Principles of Management

Block

II

PLANNING

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Block II

Planning

The second block to the course on Introduction to Management deals with the basic managerial function of planning. The block contains four units. The first unit explains the basics of the planning function. The second unit focuses on various aspects of Management by Objectives (MBO). The third unit discusses the nature and purpose of strategies and policies. The fourth unit deals with the significance of managerial decision-making in organizations.

The first unit, *Fundamentals of Planning*, discusses the nature of planning and explains the planning process and types of plans. Planning is a prerequisite not only for achieving success but also for surviving in a complex and competitive world. The unit details the prerequisites for effective planning.

The second unit, *Management by Objectives (MBO)*, provides an idea about objectives. MBO as a management concept has gained immense popularity in many organizations. The unit deals with important concepts in MBO and explains the benefits and limitations of MBO.

The third unit, *Strategies, Policies and Planning Premises*, discusses strategic planning. Business firms are increasingly relying on the use of strategic planning in order to face contemporary challenges of business. The unit gives an idea of strategic planning process and also explains strategy formulation and implementation.

The fourth unit, *Managerial Decision Making*, gives an idea about the significance of decision-making. The unit underlines that the success of an organization depends upon the approaches adopted by managers for decision-making. The unit also explains the types of managerial decisions and decision-making techniques.

Unit 4

Fundamentals of Planning

Structure

1. Introduction
2. Objectives
3. Definitions of Planning
4. Nature of Planning
5. Significance of Planning
6. Types of Plans
7. Steps in the Planning Process
8. Prerequisites for Effective Planning
9. Limitations of Planning
10. Summary
11. Glossary
12. Self-Assessment Test
13. Suggested Readings/Reference Material
14. Model Answers

1. Introduction

The previous unit discussed the concept of social responsibility. In this unit the concept of planning is discussed.

All organizations operate in an environment of uncertainty. To be successful, an organization must anticipate changes and make plans to adapt itself to the environment. By setting goals and deciding how to achieve them, planning provides a steering mechanism for an organization.

Planning is the process of bridging the gap between where we are and where we want to be in the future. In other words, planning is "looking ahead, relating today's events with tomorrow's possibilities." It is the process of deciding in advance what to do, how to do, when to do it, and who does what. Proper planning minimizes risk and ensures that resources are efficiently and effectively utilized.

In this unit, the nature of planning and the significance of planning to the organization is discussed. The unit also explains types of plans, the steps in the planning process, prerequisites for effective planning, and the limitations of planning.

2. Objectives

By the end of this unit, students should be able to:

- Discuss the nature of planning
- Identify the importance of planning
- Classify various types of plans
- Explain the steps in the planning process
- Identify the prerequisites for effective planning
- Explain the limitations of planning

3. Definitions of Planning

Peter Drucker defined planning as "a continuous process of making present entrepreneurial decisions (risk taking) systematically and with best possible knowledge of their futurity, organizing systematically the efforts needed to carry out these decisions and measuring the result of those decisions against the expectations through an organized systematic feedback." Thus, planning is the process of coping with uncertainty by formulating a future course of action to achieve specified results.

4. Nature of Planning

Planning is Goal-oriented: Planning is a means for achieving set goals or objectives.

Planning is an Intellectual and Rational Process: Planning requires managers to apply their imagination, creativity and their analytical skills to tackle problematic situations.

Planning is the Primary Function: Planning is the initial activity in the management process. All other functions of management, i.e. organizing, staffing, directing and controlling, can be carried out efficiently only if they have been properly planned.

Planning is All-pervasive: The planning function extends throughout the organization. It is an essential aspect of management at all executive levels.

Planning is Forward-looking: Planning is primarily concerned with anticipating the future. Predicting future trends and preparing for them is an integral part of planning. Thus, accurate forecasting is essential for planning.

Planning is a Perpetual Process: Planning is a continuous activity; it goes on as long as an organization exists.

Planning is an Integrated Process: Plans made at different levels are interdependent and interrelated. The top level of an organization develops strategic plans, on the basis of which the middle level of management develops tactical plans. In turn, the lower levels of management develop operational plans on the basis of tactical plans. Thus, plans constitute a hierarchy in the organization.

Planning Involves Choice: Planning is essentially a decision-making process that involves the selection of a suitable course of action. Usually, several alternatives are available for achieving a particular objective or set of objectives. Since all may not be equally feasible and suitable for the organization, only the best among the alternatives has to be selected. Thus, plans are the decisions made after evaluation of alternative courses of action.

5. Significance of Planning

Planning is a prerequisite not only for achieving success but also for surviving in a complex and competitive world. Planning is very important in all types of organizations. It forces organizations to look ahead and decide their future course of action so as to improve their profitability. The role and significance of planning is discussed below.

Focuses Attention on Objectives

Every organization seeks to achieve certain objectives. The planning process helps the organization devise means to achieve these objectives.

Offsets Uncertainty and Risk

An important element of planning is to accumulate information for use in forecasting. This information is then used to develop action plans or detailed guidelines for achieving organizational objectives. The action plans can either be primary or contingent in nature. Primary plans are formulated by managers on the basis of their future expectations of political, legal, economic, technological and social environments. A contingency plan is a plan that is implemented when certain unforeseen events occur. By forecasting the future, managers can try to reduce the risk of uncertainties and be prepared for unexpected events.

Provides Sense of Direction

Setting goals and objectives facilitates the smooth progress of organizational activities.

Provides Guidelines for Decision-making

Plans elaborate the actions necessary for achieving organizational objectives and thus help in deciding the activities to be taken up in the future.

Increases Organizational Effectiveness

Planning facilitates the optimum utilization of available resources since, while planning, objectives are set by taking into account the resources of the organization. Planning ensures that each resource is used in a specific manner at a particular time. Thus, planning and control ensure that the resources are used in accordance with organizational specifications.

Provides Efficiency in Operations

The planning process can be a valuable method for improving performance at any organization level. It improves performance by focusing management's attention on objectives and by helping management establish priorities and cope with the ever-changing external environment.

Ensures Better Coordination

Planning is essential for coordinating the activities of an organization. Well-developed organizational plans unify interdepartmental activities so that the various departments work together to achieve organizational goals.

Facilitates Control

Planning provides the basis for control. The function of control is to ensure that the activities being carried out conform to the plans that have been developed. Thus, control cannot be exercised without plans.

Encourages Innovation and Creativity

Planning facilitates innovative and creative thinking among managers, which is a prerequisite for the long-term survival and growth of a business.

Facilitates Delegation

The planning process facilitates the delegation of authority. Well-established plans act as a guide to subordinates, thus eliminating the need for constant guidance by managers.

Check Your Progress

1. Organizations use contingency plans to cope with ________________.

a. Anticipated events

b. Premeditated events

c. Unforeseen events

d. Predictable events

2. Which of the following is not true about planning?

a. Offsets uncertainty and risk

b. Provides no sense of direction

c. Increases efficiency in operations

d. Provides guidelines for decision-making

3. Planning encourages____________thinking among managers. This type of thinking is essential for the long-term survival and growth of an organization.

a. Conservative

b. Innovative

c. Conventional

d. Stereotyped

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6. Types of Plans

Plans Based on Organizational Level

Organizations establish plans at different levels. These can be classified as:

Strategic plans**:** Strategic plans are long-term plans that apply to the entire organization. They establish an organization's overall objectives and analyze various environmental factors that affect the organization. Strategic plans are applicable to the entire organization and are generally developed by top management in consultation with the board of directors and the middle management.

Tactical plans: Tactical plans are laid to achieve short-term goals. They give direction to the major departments and sub-units of an organization in the execution of strategic plans.

Operational plans: Operational plans are developed by lower level managers to perform day-to-day operations within a department. Operational plans are designed in specific and quantitative terms.

Plans Based on Frequency of Use

Single-use plans: A single-use plan is a one-time plan specially designed to meet the needs of a unique and non-recurring situation.

Standing plans: Standing plans are actions developed to deal with recurring situations.

Policies, procedure and rules are generally associated with standing plans. Program, budgets, and projects are common to both types of plan.

Programs: A program is a large-scale plan that coordinates a complex set of activities to achieve important non-recurring goals. They are action-based and result-oriented management approaches that facilitate the smooth and efficient functioning of organizations.

Budgets: A budget is a statement that outlines the expected results for a given period expressed in numerical terms.

Projects: A project is smaller in scale and less complex than a program. It helps a manager in maintaining effective control and in easy plan implementation.

Policies: A policy defines the broad area within which the organizational members operate. It ensures that members confine themselves to the organization's objectives.

Procedures: A procedure is a plan that describes the steps to be followed to accomplish certain objectives. It is more specific than a policy.

Rules: A rule is the simplest type of plan. It spells out the actions to be performed in a particular situation. It is generally rigid and cannot be deviated from.

Plans Based on their Time-Frame

Organizational plans have specific time frames. Based on the time frame, they can be classified as:

Short-term plans: These provide guidelines to first level managers regarding day-to-day activities. Short-term plans cover a time period of up to one year.

Intermediate-term plans: These define the organizational activities and also provide direction to the middle-level managers. They cover time periods ranging from one to five years.

Long-term plans: Long-term plans are the strategic plans of an organization. They are developed on the basis of broad organizational objectives. They cover time periods that are longer than five years.

Activity: Assume that after completing your MBA, you want to attain certain goals in life. What are the different types of plans that you have made to achieve your life's objectives? Also classify these plans into different categories.

Answer:

Check Your Progress

4. Which of the following indicate the actions that major departments and sub-units should take to execute a strategic plan?

a. Operational plan
b. Tactical plan
c. Single-use plan
d. Project plan

5. What type of plan is used when unique situations of a non-recurring nature occur?

a. Primary plans
b. Secondary plans
c. Single-use plans
d. Standing plans

6. Which of the following is an action-based and result-oriented management approach which contributes to the smooth and efficient functioning of organizations?

a. Projects

b. Programs

c. Rules

d. Policies

7. Which one of the following is not a type of single-use plan?

a. Programs

b. Policies

c. Budgets

d. Projects

8. Which of the following plans are rigid in nature and do not allow any deviation from the established guidelines?

a. Programs

b. Policies

c. Rules

d. Procedures

9. Which of the following plans provide guidelines for day-to-day actions in an organization?

a. Short-term plans

b. Long-term plans

c. Intermediate plans

d. Standing plans

10. Which of the following strategic plans of an organization have a time-frame exceeding five years?

a. Short-term plans

b. Single-use plans

c. Long-term plans

d. Intermediate plans

7. Steps in the Planning Process

The planning procedure differs with the size and complexity of an organization. The basic steps in planning are:

Analyzing Opportunities

Planning starts with analyzing opportunities in the external environment as well as within the organization. Managers can set realistic goals only when they have a proper understanding of the opportunities that exist outside the organization.

