product life cycle**. This is a series of stages a product or service goes through in the 'life' of its marketability. In terms of planning, different business strategies are needed to support products in the lifecycle stages of *new product development*, *introduction, growth, maturity* and *decline*. Products in the new product development, introduction and growth stages lend themselves to differentiation strategies. They require investments in market research, product development and advertising in order to establish a product, market presence and customer base. In the maturity stage, the emphasis shifts towards keeping customers and gaining production efficiencies. This may involve focused and an attempt at cost leadership.

These strategies may hold initially as the product moves into decline. But at some point, strategic planners must seek new ways to extend product life. Understanding product life cycles and adjusting strategy accordingly is an important business skill. Especially in dynamic times, managers need to recognise when a product life cycle is maturing. They should have contingency plans for dealing with potential decline, and they should be developing alternative products with growth potential. Consider what happened at IBM, an organisation that dominated the market for large mainframe computers for years. As customers began to use more powerful and smaller PCs, the mainframe became less important to their operating systems. When the mobile phone industry was starting to use new digital technologies, Motorola continued to emphasise its successful, but older, analogue products. Both IBM's and Motorola's top managers failed to properly consider industry trends. Their companies lost momentum against very aggressive competitors such as Hewlett-Packard, Compaq and Dell in the computer industry and Nokia and Ericsson and in the mobile phone industry.
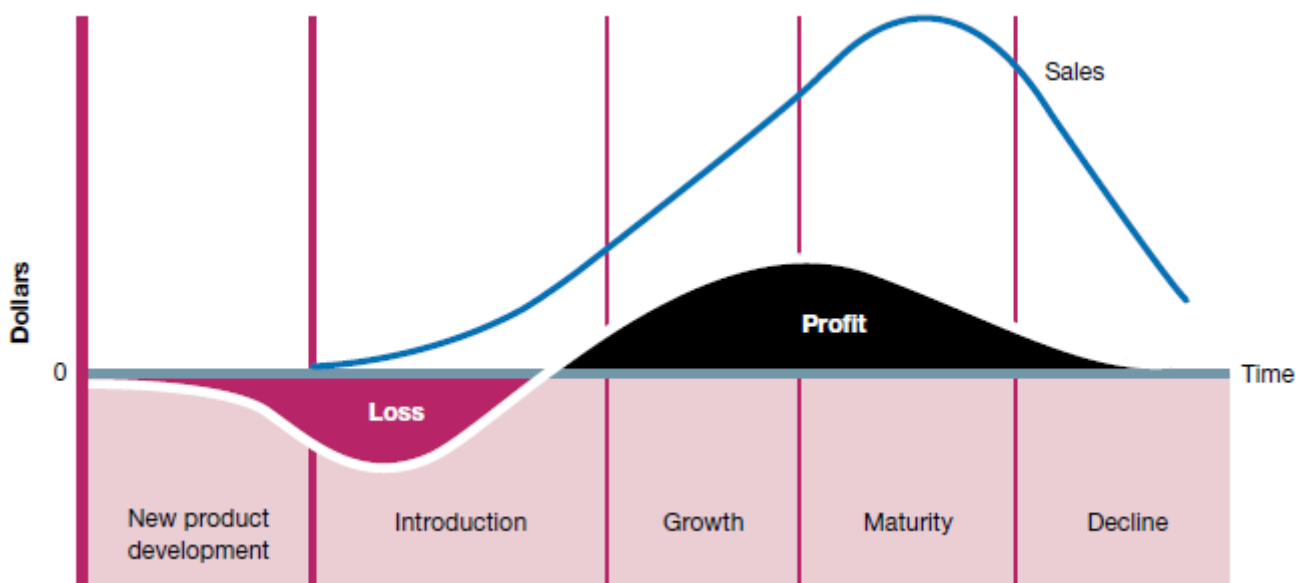

Fig 4.5.2 The product life cycle

Portfolio planning

In a single-product or single-business organisation the strategic context is one industry. Corporate strategy and business strategy are the same, and resources are allocated on that basis. When organisations move into different industries, resulting in multiple product or service offerings, they become internally more complex and often larger in size. This makes resource allocation a more challenging strategic management task, since the mix of businesses must be well managed. The strategy problem is similar to that faced by an individual with limited money who must choose between alternative shares, bonds and real estate in a personal investment portfolio. In multi-business situations, strategy formulation also involves **portfolio planning** to allocate scarce resources among competing uses.