Example: Attaining Success through Planning

Hi-Protein Foods Ltd. launched processed chicken products, i.e., pre plated, ready to cook products. They propagated the concept of processed chicken products with the launch of 'heat and eat' meal --. microwaving the items for two minutes before eating. The company launched three common varieties -- butter chicken, chicken wings, and kheema. In the first step, the company analyzed the external environment to evaluate opportunities in the market. The objective was outlined as catering to the working population, which had a time constraint, with high protein foods of the best quality and at a reasonable price. The company then determined the premises, i.e., the market where the product would be launched first. To work towards attaining the company's objective, the company test marketed the product before a full-scale launch. After evaluating the response in the test market, the company implemented the plan by launching the product on a full scale. After reviewing the plan, the manager concluded that the company was showing a targeted growth of 20% and that it expected to grow at a much faster rate.

Establishing Objectives

The second step involves establishing objectives for the whole organization and also for different work units. Organizational objectives provide direction to the major plans.

Determining Planning Premises

Planning premises means understanding the environment (both external and internal) in which the plan is to be implemented. External premises include social, economic, political and technological factors; competitor's plans and actions; government policies etc. Internal premises include an organization's policies, resources, ability to withstand environmental pressure, etc. Premises should be confined to those aspects that are critical to the plan.

Identifying Alternatives

Many alternatives are identified to achieve a particular objective since there can be many ways to achieve a particular goal.

Evaluating Available Alternatives

Alternatives must be evaluated in accordance with the premises and the objectives of the firm. While evaluating an alternative, many variables must be taken into account due to the uncertainty of the outcome of the alternative.

Example: Ineffective Planning

When entrepreneurs Siddharth and Dinesh planned to start a software development company, SIDIN SoftTech Ltd., they undertook a thorough market analysis before designing the products and services to be offered. Due to unavoidable circumstances, the company started functioning six months later than the expected. And when they entered the market, they faced a major setback due to global recession. The products and services that they planned to offer had been in immense demand at the time that they had conducted the market analysis. However, these products did not fit into the present market situation. To survive in the recessive market, Siddharth had to formulate new products that the company would offer. He had to design products that could be differentiated from those of competitors, keeping in view the external environment and market demand.

Selecting the Most Appropriate Alternative

The decision regarding the most appropriate course of action is taken in this step. Two or more contingency plans are selected keeping in mind the unpredictability of the future.

Implementing the Plan

Implementing is putting the plan into action. Managers take a series of decisions during implementation of the actions stated in the plan.

Reviewing the Plan

Reviewing helps managers to evaluate the plan. Through review, they can identify deviations from the established course of action.

Activity: Assume your course structure includes an industrial tour. The tour is for 20 days and you will have to visit 30 industries during this period. Your head of the department has put you in charge of planning the tour. You will have to make various planning decisions like the companies to visit, budget, travel arrangements, boarding, etc. What are the steps in the planning process that you will follow to plan the trip?

Answer:

8. Prerequisites of Effective Planning

- **Establishing the Right Climate for Planning:** Managers should create a climate that is conducive to planning. This can be done by setting objectives, developing realistic planning premises, ensuring information flow and providing appropriate staff assistance at all levels, reviewing subordinates' plans and their performance
- **Clear and Specific Objectives:** Since the overall objectives of the organization serve as guidelines for preparing plans at different levels, these objectives should be clearly stated for all key result areas.

- **Planning Premises:** Planning premises are assumptions about the external and internal environment in which the plan is to be carried out. A careful identification of the premises is very important for effective planning, and forecasting is very important for accurate premising.
- **Initiative at the Top Level:** The initiative and support of top level management is essential for success of the planning process.
- **Participation in Planning Process:** Allowing managers at all levels to participate in the planning process by consulting them and taking their suggestions boosts their morale and makes them feel involved.
- **Communication of Planning Process:** Planning can be effective only when employees understand their role and the plan as a whole. They should understand what a plan is trying to achieve and how it is going to achieve it.
- **Integrating Long-Term and Short-Term Plans:** For planning to be effective, long-term and short-term plans must be fully integrated. Short-term operational plans should contribute to the long-term plans and act as a means for implementing them.
- **An Open Systems Approach:** Managers should adopt an open systems approach to make the planning process effective. Since it introduces an element of flexibility in planning, thus making it effective.
- **Management Information System:** An efficient management information system should be developed so that relevant facts and figures are made available to managers at the right time. An efficient management information system will in turn lead to effective planning.

9. Limitations of Planning

Despite its importance, planning has some limitations.

Lack of Accurate Information: If the information provided to the planners is inaccurate or irrelevant, the quality of planning suffers.

Time Consuming Process: The collection of data and revision of plans make planning time-consuming, and in the process, opportunities may be lost.

Expensive: Activities such as collecting information and testing different courses of action to select the best among them, require huge funds.

Inflexibility: As part of planning, managers draw up detailed policies and procedures. This could lead to inflexibility.

Resistance to Change: Employees resist change and planning requires willingness on the part of employees to change and also to take risks.

Environmental Constraints: Changes in the environment may drastically alter an already established plan, since managers cannot anticipate these changes during planning.

Lack of Ability and Commitment: Lack of ability and commitment on the part of the employees can lead to the formulation of improper plans. Failure of a plan can also be due to inadequate support from the top management and inadequate control mechanisms.

False Sense of Security: Managers may feel secure after the formulation of a plan. However, a plan can be successfully implemented only through continuous review.

Reluctance to Establish Goals: Since goal-setting is the first step in the planning process, managers who are unable to set meaningful goals will not be able to make effective plans. Managers hesitate to establish goals due to fear of failure and lack of knowledge of organizational procedures, policies, and environment.

Check Your Progress

11. Which one of the following is the first step in the planning process?

a. Establishing objectives
b. Analyzing opportunities
c. Determining planning premises
d. Identifying alternatives

12. Which of the following is not an external environmental factor?

a. Political
b. Social
c. Organization's policies
d. Technology

13. Which of the following is the second step in the planning process?

a. Determining planning premises
b. Establishing objectives
c. Implementation
d. Identifying alternatives

14. Which of the following steps in the planning process involves the execution of a plan?

a. Implementation
b. Selection
c. Evaluation
d. Review

15. The open systems approach to planning is effective as it leads to _________ in planning.

a. Rigidity
b. Flexibility

c. Inelasticity d.
Invariability

16. Which of the following is not a limitation of planning?

a. Time consuming process
b. Expensive
c. Flexible
d. Lack of accurate information

10. Summary

- Planning is the primary function of management. According to Peter Drucker, "planning is a continuous process of making present entrepreneurial decisions (risk taking) systematically and with best possible knowledge of their futurity, organizing systematically the efforts needed to carry out these decisions and measuring the result of those decisions against the expectations through an organized systematic feedback."
- The nature of planning is goal-oriented, forward-looking, etc.
- Planning is a prerequisite not only for achieving success but also for surviving in a complex and competitive world.
- Plans can be classified into different types depending on the organizational level (strategic, tactical, operational), frequency of use (single-use and standing plans) and on their time frame (short-term, intermediate-term, and long-term plans).
- Planning is a continuous process. There are eight steps in the planning process. They are: analyzing opportunities, establishing objectives, determining planning premises, identifying alternatives, evaluating available alternatives, selecting the most appropriate alternative, implementing, and reviewing the plan.
- For planning to be effective, managers should: establish the right climate for planning, have clear objectives, have planning premises, participate in the planning process, communicate the planning elements to all employees, integrate the long-term and short-term plans, have an open system, and a management information system.
- Though planning offers a lot of benefits, it has its own limitations, i.e., it needs accurate information, it is a time-consuming process, it is expensive, and it lacks flexibility. Changes in the environment may have a negative impact on planning.

11. Glossary

Internal Environment: The general conditions that exist within an organization.

Operational Plans: The means devised to support implementation of tactical plans and achievement of operational goals. Such plans are usually developed by operational employees in conjunction with middle management.

Plans: Detailed expressions of actions necessary to accomplish stated organization objectives.

Policies: General guidelines for decision-making.

Procedures: The guides to action that explain in detail the manner in which activities are to be performed.

Program: Large-scale, single use plan that coordinates a complex set of activities related to a major non-recurring goal.

Rules: Statements of actions that must be taken or not taken in a given situation.

Single-use Plans: Predetermined courses of action developed for non-repetitive situations.

Standing Plans: Plans that provide ongoing guidance for performing recurring activities.

Tactical Planning: Process of focusing on short-term implementation of current activities and the allocation of resources for those activities.

12. Self-Assessment Test

1) Assume you are doing a summer project with a consumer durables company. The manager of the firm asked you to conduct a survey for kitchen appliances, which is one of the product categories of the company. How would you go about planning the survey? List the major plans that you will develop for conducting the survey.
2) Planning refers to the process of designing the future course of action for an organization to achieve specific goals. Describe in brief the nature of planning.
3) Briefly explain the role and significance of planning.
4) Plans can be classified in a number of ways, on the basis of the organization level, the frequency of use and their time-frame. Explain the different types of plans.
5) Give examples of strategic and operational plans that you have used at any time in your college or personal life.
6) Discuss the role of policy, procedure, and budget in the formulation and implementation of the project.
7) Describe the steps in the planning process.
8) Describe briefly the prerequisites for effective planning.
9) What are the major limitations of planning? What action can be taken to make planning effective?

13. Suggested Readings/Reference Material

- Chapter 3: *The Nature and Purpose of Planning*, Harold Koontz and Heinz Weihrich. *Essentials of Management.* Fifth edition. Singapore: McGraw-Hill, 1990.
- Chapter 7: *Foundations of Planning*, Stephen P. Robbins and Mary Coulter. *Management* Delhi: Pearson Education Inc., 2002.
- "Planning in Organizations"

  <http://www.mapnp.org/library/plan_dec/plan_dec.htm>
- "Planning Process"

  <http://ollie.dcccd.edu/mgmt1374/book_contents/2planning/plng_process/plng_process.htm>

14. Model Answers

14.1 Model Answers to Check Your Progress Questions

Following are the model answers to the Check Your Progress questions given in the Unit.

1. **(c) Unforeseen events**

   A contingency plan is a plan that is implemented when certain unforeseen events occur.

2. **(b) Provides no sense of direction**

   The first step in planning is setting goals and objectives for the organization. Setting goals and objectives facilitates the smooth progress of organizational activities. The absence of planning makes it difficult for managers to have a sense of focus or direction regarding the future of the organization.

3. **(b) Innovative**

   Planning encourages managers to devise new ways of doing things. It facilitates innovative and creative thinking among managers, which is a prerequisite for the long term survival of any company. Employee participation in the planning process leads to the creation of a healthy environment at the workplace and the identification and development of new ways of doing things.

4. **(b) Tactical plan**

   Tactical plans are developed by middle-level managers. Such plans cover a short period (one to three years), require less information, and involve less risk than strategic plans.

5. **(c) Single-use plans**

   Single-use plans are one time plans created to deal with non-programmed decisions. Programs, budgets and projects are single-use plans.

6. **(b) Programs**

   Programs are large scale single-use plans that coordinate a complex set of activities to achieve important non-recurring goals. These programs serve as useful guides for day-to-day operations.

7. **(b) Policies**

   Policies fall under the category of standing plans. They constitute general guidelines for decision-making.

8. **(c) Rules**

   Rules are standing plans which state the actions to be taken or not to be taken in a particular situation. They dictate what must or must not be done and provide very little flexibility. Therefore, rules are rigid and definite plans that do not allow for deviation.

9. **(a) Short-term plans**

   Short-term plans provide guidelines to lower-level managers. These plans help managers by stating what task they must do, what methods they should use and where and when they should do them. They also identify the resources available for performing the tasks.

10. **(c) Long-term plans**

    Long-term plans are developed by the top management of an organization. These plans identify broad organizational objectives and the procedures for achieving those objectives.

11. **(b) Analyzing opportunities**

    Analyzing opportunities in the external environment is the first step in the planning process. A proper understanding of these opportunities helps managers set realistic objectives.

12. **(c) Organization's policies**

    An organization's policies fall in the category of internal factors. They must be considered during the planning process, when formulating planning premises.

13. **(b) Establishing objectives**

    After analyzing opportunities, objectives are formulated for every work unit within the organization. Objectives should be clearly set and communicated to all the employees in the organization.

14. **(a) Implementation**

    Managers can implement plans through the use of authority, persuasion or policy.

15. (b) Flexibility

The open systems approach considers the effect of changes in external environmental factors on the organization and its plans. Managers should use the open systems approach as it leads to flexibility in planning (which makes the whole process of planning effective).

16. (c) Flexible

Planning is a time consuming and expensive process. Sometimes accurate information is not available for planning. These are a few limitations of planning. The planning process might increase internal inflexibility as employee initiative and individual freedom may be constrained because of the presence of policies and procedures. This kind of inflexibility results in the delayed performance of tasks.

Unit 5

Management by Objectives

Structure

1. Introduction

In the previous unit, the basics of planning, its significance, and limitations were discussed. In this unit, the concept of management by objectives (MBO) is discussed.

Managing an organization effectively requires the formulation of clear objectives. Objectives serve as guidelines or roadmaps for managerial effort and action. Well thought out objectives steer an organization to success.

An objective is a goal or an end that an organization or an individual aims at or strives to attain. A supervisor or a team sets the objectives and decides the processes by which these objectives can be achieved. Objectives provide a direction for the organization and specify the quantity and quality of work to be accomplished within a given period of time. Objectives determine what individuals, groups, and organizations are expected to accomplish. They provide a fundamental basis for decision-making and a criterion against which outcomes are measured. Thus, objectives are the foundation of good planning.

In this unit, the nature of objectives and concepts in MBO are discussed. The unit then discusses the MBO process, its benefits, and limitations. The unit also explains the prerequisites for making MBO an effective process.

2. Objectives

By the end of this unit, students should be able to:

- State the nature of objectives
- Identify the concepts in MBO
- Explain the steps in the MBO process
- List the benefits and limitations of MBO
- Identify the prerequisites for making MBO effective

3. Nature of Objectives

Objectives are the basis of all good planning processes. They form a network as well as a hierarchy.

Hierarchy of Objectives

Objectives range from the overall goals of the organization to specific individual objectives.

The Process of Forming Objectives and Organizational Hierarchy

Managers at different levels are responsible for formulating different kinds of objectives. The objectives can be set using either the top-down approach or the bottom-up approach. In the top-down approach, the top-level management determines the objectives and the subordinates have to achieve them. In the bottom-up approach on the other hand, the subordinates formulate the objectives and get the approval from superiors.

A Network of Objectives

Objectives and planning programs are co-existential and correlational. A network of expected results is formed with the objectives and the program planning supporting each another. If the objectives are not linked to one another, then the individual goals may not be in accordance with the overall organizational objectives, and this will prove harmful for the organization.

Multiplicity of Objectives

Organizations plan to achieve many goals and objectives. However, if there are too many objectives, there may not be adequate attention paid to any of them, and this will make planning ineffective. It is generally assumed that managers can effectively take up only a few objectives at a particular point of time. If they pursue too many objectives, then the drive required to finish the task only gets diluted. Though there is no fixed number of objectives that an organization can have, the number depends on how many tasks the managers can handle themselves and how much they delegate to their subordinates.

4. Concepts in MBO

Harold Koontz and Heinz Weihrich defined Management by Objectives (MBO) as “a comprehensive managerial system that integrates many key managerial activities in a systematic manner and that is consciously directed toward the effective and efficient achievement of organizational and individual objectives.”

MBO uses a ‘what-how’ approach. The employees in question are told what to do, but not how. The ‘how’ thus becomes a part of their contribution to a successful conclusion.

Management by objectives (MBO) is a systematic and organized approach that allows management to focus on achievable goals and to attain the best possible results from available resources. It aims to increase organizational performance by aligning goals and subordinate objectives throughout the organization. The principle behind MBO is to make sure that all employees in the organization have a clear understanding of the aims, or objectives, of that organization, as well as awareness of their own roles and responsibilities in achieving those aims. When the managers and empowered employees implement and achieve their plans, the objectives of the organization is automatically achieved.

Early Impetus to MBO

Peter F. Drucker used the term MBO in 1954, one of the earliest management thinkers to do so. He considered MBO as a means of managerial self-direction and self-control. He emphasized that objectives should be set in those areas where performance is essential for the survival and success of the enterprise. He also emphasized the setting of individual objectives, which would help managers gain better understanding of the broader aims of the organization.

Example: Implementing MBO in an Organization

Sterling Group of Hotels is a chain of five star hotels across the metro cities of India. The main goal of the Sterling Group is to gain a position among the top three players in the industry. To achieve this strategic objective, the group expanded its operations by taking over a chain of hotels, which has a presence in all the state capitals. In order to fine tune its operations and upgrade the services provided by its employees, Sterling Group took the decision to implement MBO. With this in mind, it decentralized activities without losing overall control. Now the role of managers was to set their own verifiable objectives involving their subordinates. Managers confined themselves to providing the direction and the subordinates were given the freedom to implement the objectives, since they were in direct contact with the customers. Managers had the responsibility to evaluate subordinates’ performance and give feedback for improvement. These steps were expected to help improve customer satisfaction, ultimately leading to improving the company’s image.

Emphasis on Performance Appraisal

Douglas McGregor, who propounded Theory X and Theory Y, supported the use of MBO as a performance planning and appraisal system. According to him, subordinates should plan their short-term objectives themselves and their superiors should then review these objectives. This system emphasized self-appraisal and self-development.

Emphasis on Short-term Objectives and Motivation

Studies have shown that performance levels were higher when people worked towards specific objectives than when they were simply asked to do their best. Therefore, goal-setting is an important factor in motivating employees.

Inclusion of Long-term Planning in the MBO Process

Apart from setting individual short-term plans, long-term strategic planning was also recognized as essential for the success of an organization.

> **Activity:** Your objective is to top the class in the final examinations which are due in two months. What steps will you follow to achieve this objective and how will you appraise your performance?
>
> **Answer:**
> ____
> ____
> ____
> ____
> ____

The Systems Approach to MBO

MBO has come a long way -- from being considered as a way of promoting managerial self-control to being used in appraising performance, both at the individual and collective levels, in motivating individuals, and in strategic planning. There are many activities that can be integrated with the MBO process. Functions such as planning, controlling, and directing have the highest degree of integration in the process. But other managerial functions like organizing and staffing can also be integrated. Therefore, MBO needs to be viewed as a comprehensive system.

Check Your Progress

1. ____________is a comprehensive managerial system that integrates many key managerial activities in a systematic manner and is consciously directed toward the effective and efficient achievement of organizational and individual objectives.

a. Management by objectives

b. Management by goals

c. Management by exception
d. Organization by objectives

2. MBO was first suggested by ____________.
a. Frederick Taylor
b. Henri Fayol
c. Peter F. Drucker
d. Henry Mintzberg

3. _____________advocated the use of MBO as a performance planning and appraisal system.
a. Douglas McGregor
b. Peter Drucker
c. William Ochi
d. Elton Mayo

5. The Process of MBO

The process of MBO emphasizes clarity and balancing of organizational objectives and the participation of managers and subordinates at all levels of the organization. The managers and subordinates sit together to set objectives in their relevant areas.

Steps in the MBO Process

The various steps in the MBO process are:

Developing overall organizational goals: The first step consists of the managers determining the mission and the strategic goals of the organization. Goals should be based on what the organization can and should accomplish. While setting organizational goals, the organization's strengths and weaknesses have to be considered with regard to opportunities and threats. Managers must also determine the methods by which the goals have to be achieved. The responsibility for achieving specific goals should be assigned to particular individuals.

Establishing specific goals for various departments, subunits and individuals: At this stage, the managers set goals for various organizational levels such that each goal is in accordance with the organization's overall goals.

Formulating action plans: In this step, the managers develop action plans. Action plans convey what is to be done and how, when, where and by whom the goal is to be achieved. The focus of the action plans should be on the methods or activities required for achieving a particular goal. Usually, action plans are developed by subordinates in conjunction with their superiors.

Implementing and maintaining self-control: The employees should be given considerable freedom to implement their plans. The main aim of MBO is supposed to be to help subordinates by providing them with a clear idea of what they need to achieve. The process gives the subordinates a sense of direction and helps them in evaluating their own performance. The responsibility of the superiors is restricted to keeping track of the subordinates' progress.

Periodic review: Monitoring performance at regular intervals is essential during the plan implementation stage to ensure that the objectives are achieved. Reviews help managers to give timely feedback to subordinates, measure results, identify and remove obstacles, solve problems, and make changes in the action plan.

***Performance appraisal*:** At the end of the MBO process, which usually takes one year, the final performance is matched with the previously formulated objectives. The managers evaluate each subordinate's performance during the year. The focus of performance appraisal is to check the extent to which the formulated objectives have been achieved, to see if there has been any shortfall in the achievement of goals, to discover the reasons for the shortfall, and to decide on the action required to prevent such shortfall in the future.

Check Your Progress

4. Periodic reviews allow managers to give ________to their subordinates.

a. Objectives
b. Feedback
c. Bonus
d. Gifts

5. The first step in an MBO program is _______________.

a. Formulating action plans
b. Clarifying organizational roles
c. Establishing specific goals for various departments
d. Developing overall organizational goals

6. In ___________managers and subordinates sit together to set objectives in their relevant areas.

a. Management by walking around
b. Management by objectives
c. Management practices
d. Motivational techniques

7. Which of the following is a best practice for ensuring employee participation in various activities at all levels of the organization?

a. Management by walking around
b. Management by goals
c. Management by objectives
d. Management by exception

Activity: Develop the overall objectives of your college. Also develop the objectives of the various departments of the college. Show how these objectives are interrelated to form a network.