BCG matrix

One of the approaches to business portfolio planning is developed by the Boston Consulting Group and known as the **BCG matrix**. This framework ties strategy formulation to an analysis of business opportunities according to industry or market growth rate and market share. This comparison results in the following four possible business conditions, with each being associated with a strategic implication: *stars* —high market share, high-growth businesses; *cash cows* — high market share, low-growth businesses; *questionmarks* — low market share, high-growth businesses; and *dogs* — low market share, low-growth businesses *Stars* are high market share businesses in high-growth markets. They produce large profits through substantial penetration of expanding markets. The preferred strategy for stars is growth, and further resource investments in them are recommended. *Question marks* are low market share businesses in high-growth markets. They do not produce much profit but compete in rapidly growing markets. They are the source of difficult strategic decisions. The preferred strategy is growth, but the risk exists that further investments will not result in improved market share. Only the most promising question marks should be targeted for growth; others are restructuring or divestiture candidates. *Cash cows* are high market share businesses in low-growth markets. They produce large profits and a strong cash flow. Because the markets offer little growth opportunity, the preferred strategy is stability or modest growth. 'Cows' should be 'milked' to generate cash that can be used to support needed investments in stars and question marks. *Dogs* are low market share businesses in low-growth markets. They do not produce much profit, and they show little potential for future improvement. The preferred strategy for dogs is retrenchment by divestiture.
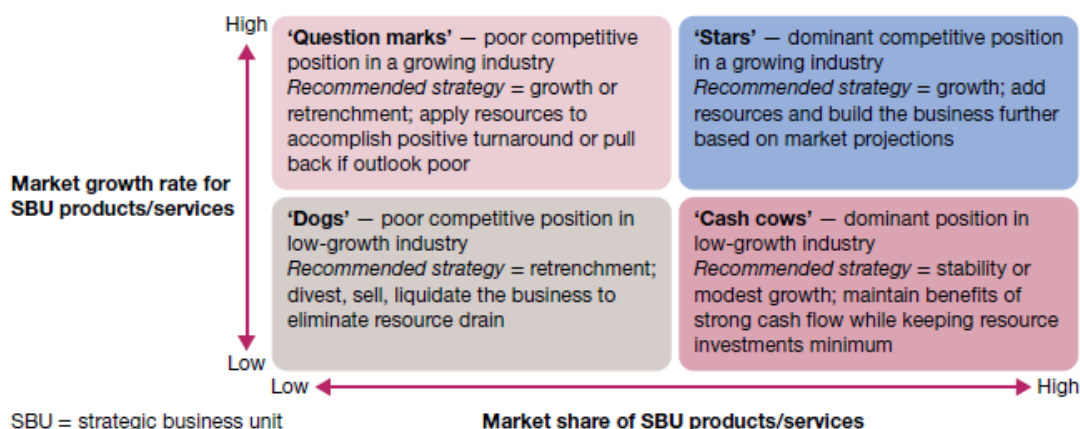

Fig 4.5.3 The BCG matrix approach to corporate strategy formulation

Adaptive strategies

The Miles and Snow adaptive model of strategy formulation suggests that organisations should pursue product/market strategies congruent with their external environments. A well-chosen strategy, in this sense, allows an organisation to successfully adapt to environmental challenges. The *prospector strategy* involves pursuing innovation and new opportunities in the face of risk and with prospects for growth. This is best suited to a dynamic and high-potential environment. A prospector 'leads' an industry by using existing technology to new advantage and creating new products to which competitors must respond. This contrasts with a *defender strategy*, in which an organisation avoids change by emphasising existing products and current market share without seeking growth. Defence as a strategy is suited only for a stable environment and perhaps declining industries. Defenders, as do many small local retailers, try to maintain their operating domains with only slight changes over time. As a result, many suffer long-term decline in the face of competition. The *analyser strategy* seeks to maintain the stability of a core business while exploring selective opportunities for innovation and change. This strategy lies between the prospector and reactor strategies. It is a 'follow-the-leader-when-things-look-good' approach. Many of the 'clone' makers in the personal computer industry are analysers; that is, they wait to see what the industry leaders do and how well it works out before modifying their own operations. Organisations pursuing a *reactor strategy* are mainly responding to competitive pressures in order to survive. This is a 'follow-as-last-resort' approach. Reactors do not have long-term and coherent strategies. Some public utilities and other organisations operating under government regulation may use this strategy to some extent.

Incrementalism and emergent strategy

Not all strategies are clearly formulated at one point in time and then implemented step by step. Not all strategies are created in systematic and deliberate fashion and then implemented as dramatic changes in direction. Instead, strategies sometimes take shape, change and develop over time as modest adjustments to past patterns. James Brian Quinn calls this a process of *incrementalism*, whereby modest and incremental changes in strategy occur as managers learn from experience and make adjustments. This approach has much in common with Henry Mintzberg's and John Kotter's descriptions of managerial behaviour.They view managers as planning and acting in complex interpersonal networks and in hectic, fast-paced work settings. Given these challenges, effective managers must have the capacity to stay focused on long-term objectives while still remaining flexible enough to master short-term problems and opportunities as they occur. Such reasoning has led Mintzberg to identify what he calls **emergent strategies**. These are strategies that develop progressively over time as 'streams' of decisions made by managers as they learn from and respond to work situations. There is an important element of 'craftsmanship' here that Mintzberg worries may be overlooked by managers who choose and discard strategies in rapid succession while using the formal planning models. He also believes that incremental or emergent strategic planning allows managers and organisations to become really good at implementing strategies, not just formulating them.

4.6 Strategy implementation

No strategy, no matter how well formulated, can achieve longer term success if it is not properly implemented. This includes the willingness to exercise control and make modifications as required to meet the needs of changing conditions. More specifically, current issues in strategy implementation include re-emphasis on excellence in all management systems and practices, the responsibilities of corporate governance, and the importance of strategic leadership.