Answer:

6. Benefits of MBO

The MBO style is appropriate for knowledge-based enterprises with competent staff. It is appropriate in situations where the management wants to build employees' management and self-leadership skills and tap their creativity. MBO is also used by chief executives of multinational corporations (MNCs) for their country managers abroad. MBO yields a range of benefits when used as an approach to management. These are:

Better Managing: MBO helps managers to allocate resources and plan activities effectively. As part of the process, managers should decide on the methods of accomplishing the objectives through the proper allocation of resources.

Clarity in Organizational Action: MBO helps to identify the key areas at which the organizational efforts need to be directed.

Encouragement of Personal Commitment: In an MBO program, employees are encouraged to set their own objectives. This encourages them to show a commitment to achieving the goals. Organizational objectives are always influenced by the external environment in which the organization functions. Thus, if there is any change in the external environment, it must be taken into account at the objective-setting stage itself to help the organization develop effective short-term as well as long-term plans.

Personnel Satisfaction: Employees are satisfied since they are allowed to participate in setting their objectives and appraising their performance. This satisfaction motivates them to perform better.

Basis for Organizational Change: The MBO process stimulates organizational change. It provides the framework and guidelines for a planned change and helps managers to overcome resistance to change (by employees).

Development of Effective Controls: Effective control is possible because MBO makes the management state the objectives clearly. The availability of clearly stated objectives gives the direction for effective control and helps the manager take corrective action in case of deviations.

7. Limitations of MBO

Though there are many advantages, MBO carries certain limitations. They are:

Failure to Teach MBO Philosophy: Managers should communicate the benefits of the MBO process to their subordinates. Failure to understand and make others understand the philosophy of MBO leads to the failure of the MBO process itself.

Failure to Give Guidelines to Goal Setters: MBO requires that adequate guidelines be provided to those who are expected to set goals, just like any other kind of planning. Put in other words, managers must understand the corporate goals and how their own activities contribute to the achievement of these goals.

Difficulty in Goal-setting: MBO emphasizes on setting verifiable goals against which performance can be measured. But setting such goals is a difficult task.

Emphasis on Short-term Goals: For quick results, managers emphasize more on short-term goals and giving less emphasis to long-term goals. Therefore, the top management should ensure that short-term goals should be in accordance with the long-term goals.

Inflexibility: Managers need to make changes to their goals in keeping with the revisions in organizational objectives and policies. But they are generally reluctant to change them.

Other Dangers: The implementation of MBO gives rise to some problems. For instance, in their desire to make goals verifiable, managers may make excessive use of quantitative goals, or may set quantitative goals in areas where they are not applicable. In the process, they may downgrade important goals that are difficult to state in terms of end results. Often, in spite of having the participation and assistance from superiors, managers may fail to use objectives to bring about constructive change in the organization. There is also the fear of managers getting excessively involved in the MBO process and forgetting that managing involves more than goal-setting.

Some other weaknesses of MBO are listed below:

- It takes too much time and effort and involves too much paperwork.
- It necessitates training of managers.
- It tends to falter without strong, continual commitment from top management.
- Its emphasis on measurable objectives can be used as a threat by overzealous managers.
- It can lead to considerable frustration if one manager’s efforts to achieve goals are dependent on the achievement of goals of others within the organization. Group goal-setting and flexibility are required to solve this type of problem.

8. Making MBO Effective

For MBO to be successful, there should be

Top Management Support: Continuous support from the top management is essential.

Training for MBO: Employees need to be trained on the concepts and philosophy underlying MBO.

Formulating Clear Objectives: The success of an MBO program depends on how clearly the objectives are formulated.

Effective Feedback: Regular performance reviews should be conducted and feedback provided.

Encouraging Participation: The commitment and participation of the employees at all levels of the organization is essential and has to be encouraged.

Check Your Progress

8. At which stage of the MBO process should an organization consider changes in the external environment to develop effective short-term as well as long-term plans?

a. Objective setting

b. Implementation c.
Control

d. Appraisal

9. Which of the following methods encourages the involvement of employees in the setting of objectives?

a. Management by walking around

b. Management by goals

c. Management by objectives

d. Management by exception

10. Which of the following is not a limitation of Management by Objectives (MBO)?

a. Difficulty in goal setting

b. Flexibility

c. Failure to give guidelines to goal setters

d. Importance of short-term goals

11. Which of the following is a limitation of MBO?

a. Helps in the coordination of goals and plans

b. Provides clarity in organizational action

c. Emphasizes short-term goals

d. Develops effective controls

12. Which of the following is/are the weakness(es) of MBO programs?
a. Takes too much time and effort
b. Necessitates the training of managers
c. Decreases paperwork
d. Both a and b

13. The MBO process should receive continuous support from ______________ managers for its successful implementation.
a. Top-level
b. Middle-level
c. First-level
d. Link-level

9. Summary

- Objectives are important ends towards which organizational and individual activities are directed. MBO is an effective planning tool that helps supervisors to set objectives.
- Objectives form a network as well as a hierarchy. Organizations have a multiplicity of objectives.
- MBO has evolved through various stages since it was first suggested by Peter F Drucker as a way of promoting managerial self-control. It has been used to appraise performance, to motivate individuals and, recently, even for strategic planning.
- The MBO process consists of the steps for developing overall organizational goals, establishing specific goals for various departments and individuals, formulating action plans, implementing and maintaining self control, carrying out periodic reviews, and conducting performance appraisal of employees.
- MBO offers benefits such as better management of resources, clarity in organizational action, and satisfied personnel. It encourages personal commitment, provides a basis for organizational change and leads to the development of effective controls.
- The disadvantages of MBO are that it is time consuming, costly, and sometimes inflexible. Failure to teach MBO philosophy and lack of proper guidance to goal setters may lead to its unsuccessful implementation.
- To make MBO effective, the support of the top management is essential. They must formulate clear objectives, encourage participation at all levels, and provide training to employees for implementing the MBO program and carrying out performance reviews.

10. Glossary

Management by Objectives (MBO): Organizational planning/control technique in which specific goals are set collaboratively by superiors and subordinates for the organization as a whole and every unit and individual within it.

Objectives: An objective is a goal or end that an organization or individual aims at or strives to attain. Objectives serve as guidelines or roadmaps for managerial effort and action.

11. Self-Assessment Test

1) Write a brief note on the nature of objectives.
2) Explain various concepts in MBO.
3) Describe the MBO process.
4) MBO yields a range of benefits when used as an approach to management. Explain.
5) The CEO of Gayatri Agencies wanted to implement management by objectives (MBO) in the organization. What advantages should the CEO communicate to the employees to motivate them to implement MBO?
6) List and describe the limitations of MBO.
7) Explain the criteria for making MBO an effective process.

12. Suggested Readings/Reference Material

- "Management by Objectives and Self-Control" <http://www.softwareresearch.net/site/teaching/SS2002/PM.SS2002/Chapter8_presentation.pdf>
- "Management by Objectives" <http://www.aloa.co.uk/members/downloads/mbo.pdf>
- "Management by Objectives and Performance Appraisal" <http://www.airpower.maxwell.af.mil/airchronicles/aureview/1979/sep-oct/seevers>
- "Management by Objectives for Better Management Effectiveness in the SAF" <http://www.mindef.gov.sg/safti/pointer/back/journals/1999/Vol25_4/6.htm>
- "A Management by Objectives History and Evolution" <http://www.performancesolutionstech.com/FromMBOtoPM.pdf>

13. Model Answers

13.1 Model Answers to Check Your Progress Questions

Following are the model answers to the Check Your Progress questions given in the Unit.

1. **(a) Management by objectives**

   Management by objectives is a planning or control technique in which goals are formed by superiors and subordinates for the whole organization and for every unit and individual in it.

2. **(c) Peter F. Drucker**

   MBO is an organizational planning/control technique in which specific goals are set collaboratively by superiors and subordinates for the organization as a whole and every unit and individual within it.

3. **(a) Douglas McGregor**

   Douglas McGregor, the propounder of Theory X and Theory Y, advocated the use of the MBO as a performance planning and appraisal system. He suggested that subordinates should set short-term objectives for themselves and then review those objectives with their superiors. Evaluation of performance should be done against the set objectives, primarily by the subordinates themselves. This new approach encouraged self-appraisal and self-development in keeping with overall company objectives.

4. **(b) Feedback**

   Periodic review is an important step in the MBO process. Periodic reviews give managers a chance to measure results, solve problems, and provide timely feedback to subordinates.

5. **(d) Developing overall organizational goals**

   The first step in the MBO process is to establish the mission and the strategic goals of the firm in all the key result areas. Before setting objectives, managers should assess the company's strengths and weaknesses in the light of available opportunities and potential threats.

6. **(b) Management by objectives**

   To make the planning process more effective, the active participation of employees at all levels of the organization is required. The MBO approach ensures employee participation.

7. **(c) Management by objectives**

   Management by objectives encourages employee participation (in setting objectives, decision making, etc.) at all levels of the organization.

8. **(a) Objective setting**

   External environmental factors have an impact on organizational objectives. Therefore, when changes in these factors occur, organizations should consider them at the objective setting stage itself.

9. **(c) Management by objectives**

   Management by objectives is a planning or control technique which encourages employee participation in goal setting for the organization.

10. **(b) Flexibility**

    When there are revisions in organizational objectives, premises and policies, managers should make corresponding changes in their own objectives. If managers are not willing to change the objectives, the MBO process becomes inflexible.

11. **(c) Emphasizes short-term goals**

    Managers focus on short-term goals to achieve quick results at the expense of long-term goals. Top-management should ensure that these short-term goals contribute to the achievement of the long-term goals of the organization.

12. **(d) Both a and b**

    Managers should be trained so that they understand the concepts and philosophy underlying MBO. Both managers and subordinates have to spend a lot of time and energy to make MBO a success.

13. **(a) Top-level**

    Since employees resist change in organizations, top-level management's support and commitment is necessary. Their support represents the degree to which an MBO process can be successful.

Unit 6

Strategies, Policies and Planning Premises

Structure

1. Introduction

In the previous unit, the concept of MBO, its benefits and limitations were discussed. In this unit, the concept of strategic planning is discussed. Strategic planning is the formalized, long-range planning process used to define and achieve organizational goals.

Strategic planning involves understanding present and future trends, determining the direction in which the firm is headed, and developing the means to achieve the organization's goals. Strategic planning is a very complex process. The impact of various external factors on the functioning of the firm and the utilization of these factors to the firm's advantage are also part of the process of strategic planning.

In this unit, the nature and purpose of strategies and policies, the three levels of strategy, and strategic planning process is discussed. The unit then discusses competitive analysis in strategy formulation, major kinds of strategies and policies, and Porter's competitive strategies. The unit also explains effective implementation of strategy, and the premises for planning.

2. Objectives

By the end of this unit, students should be able to:

- Classify the three levels of strategy
- Determine the significance and limitations of strategic planning
- List the steps in the strategic planning process
- Explain Michael E. Porter's competitive strategies
- Discuss the steps in strategy implementation

3. Nature and Purpose of Strategies and Policies

Strategies and policies are closely related terms. They provide a direction or a sense of purpose to an organization. They form the basis for operational plans and influence the other areas of management.

Strategy refers to the determination of the mission (or purpose), and the basic long-term objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to achieve these objectives.

Policies are general concepts or statements that guide managers' thought processes and behaviors when they make decisions. Policies are framed to make sure that managerial decisions are made within defined parameters. Although it is not essential that policies be necessarily followed by action, they serve as guides to ensure that managers remain committed to the decisions they have made.

The nature and purpose of strategies and policies are discussed below:

The Key Function: Giving a Direction to Planning

The key function of strategies and policies is to give a specific direction to plans. They serve as a guide for the achievement of organizational goals.

The Guide: Furnishing a Framework for Plans

Strategies and policies help managers to prepare plans. They are equally helpful in guiding operational decisions.

The Need for Operational Planning: Tactics

In order to be effective, an organization must put its strategies and policies into practice by means of plans. Tactics are the action plans with the help of which organizations execute their strategies. Further, if strategies are to be effective, they must be supported by effective tactics.

The Effect on all Areas of Management

Strategies and policies affect planning. As planning is the initial step in the management process, other areas of management are also greatly influenced by the predetermined strategies and policies.

4. The Three Levels of Strategy

Organizational strategies are framed at three levels:

1) corporate-level

2) business-level

3) functional-level

Corporate-level Strategy

Corporate level strategies are developed by the top management in association with the strategic planning personnel. A corporate level strategy determines the business areas in which an organization wants to operate. Corporate-level strategy states a wide action plan for the entire organization and the role of each business constituent. There are two major approaches, which managers can adopt to develop corporate-level strategy. They are:

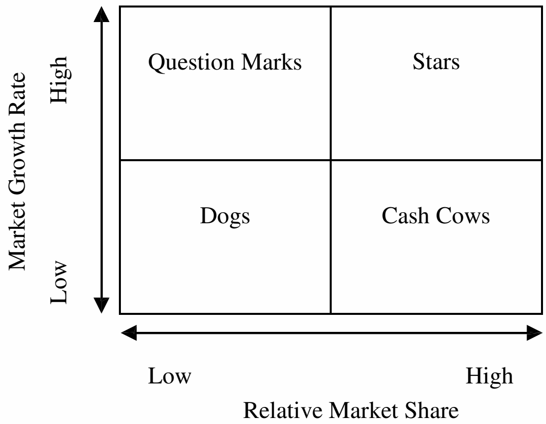
The values-based approach: This approach provides a long-term strategy for the implementation of business activities. It is mainly based on the values and convictions of the manager and personnel of an organization.

The corporate portfolio approach: Managers use this approach to analyze and evaluate each business unit, based on their performance, relative to their competitors and their internal makeup (organizational structure, systems, and processes). The most popular device used for portfolio analysis is the BCG matrix.

The BCG Matrix: The BCG Matrix was devised by the Boston Consulting Group, a leading management consulting firm in the 1970's. This method of portfolio management helps businesses to evaluate their business portfolios to estimate their profitability. Two dimensions are used in this approach to classify the various businesses of a diversified organization. The dimensions are market growth rate and relative market share. Business units fall into four categories based on their performance – question marks, stars, cash cows and dogs (Refer to Figure 6.1 for BCG Matrix).

Question marks: A business unit in the question mark category has a relatively low market share but has high growth potential. Therefore, the business units that fall under this category require huge investment to tap growth opportunities and to be converted into stars. Further, if the parent organization wishes to increase the market share of a question mark, it will require still larger investments. Nevertheless, a rapidly growing market offers exciting opportunities to an organization provided it adopts the right business strategy and is able to obtain funds to implement the strategy.

Figure 6.1: BCG Matrix



Stars: Stars represent the business units that have a high market share and a high growth rate. The profits as well as investments are high in this category. Companies need to invest large sums to maintain the high growth rate.

Cash cows: A business unit in this category has a high market share and low market growth rate. They generate high profits and are the source of surplus cash. However, investment needs to be restricted to the business unit as the growth rate of the market is very low.

Dogs: Dogs are businesses that fall under the category of low market share and low market growth rate. They are loss making units as they generate no profits and should be dropped from the portfolio.

Business-level Strategy

An organization with multiple businesses requires business-level strategies. Each business, which operates independently and has its own goals and strategies, is called a strategic business unit. Business-level strategy is related to the development of a competitive advantage for the goods and services that are produced. It deals with positioning the products, tracking environmental changes, and framing strategies that adapt to the changes.

Functional-level Strategy

Functional-level strategies are related to the development of action plans for the effective management of a particular functional area. Functional strategies in the areas of marketing, finance, human resources, R&D, etc., involve the coordination of activities, which leads to the efficient execution of business-level strategies.

Check Your Progress

1. Which of the following refers to the determination of the purpose and the basic long-term objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for achieving those objectives?

a. Strategies

b. Plans

c. Policies

d. Procedures

2. The _____________ level strategy identifies the business area that an organization will operate in.

a. Business

b. Functional

c. Corporate

d. Operational

3. "Cash cows" refers to businesses that have a high relative market share in a _________market. a.

Moderately growing

b. Slowly growing

c. Rapidly growing

d. Stagnant

4. Which of the following is not a representation of the characteristics of businesses in a diversified organization as per the BCG matrix?

a. Question marks

b. Stars

c. Cash cats

d. Dogs

5. Which category in the BCG matrix is a source of surplus cash?

a. Problem children

b. Stars

c. Cash cows

d. Dogs

6. Which of the following in the BCG matrix represents businesses that have a relatively low market share in a market that is growing very slowly or is declining?

a. Question marks

b. Stars

c. Cash cows

d. Dogs

5. Strategic Planning

Strategic planning is defined by Stoner and Wankel as "the process of selecting an organization's goals, determining the policies and programs necessary to achieve specific objectives en route to the goals, and establishing the methods necessary to assure that the policies and strategic programs are implemented."[1] In other words, strategic planning is the process of developing long-term plans that help in defining and accomplishing an organization's goals. It involves setting out the organization's objectives and laying down specifications as to how they ought to be accomplished.

Characteristics of Strategic Planning

The following are some of the characteristics of strategic planning:

i. Strategic planning deals with and provides answers to certain basic questions pertaining to the organization such as, "What business are we in and what business should we be in?", "Who are our customers and who should our customers be?" and "What goods or services are we going to offer?"

ii. Strategic plans are formulated for a long-term period.

iii. Strategic planning is based on long-term forecasts and appraisal of the external environment.

iv. It helps an organization to prioritize its activities and to focus its resources on the most important activities.

v. The top-level management is responsible for formulating strategic plans for the organization, since top-level managers have the vision as well as the conceptual and design skills necessary to consider various aspects for the overall benefit of the organization.

vi. Strategic plans enable a manager to plan daily activities in a detailed manner.

Significance of Strategic Planning

Strategic planning provides management with a framework for the activities of the organization. Such a framework, in turn, helps the management to improve the functioning of the organization and its responsiveness to the environment. It provides direction for an organization's mission, objectives, and strategies, and facilitates the development of plans for each functional area of the organization. In addition to providing managers with a clear picture of the activities of the organization, strategic planning also makes it possible for them to formulate plans and activities that can help the organization achieve its goals. Another benefit of strategic planning is that it enables managers to prepare for and deal with the rapidly changing environment in which their organizations conduct business.

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[1] James A. F. Stoner and Charles Wankel, *Management* (New Delhi: Prentice-Hall of India Private Limited, Sixth Indian Reprint, 1987) 114.

Some of the other benefits of strategic planning are listed below:

- It provides managers with consistent guidelines on how to carry out organizational activities.
- It helps managers make appropriate decisions.
- During strategic planning, the goals, objectives, and strategies of the organization are carefully scrutinized.
- It helps managers to anticipate problems before they actually occur and deal with problems before they become critical.

Limitations of Strategic Planning

The following are some of the disadvantages of strategic planning:

- It is very expensive. In order to develop effective strategic planning systems, some companies invest heavily in consultants, planning staff, and expensive, sophisticated models and planning programs.
- The planning staff drawing up strategic plans may take decisions based on abstract concepts instead of taking decisions based on the real needs of the business.
- Strategic planning requires considerable investment in time, money, and people and may take years to produce results.
- Strategic planning can be a lengthy and time-consuming process.
- Strategic planning sometimes encourages the firm to adopt the most rational and risk-free option. Managers may develop only risk-free objectives and strategies that can survive the detailed analysis that takes place during the planning process. They may thus avoid considering options that may involve high degrees of risk and uncertainty and which may be difficult to analyze and communicate.
- It may take time for the process of strategic planning process to begin to function smoothly. Till this happens, the organization may be rather slow and uncertain in making decisions pertaining to important issues that affect the organization.

6. Strategic Planning Process

Strategic planning is a six-step process, which includes planning, implementation and control stages (Refer to figure 6.2 for strategic planning process). The six steps are described below:

Step One: Defining the Mission of the Organization

The first step in the process of strategic planning is to define the mission of the organization. The mission of a business is a general and lasting statement and describes the fundamental purpose for which it exists. The mission of an organization differentiates the organization from other organizations of the same kind. It should basically address three important issues: (i) What is the business we are in? (ii) Who are our customers? and (iii) What goods or services will we offer?

Step Two: Drawing up Organizational Objectives

After defining an organization's mission, the next step is to determine the means of accomplishing that mission. This is done by formulating a set of objectives that the organization must achieve within a specified period of time. Objectives help organizations improve their effectiveness in three ways: they provide the organization with a direction, they set standards to evaluate the organization's performance, and they motivate the employees of the organization to perform better.

Step Three: Assessing Organizational Resources, Risks and Opportunities

The third step in the process of strategic planning is an analysis of the organization's strengths and weaknesses. These are then compared with those of other organizations. At this stage, the risks and opportunities present in the environment in which the firm operates, are also evaluated. A SWOT analysis of the firm helps in assessing its strengths, weaknesses, opportunities and threats.

Step Four: Formulating Strategy

After an organization analyzes its resources, and the environment within which it operates, the next step is to formulate a strategy. This involves identification, evaluation and selection of strategic alternatives.