Management practices and systems

The rest of *Management* is all about strategy implementation. In order to successfully put strategies into action the entire organisation and all its resources must be mobilised in support of them. This, in effect, involves the complete management process from planning and controlling through organising and leading. No matter how well or elegantly selected, a strategy requires supporting structures, the right technology, a good allocation of tasks and workflow designs, and the right people to staff all aspects of operations. The strategy needs to be enthusiastically supported by leaders who are capable of motivating everyone, building individual performance commitments, and using teams and teamwork to best advantage. And the strategy needs to be well and continually communicated to all relevant persons and parties. Only with such total systems support can strategies succeed in today's environments of change and innovation.

Common strategic planning pitfalls that can hinder implementation include both failures of substance and failures of process. *Failures of substance* reflect inadequate attention to the major strategic planning elements — analysis of mission and purpose, core values and corporate culture, organisational strengths and weaknesses, and environmental opportunities and threats. *Failures of process* reflect poor handling of the ways in which the various aspects of strategic planning were accomplished. An important process failure is the *lack of participation error*. This is failure to include key people in the strategic planning effort. As a result, their lack of commitment to all-important action follow-through may severely hurt strategy implementation. Process failure also occurs with too much centralisation of planning in top management or too much delegation of planning activities to staff planners or separate planning departments. Another process failure is the tendency to get so bogged down in details that the planning process becomes an end in itself instead of a means to an end. This is sometimes called 'goal displacement'.

Recent research on strategy implementation has identified that information flow and decision rights are two of the most important drivers in strategy execution.75 Clarification on what decisions and actions each person in the organisation is responsible for is one of the most important factors in strategy implementation. Also, in terms of decision rights, once decisions are made they should only rarely be second-guessed, as second-guessing tends to slow down implementation. In terms of information flow, information about the competitive environment must flow to headquarters quickly and information must flow freely across organisational boundaries.

Corporate governance
Organisations today are experiencing new pressures at the level of **corporate governance**, especially since the spate of high-profile corporate collapses in the past decade. Corporate governance is the system of control and performance monitoring of top management that is maintained by boards of directors and other major stakeholder representatives. In businesses, for example, corporate governance is enacted by boards, institutional investors in a company's assets, and other ownership interests. Each in its own way is a point of accountability for top management.

The trend towards strategic alliances within and between industries raises new issues for corporate governance. Boards of directors are formally charged with ensuring that an organisation operates in the best interests of its owners and/or the representative public in the case of not-for-profit organisations. Controversies often arise over the role of *inside directors*, who are chosen from the senior management of the organisation, and *outside directors*, who are

chosen from other organisations and positions external to the organisation. In the past, corporate boards may have been viewed as largely endorsing or confirming the strategic initiatives of top management. Today they are increasingly expected to exercise control and take active roles in ensuring that the strategic management of an enterprise is successful. If anything, the current trend is towards greater emphasis on the responsibilities of corporate governance. Top managers probably feel more accountable for performance than ever before to boards of directors and other stakeholder interest groups. Furthermore, this accountability relates not only to financial performance but also to broader social responsibility concerns.

Strategic leadership
Strategic management is a leadership responsibility. Effective strategy implementation and control depends on the full commitment of all managers to supporting and leading strategic initiatives within their areas of supervisory responsibility. To successfully put strategies into action, the entire organisation and all its resources must be mobilised in support of them. In our dynamic and often uncertain environment, the premium is on **strategic leadership** — the capability to enthuse people to successfully engage in a process of continuous change, performance enhancement and implementation of organisational strategies.

Porter argues that the managing director or CEO of an organisation has to be the chief strategist, someone who provides strategic leadership.80 He describes the task in the following way: a strategic leader has to be the *guardian of trade-offs*. It is the leader's job to make sure that the organisation's resources are allocated in ways consistent with the strategy. This requires the discipline to sort through many competing ideas and alternatives to stay on course and not get sidetracked. A strategic leader also needs to *create a sense of urgency*, not allowing the organisation and its members to grow slow and complacent. Even when doing well, the leader keeps the focus on getting better and being alert to conditions that require adjustments to the strategy. A strategic leader needs to *make sure that everyone understands the strategy*. Unless strategies are understood, the daily tasks and contributions of people lose context and purpose. Everyone might work very hard, but without alignment to strategy the impact is dispersed rather than advancing in a common direction to accomplish the goals. Importantly, a strategic leader must *be a teacher*. It is the leader's job to teach the strategy and make it a 'cause', says Porter. In order for strategy to work it must become an ever present commitment throughout the organisation. People must understand the strategy that makes their organisation different from others. This means that a strategic leader must *be a great communicator*.

Finally, it is important to note that the challenges faced by organisations today are so complex that it is often difficult for one individual to fulfil all strategic leadership needs. Strategic management in large firms is increasingly viewed as a team leadership responsibility. It takes hard work and special circumstances to create a real team — at the top or anywhere else in the organisation. Top management teams must work up to their full potential in order to bring the full advantages of teamwork to strategic leadership.