***Identification of strategic alternatives*:** An analysis of the environment and the firm's capabilities helps a firm determine the various strategic alternatives available to it.

Evaluation of strategic alternatives: After identifying the various strategic alternatives, they have to be carefully evaluated before a final selection is made. According to Richard R. Rumelt, the various strategic alternatives can be evaluated on the following criteria:

- The strategies and their component parts should have consistent goals, objectives, and policies.
- The strategies should focus organizational resources and efforts on resolving the crucial issues identified during strategy formulation.
- Strategic alternatives should attempt to resolve problems with the help of organizational resources and skills.
- Finally, the strategies should be able to produce the intended results.

Selection of strategic alternatives: After evaluating different alternatives, the best among them should be selected. For selection of the best alternative, the manager should consider those alternatives which make the best use of an organization's capabilities and resources.

Step Five: Implementing Strategy

After a strategy is formulated, the organization must implement it. Tactical and operational plans should be designed to help in the successful implementation of the firm's strategic plans. Tactical plans focus on allocation of organizational resources for the various short-term activities of the organization. These are developed by managers at the functional level.

Step Six: Monitoring and Adapting Strategic Plans

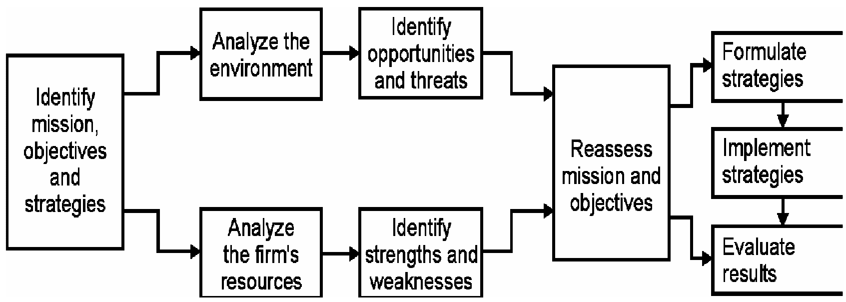
Monitoring and adapting strategic plans ensures that the actual performance of the organization matches its expectations. Appropriate control mechanisms help in acquiring feedback and in monitoring strategic plans. Feedback enables the manager to determine the effectiveness of a particular strategy and whether the actual performance is in accordance with the formulated strategy.

Example: Strategies of P&G

Procter & Gamble's mission is to provide branded products (goods and services) of superior quality and also to ensure that the products improve the lives of the consumers. Procter & Gamble (P&G) has gained a competitive advantage through its innovation strategy. The company has standard functional policies in various areas like human resources, marketing, sales and distribution. Apart from these, the company also has strong social strategies involving citizenship activities, support of public events, and environmental protection programs. These policies are aimed at making the company socially responsible and publicly accepted.

Source: P&G company profile, "our purpose" <www.pg.com>

Figure 6.2: The Strategic Planning Process



Source: "Management Planning," <http://www.uvawise.edu/frey/planning.pdf>

Strategic Planning Vs. Operational Planning

Strategic planning is the planning activity of an organization in which the top management plays the most crucial role. Operational planning, on the other hand, is the planning activity that takes place at the lower levels. Strategic planning provides guidance and defines the boundaries for operational planning. Thus, there is considerable overlap between the two types of planning activities. However, it should be noted that the emphasis of strategic planning is on doing the right things, whereas the emphasis in operational planning is on doing those things right. Thus, strategic planning focuses on improving organizational effectiveness to counter the challenges posed by competitors, while operational planning focuses on enhancing the efficiency of employees within the organization. Strategic planning also lays down the major goals and policies of the organization, in contrast to operational planning, which decides the use of organizational resources in day-to-day operations.

7. Competitive Analysis in Strategy Formulation

Organizations need to analyze their competitive situation so that they can formulate an effective strategy to gain a competitive edge over others. The competitive situation can be analyzed through the assessment of both environmental and internal factors. The SWOT analysis technique can be used to analyze the firm's competitiveness.

Environmental Assessment

There are certain elements in the mega-environment, which have an impact – either positive or negative – on an organization's ability to achieve its strategic goals. Apart from the mega-environment, managers should also evaluate major elements in the organization's task environment like customers, competitors, and suppliers to understand their impact on strategic goals.

Porter's five competitive forces model: Michael E. Porter developed the five competitive forces model in order to analyze the nature and intensity of competition in a given industry. The five competitive forces are: rivalry among existing firms, bargaining power of customers, bargaining power of suppliers, threat of new entrants, and threat of substitute products. Rivalry is the extent to which competitors continually compete in order to secure the top position in the industry for themselves. The bargaining power of customers is the ability of the customers of a company to force the firm to lower the price it charges for its products or services, or the customers' ability to demand better quality or more service from the firm at the same price. An increase in the bargaining power of customers tends to lower the profit potential for businesses in that industry. The bargaining power of suppliers is the extent to which suppliers can threaten either to increase the prices or reduce the quality of their goods and services. The threat of new entrants refers to the ease with which new competitors can enter the market. New entrants may have substantial resources and bring in additional production capacity. This can trigger price wars and/or increase the cost of doing business for existing businesses due to the higher expenditures they will have to incur to retain their market position. The threat of new entrants is low when barriers to entry are high and new entrants expect a strong reaction from the present competitors. The threat of substitute products or services is the extent to which firms in other industries offer substitute products for a reputed product line.

Activity: Rakesh has been made managing director of RK Textiles and given the responsibility of framing strategies for the organization. He has to consider several areas in which he can develop strategies. Discuss possible areas that he would consider for developing the strategies.

Answer:

Check Your Progress

7. According to Michael Porter's five competitive forces model, ________can trigger price wars and/or increase the cost of doing business for existing businesses.

a. Rivalry
b. The threat of new entrants
c. The threat of substitute products or services
d. The bargaining power of suppliers.

8. _______refers to the extent to which customers can force prices down or secure higher quality or better service at the same price.

a. The bargaining power of customers
b. The bargaining power of suppliers
c. The threat of new entrants
d. Both b and c

9. According to Michael Porter's competitive forces model, the greater the bargaining power of suppliers, the __________ the profit potential for businesses operating in the industry.

a. Greater
b. Moderate
c. Stable
d. Lower

10. Who developed the five competitive forces model for analyzing the intensity of competition in the market?

a. Peter F. Drucker
b. Max Weber
c. Michael E. Porter
d. Henri Fayol

11. When is the threat of new entrants low?

a. No barriers to entry
b. Low barriers to entry
c. High barriers to entry
d. No government regulations

12. ______________ refers to the extent to which competitors continually compete to secure the top position in the industry.

a. Bargaining power of suppliers
b. Bargaining power of buyers
c. Threat of new entrants
d. Rivalry

Organizational Assessment

In the process of conducting a competitive analysis, managers must pay considerable attention to factors within the organization that affect its competitiveness. They need to assess the major internal strengths and weaknesses that influence the organization's ability to compete.

Strengths are an important source of competitive advantage. When a strength is unique and does not allow competitors to easily match or imitate it, it is known as distinctive competence. Distinctive competence enables an organization to gain competitive advantage over its competitors. On the other hand, organizational weaknesses can leave the organization vulnerable to competitors' actions. Organizations that fail either to recognize or to overcome their weaknesses are likely to suffer from competitive disadvantages. This, in turn, would lead to the unsatisfactory performance of these organizations.

One common aid in assessing organizational strengths and weaknesses is a functional audit. This is an exhaustive appraisal of the important positive and negative attributes of each major functional area.

An analysis of the environmental opportunities and threats, as well as organizational strengths and weaknesses, sets the basis for strategy formulation. SWOT analysis is a technique for analyzing a firm's competitiveness by assessing the organization's strengths and weaknesses and the environmental opportunities and threats.

SWOT analysis evaluates the firm's internal strengths and weaknesses and the impact of environmental opportunities and threats. An organization should evaluate its internal characteristics to determine its strengths and weaknesses, and the relevant external environmental factors to determine the opportunities and threats.

A strength is an internal characteristic that has the capacity to improve the organization's competitive situation while a weakness is an internal feature that may cause the organization to be susceptible to competitors' strategic moves. An opportunity is an environmental condition that an organization can exploit to improve its competitiveness and get ahead of its competitors. On the other hand, a threat is an environmental condition that can adversely affect the organization's competitive ability.

Check Your Progress

13. In a SWOT analysis, a ________is regarded as an internal characteristic which can improve an organization's competitive capabilities.

a. Threat

b. Weakness

c. Strength

d. Opportunity

14. A/An ________ is an environmental condition that helps an organization improves its situation relative to its competitors.

a. Strength
b. Opportunity
c. Threat
d. Weakness

15. A/an _______ is an environmental condition that has the possibility of undermining an organization's competitive capability.

a. Strength
b. Threat
c. Opportunity
d. Weakness

8. Major Kinds of Strategies and Policies

Major strategies and policies are developed in the following areas for effective functioning of an organization:

Growth: Growth strategies provide guidelines for the organization's growth. They direct managers on issues such as the quantity of growth necessary, the required pace of growth, the area of growth, and the ways that will lead to growth.

Finance: Financial strategies guide managers in adopting a clear strategy to finance the various organizational activities. They help the managers to carefully evaluate the different alternatives and choose the best strategy.

Organization: Organizational strategy deals with issues like the organizational structure of the company, the centralization and decentralization of the decision making authority, design of the staff positions, etc.

Personnel: Personnel strategies help managers to take decisions regarding recruitment, training and development, compensation, appraisal, etc. They also guide managers with regard to sensitive issues like industrial relations, labor welfare programs, trade unions, etc.

Public relations: Public relations strategies are supportive of other strategies. Certain factors like nature of business, the company's image, the effect of government polices on the business, etc., are considered while designing the public relations strategies.

Marketing: The purpose of the marketing strategy is to make people aware of the company's products and convince them to respond favorably towards these products. It deals with issues like target market, selling methods, competitive advantage, and pricing strategies.

9. Porter's Competitive Strategies

Michael E. Porter established three business level strategies, which are commonly called generic strategies. They are useful for managers to secure a competitive advantage for the company's products. Porter's competitive strategies are overall cost leadership, differentiation, and focus.

Overall Cost Leadership

Efficient production can be achieved by adopting a cost leadership strategy. This strategy helps to minimize the cost of production and other organizational activities by developing effective methods. But quality should not be ignored while practicing the low cost strategy. Instead, advanced technologies should be used to bring about operational efficiency.

Differentiation

The differentiation strategy determines the uniqueness of a product or service. By differentiating its products from those of competitors, a firm can gain a competitive advantage. The benefit of this strategy is that firms can charge a premium price. But the company that follows a differentiation strategy should always track the changes that take place with regard to customer tastes and preferences.

Focus

A firm that follows a focus strategy concentrates on a particular market segment like a group of customers, a geographic area, or a particular product or service instead of serving the entire market. Focus strategy allows a firm to serve the segment more effectively as it is specialized in that area.

Check Your Progress

16. _____________strategies provide guidelines for organizational growth.

a. Organization

b. Finance

c. Marketing

d. Growth

17. Growth strategies are not concerned with _____________.

a. Determining the quantity of growth necessary for the firm

b. Obtaining funds for operations

c. Determining the required speed of growth

d. Determining the area in which growth should take place

18. Which of the following is not determined by organizational strategies?

a. How centralized the decision making authority should be

b. How decentralized the decision-making authority should be

c. How the employees should be trained

d. How the staff positions should be designed

19. Recruitment, training, appraisal, etc. are required for managing __________.

a. Financial resources
b. Human resources
c. Customer relations
d. Public relations

20. Cost leadership, differentiation, and ______________are the three generic business-level strategies identified by Michael Porter.

a. Growth
b. Market leadership
c. Focus
d. Product leadership

21. An organization can differentiate its products from those of its competitors by _______________

a. Offering better customer service
b. Offering new features
c. Creating a brand image
d. Using all the above strategies

Example: Competitive Strategies

- Maruti 800 is the largest selling car in the small car segment due to its cost advantage.
- Bajaj Scooters differentiate themselves from other scooter manufacturers by their extensive all-India distribution network.
- Sony's focus is on miniaturization and this has led to production of core mobile products such as the walkman and the discman.

Source:www.blonnet.com/ufe/2002/12/23/stories/2002/22300100100.htm.28k

Example: Strategies of Daimler Chrysler India

Daimler Chrysler has created its own style in marketing products. It has adopted different strategies to gain a competitive advantage.

- It has been following the product extension strategy and offering the latest and most sophisticated technology.
- The company has implemented the Mercedes-Benz production system, which is a combination of several very good practices. The system comprises unique standardization, high quality focus, and continuous improvement.
- It also provides individualization facilities to customers by offering them wide choices.

Source: "World Class Production Facility", Diamler Chrysler, <www.mercedes-benz.co.in>

10. Strategy Implementation

Strategy implementation is the process through which a chosen strategy is put into action. It includes those management activities that are necessary to convert a strategy into action, to institute strategic controls for monitoring progress, and ultimately to achieve the organization's goals. Strategy implementation involves two steps: (i) carrying out of strategic plans and (ii) maintaining strategic control.

Carrying Out Strategic Plans

According to strategy implementation experts, Jay R. Galbraith and Robert K. Kazanjian, certain major internal elements of the organization may need to be synchronized to convert a chosen strategy into action. These elements which include technology, human resources, reward systems, decision processes and structure, are interdependent and affect each other. A change in one variable forces change in one or more of the other variables. We shall now discuss these internal elements in detail.

Technology

Technology consists of the knowledge, work techniques, tools, and equipment used by an organization to deliver its products or service to the customers. The technological functions of the business must be taken into consideration while implementing strategy at all levels. Technological changes may also be necessary when a firm follows a differentiation strategy, as it has to develop and/or produce better products or services.

Human resources

All the individuals working in an organization comprise its human resources. One of the prerequisites for effectively implementing a human resources strategy is to have a skilled workforce. Strategic human resource planning that links the human resource needs with strategies can help develop a workforce which has the relevant skills. The skills and experience of a firm's employees are also a source of its competitive advantage.

Reward systems

Reward systems consist of tangible rewards such as bonuses, awards, and promotions as well as intangible rewards like personal feelings of accomplishment and challenge. Good reward systems help in motivating employees to perform better and provide support to a given strategy.

Decision processes

Decision processes consist of the means and methods of resolving organizational problems. An important issue in the area of decision processes is that of resource allocation. Resource allocation helps in effective implementation of strategies since strategic plans are more likely to succeed if the resources needed for implementing them are readily available.

Structure

Organization structure refers to the formal pattern of interaction and relationships among various individuals in the organization. It is designed by the management to link individual tasks with group tasks so as to facilitate the accomplishment of the goals of the organization.

Maintaining Strategic Control

Managers need to monitor the progress of planned activities. This is done through strategic control. A formal strategic control system helps keep strategic plans on track.

Strategic control involves the following:

(i) Looking out for critical environmental factors that could affect the feasibility of strategic plans

(ii) Analyzing how the strategic actions affect the organization

(iii) Ensuring the proper implementation of strategic plans.

Establishing strategic control measures involves designing relevant information systems that provide feedback on how strategic plans are being carried out and how they affect the organization's functioning.

11. Effective Implementation of Strategy

Although formulating clear and meaningful strategies is very important, the strategies serve no purpose unless they are properly implemented. Managers should keep in mind the following recommendations in order to implement strategies effectively:

Communicating Strategies to all Key Decision-making Managers

Formulating meaningful strategies is of no use unless these are communicated to the managers who are in a position to implement them. Strategies should be communicated in writing, and it should be ensured that all those involved in implementing these strategies understand them well.

Developing and Communicating Planning Premises

Planning premises are assumptions about the environment in which plans will operate. Managers are responsible for laying out the premises which are the basis for formulating plans and taking decisions. They should explain and clarify the planning premises to all those involved in the process of decision-making. Managers should also develop programs and make decisions in tune with the planning premises. If key assumptions about the environment are not included in the planning premises, the decisions made by the managers are often just personal opinions, which may be inaccurate and may also lead to confusion.

Developing an Appropriate Fit between Organizational Structure and Planning Needs

The organizational structure should be conducive for managers to implement plans that lead to the accomplishment of the organization's goals. Ideally, a single person should be responsible for implementing all the strategies leading to attainment of a particular goal. The organization should opt for a different organizational structure when such assignment of tasks is no longer feasible.

Ensuring that Action Plans Contribute to and Reflect Major Objectives and Strategies

Action plans are major or minor tactical programs and decisions, and should reflect the desired objectives and strategies. There are several ways in which the contribution of action plans to major goals can be ensured. Managers at all levels can review the recommendations of staff advisers and line subordinates to make certain that the action plans are consistent and contribute to the development of the organization.

Developing Contingency Strategies and Programs

A manager should always be prepared with a contingency plan to counter unforeseen changes in competitive factors or other external environmental elements. Since the environment is unpredictable, there is every possibility that a given set of objectives, strategies, or programs may quickly become obsolete. In such a case, the manager has to proceed on the most reliable set of premises he or she can come up with at the given time. Contingency plans help managers to deal with unforeseen situations.

Reviewing Strategies Regularly

When conditions change, even the best strategies may not remain viable. Therefore, strategies should be periodically reviewed. Major strategies should be reviewed at least once a year, and more often if possible. Also, the external environment of the firm should be continuously monitored to assess and predict potential opportunities and threats which may affect the performance of the firm.

Continuing to Emphasize Planning and Implementing Strategy

Even if an organization has developed a feasible system of objectives and strategies and has implemented it, the system may fail unless managers realize its significance. The managers need to ensure that everyone in their team understands the underlying strategies. Managers can orient their subordinates in their day-to-day interactions with them.

Creating a Proper Organizational Climate

Creating an organizational climate that is suitable for strategy implementation is important for making a strategy work. The term 'organizational climate' refers to the characteristics of the internal environment of an organization such as the extent of commitment and dedication of the employees towards organizational goals, the existing cooperation among the employees, and the efficiency with which plans are translated into results.

12. Planning Premises

Managers should consider premising as an essential element of effective planning. Planning premises are defined as the anticipated environment in which plans are expected to operate. They include assumptions or forecasts of the future and known conditions that will affect the operation of plans.

Planning Premises versus Future Expectations

Planning premises include forecasts which indicate what can be expected in the future. They provide a framework on which plans can be developed. However, not all premises are forecasts. One should differentiate between forecasts that are planning premises, and forecasts that are translated into future expectancies (generally in financial terms) from the original plans. For instance, a forecast which determines future business conditions, sales volume, or the political environment provides the premises on which plans can be developed. However, a forecast of revenues or costs from a new project translates a planning program into future expectations. In the first case, the forecast is a necessary input for planning, while in the second case, the forecast is an end-result of planning.

Effective Premising

Premising should be given due consideration as a plan will fail without it. There are certain steps to be followed for effective premising. They are:

- ***Selection of premises that affect the plans of the organization:*** Managers at all levels should select their own planning premises.
- ***Development of alternative premises for contingency planning:*** Managers should develop plans based on different assumptions as the future is unpredictable.
- ***Verification of consistency of premises:*** The planning premises used in an organization must be consistent with each other; this should be verified before they are adopted.
- ***Communication of the premises:*** It is important to analyze the information needs of managers and to ensure that the premises needed for planning can be developed by them.

13. Summary

- Organizational decisions are influenced by the external environment. Strategic planning is undertaken by managers because it provides a systematic means of analyzing the environment and framing strategies that match the changes.
- Strategies are framed at three levels. Corporate-level strategy determines the type of businesses the company wants to be in, business-level strategies are the plans that are suitable for individual strategic business units, and functional-level strategies help in the effective management of a particular functional area.

- Strategic planning is the process of developing long-term plans that help in defining and accomplishing an organization's goals. It involves setting out the organization's objectives and laying down specifications as to how they ought to be accomplished.
- Strategic planning is a long-term process, which consists of seven steps: a) defining the mission of the organization b) drawing up organizational objectives c) assessing organizational resources, risks and opportunities d) formulating strategy f) implementing strategy, and g) monitoring and adapting strategic plans.
- In order to formulate an effective strategy for gaining a competitive edge, managers need to analyze thoroughly their organization's competitive situation. This can be done by assessing both environmental and internal factors that influence the effectiveness of the organization.
- Strategies and policies direct managers in their decision-making. Organizations develop different strategies depending on the nature of their business and their goals and objectives.
- Strategies are developed in areas like growth, finance, organization, personnel, products or services, public relations, and marketing.
- Porter recommended three competitive strategies, called generic strategies, which are helpful for organizations to gain a competitive advantage over their competitors. The strategies include overall cost leadership, differentiation, and focus.
- Overall cost leadership is useful to achieve operational efficiency, which means the costs can be reduced by various methods. The differentiation strategy guides managers to differentiate their products from those of their competitors. Focus strategy concentrates on a specific segment instead of serving the whole market.
- Strategy implementation is the process through which a chosen strategy is put into action.
- Strategies can be implemented effectively using the recommendations like communicating strategies to all key decision-making managers, developing and communicating planning premises, developing an appropriate fit between organizational structure and planning needs, ensuring that action plans contribute to and reflect major objectives and strategies, developing contingency strategies and programs, reviewing strategies regularly, continuing to emphasize planning and implementing strategy, and creating a proper organizational climate.
- Effective premising is required for effective and coordinate planning. Certain steps are to be followed for effective premising.

14. Glossary

BCG Matrix: A portfolio approach involving a four-cell matrix (developed by the Boston Consulting Group) that compares various businesses in a firm's portfolio on the basis of relative market share and market growth rate.

Business Strategy: Strategy formulated to meet the goals of a particular business; also called line-of-business strategy.

Cash Cow: According to the portfolio framework, a business with a high relative market share in a slowly growing market.

Contingency Planning: The development of alternative plans for use in the event that environmental conditions evolve differently than anticipated, rendering original plans unwise or unfeasible.

Corporate-level Strategy: A type of strategy that addresses issues such as what businesses the organization will operate, how the strategies of those businesses will be coordinated to strengthen the organization's competitive position, and how resources will be allocated among the businesses.

Cost Leadership Strategy: A business-level strategy outlined by Michael E. Porter that involves emphasizing organizational efficiency so that the overall costs of providing products and services are lower than those of competitors.

Distinctive Competence: An organizational strength that is unique and not easily matched or imitated by competitors.

Dogs: Products or businesses with both low market share and poor growth potential.

Five Competitive Forces Model: A model, developed by Michael E. Porter and used in the examination of an organization's task environment, that offers an approach for analyzing the nature and intensity of competition in a given industry in terms of five major forces.

Focus Strategy: A generic business-level strategy outlined by Michael E. Porter that entails specializing by establishing a position of overall cost leadership, differentiation, or both, but only within a particular portion, or segment, of an entire market.

Forecasts: Estimates or predictions of future events or outcomes for a specified time period.

Functional Audit: A technique for evaluating organizational internal strengths and weaknesses that involves an exhaustive appraisal of the important positive and negative attributes of each major functional area.

Functional-level Strategy: Strategy formulated by a specific functional area in an effort to carry out business-unit strategy.

Growth Strategies: Grand strategies that involve organizational expansion along some major dimension.

Organization Structure: The formal pattern of interactions and coordination designed by management to link the task of individuals and groups in achieving organizational goals.

Portfolio strategy approach: A corporate-level strategy approach that involves analyzing an organization's mix of businesses in terms of both individual and collective contributions to strategic goals.

Question Marks: Products or businesses with low market-share in a high-growth market.

Stars: Products or businesses that are high-growth market leaders.

Strategic Goals: Broadly defined targets or future end results set by top management.

Strategic Planning: Process of determining organization objectives and then adopting courses of action and allocating resources necessary to achieve these objectives.

SWOT Analysis: Strategic planning tool that forces management to assess organization's strengths (S) and weaknesses (W), as well as environmental opportunities (O) and threats (T).

15. Self-Assessment Test

1) Describe in brief the nature and purpose of strategies and policies.
2) Arthur A. Thompson and A.J. Strickland describe three types or levels of strategies: (i) corporate-level strategy, (ii) business-level strategy and (iii) functional-level strategy. Explain in detail.
3) Discuss the significance of strategic planning in a dynamic and uncertain environment.
4) Strategic planning is a long-term planning process, which aids in the development of strategies that best suit the environment. Describe the various steps and their importance in the strategic planning process.
5) Describe Porter's five competitive forces model.
6) Briefly describe the major kinds of strategies and policies.
7) Describe the different generic strategies developed by Porter.
8) Strategy implementation is the process through which a chosen strategy is put into action. Explain the steps of strategy implementation.
9) Managers should keep in mind the a few recommendations in order to implement strategies effectively. Explain the recommendations for effective implementation of strategy.
10) Premising is an essential ingredient in effective planning. Define premising and explain the different stages of effective premising.

16. Suggested Readings/Reference Material

- Chapter 8: Strategic Management, Stephen P. Robbins and Mary Coulter. *Management*. Delhi: Pearson Education Inc., 2002.
- "What is Strategic Planning?"

  <http://www.nonprofits.org/npofaq/03/22.html>
- "What are the Steps of a Strategic Planning Process?"

  <http://www.nonprofits.org/npofaq/03/24.html>
- "Michael Porter on How to Marry Strategy & Operational Effectiveness" <http://www.best-in-class.com/research/bestpracticespotlights/porter.htm>

17. Model Answers

17.1 Model Answers to Check Your Progress Questions

Following are the model answers to the Check Your Progress questions given in the Unit.

1. **(a) Strategies**

   Strategies help managers achieve organizational objectives and influence an organization's growth and progress.

2. **(c) Corporate**

   The corporate level strategy identifies the business areas in which an organization will carry out its operations. An organization operating in more than one business area requires a corporate level strategy. These strategies can be developed by adopting either a value-based approach or corporate portfolio approach.

3. **(b) Slowly growing**

   Cash cows operate in a slowly growing market and have a high market share. These business units are profitable and the surplus cash from these units can be used to support question marks and stars.

4. **(c) Cash cats**

   The BCG matrix (developed by the Boston Consulting Group) is a method of portfolio management that helps businesses evaluate their business portfolios in terms of their profitability. In the BCG matrix, business units are plotted according to the growth rate of the industry they are operating in and according to their relative market share. The businesses of large and diversified organizations are classified according to their characteristics as 'question marks,' 'stars,' 'cash cows,' and 'dogs.'

5. **(c) Cash cows**

   'Cash cows' are businesses that have a high market share in a market that has slow growth. Profits from businesses in this category can be used to maintain question marks and stars.

6. **(d) Dogs**

   'Dogs' operate in a relatively slow or declining market and have a low market share. According to the BCG matrix, businesses should either sell 'dogs' or stop investing in them.

7. **(b) The threat of new entrants**

   The threat of new entrants refers to the ease with which new entrants are able to enter the market. The threat of new entrants is low when barriers to entry are high and vice versa.

8. **(a) The bargaining power of customers**

   The bargaining power of customers is high when customers purchase products and services in bulk, when no difference exists between the products manufactured by other suppliers, and when customers purchases form a large part of the total sales of the seller.

9. **(d) Lower**

   The bargaining power of suppliers refers to the degree to which suppliers can threaten either to increase the prices or reduce the quality of goods and services. Their bargaining power is high when there are only a few players in the market and substitute products are not available.

10. **(c) Michael E. Porter**

    Michael E. Porter developed the 'five competitive forces' model. The forces are rivalry, bargaining power of customers, bargaining power of suppliers, threat of new entrants, and threat of substitute products or services.

11. **(c) High barriers to entry**

    Michael E. Porter developed the 'five competitive forces' model for analyzing the intensity of competition in the market. The forces are rivalry, bargaining power of customers, bargaining power of suppliers, threat of new entrants, and threat of substitute products or services. The threat of new entrants refers to the ease with which new competitors can enter the market. When there are high barriers to entry the threat of new entrants is low. For example, new entrants are discouraged when the capital required for setting up a business is high.

12. **(d) Rivalry**

    Michael E. Porter developed the 'five competitive forces' model for analyzing the intensity of competition in the market. The forces are rivalry, bargaining power of customers, bargaining power of suppliers, threat of new entrants, and threat of substitute products or services. Rivalry refers to the degree to which competitors compete to secure the top position in the industry.

13. **(c) Strength**

    The internal strengths of an organization help it improve its competitive capabilities. A strong brand name, and a strong financial condition are regarded as the strengths of an organization.

14. (b) Opportunity

Companies should be aware of the opportunities available in the external environment and should use them to gain an upper hand over its competitors.

15. (b) Threat

A company should be aware of the existing external threats in the environment. Ignorance of external threats might lead to a decline in the competitive ability of a company. Some examples of potential threats to a company are entries of new competitors, loss of sales to substitute products, and increase in bargaining power of customers and suppliers.

16. (d) Growth

Growth strategies provide guidelines for the organization's growth. Growth strategies help managers forecast the necessary growth for the firm, the area and the manner in which the growth should take place, and the manner in which it should occur.

17. (b) Obtaining funds for operations

Growth strategies give guidelines for an organization's growth. They provide answers to such issues as a forecast of the quantity of growth necessary for the firm, the necessary speed of that growth, the area where growth should take place, and the manner in which it should occur.

18. (c) How the employees should be trained

Organizational strategies determine the organizational pattern of a company. This type of strategies provides answers to questions like how centralized or decentralized the decision-making authority should be, how the staff positions should be designed, and so on. Personnel strategies are developed for managing human resources of a firm. The training of employees is a personnel strategy and not an organizational strategy.

19. (b) Human resources

Personnel strategies are developed for managing the human resources of a firm. Recruitment, training and appraisal are personnel strategies.

20. (c) Focus

Business-level strategies deal with the manner in which operations are carried out by a firm. These strategies help an organization gain competitive advantage over its competitors.

21. (d) Using all the above strategies

A differentiation strategy seeks to offer innovative and unique products and services. Innovative methods of serving customers, unique product features, and a strong brand image help a firm in differentiating its products or services from those of its competitors. A differentiation strategy can be effective when the differentiating factor is needed by customers and is difficult for competitors to imitate.

Unit 7

Managerial Decision Making

Structure

1. Introduction

In the previous unit, the concept of strategic planning, strategy formulation, and effective implementation of strategy were discussed. In this unit, decision-making and its significance is discussed.

Decision-making describes the process by which a course of action is selected as the way to deal with a specific problem. People at all levels in an organization are constantly making decisions and solving problems. For managers, the decision-making and problem-solving tasks are particularly important aspects of their jobs. The manager has to make decisions when there is an opportunity that can be exploited. If the firm has surplus funds, the manager has to decide whether the extra funds should be used to increase shareholder dividends, reinvested in current operations, or to expand into new markets.

The quality of managers' decisions is the yardstick of their effectiveness and value to the organization. Managers are usually evaluated and rewarded on the basis of the importance and results of their decisions. Therefore managers must necessarily develop decision-making skills.

In this unit, the significance and limitations of rational decision-making is discussed. The unit then discusses the decision-making process, types of managerial decisions, and decision-making under certainty, uncertainty, and risk.

The unit also explains the systems approach to decision-making, group decision-making, and various techniques of decision-making.

2. Objectives

By the end of this unit, students should be able to:

- Discuss the rational and non-rational model of decision-making
- Classify the types of managerial decisions
- Contrast decision-making under certainty, risk, and uncertainty
- Differentiate between management information system and decision support system
- Explain the various techniques of decision-making

3. Significance and Limitations of Rational Decision-making

Significance of Rational Decision-making

i. Managers who use rational decision-making tend to provide better solutions to problems.

ii. Rational decision makers have a clear understanding of the alternative courses of action through which to accomplish a goal under a given set of conditions and limitations.

iii. Rational decision-making helps the manager decide on the best solution by selecting the alternative that effectively facilitates goal achievement.

Example: Significance of Rational Decision-making

'Coca-cola' made a number of important decisions after 1981. The most difficult one was to extend the venerable Coke name to another product, namely 'Diet Coke'. Another decision that of changing the formula of Coke was also critical to the company's strategies. Market research showed a strong consumer preference for the new, sweeter-tasting formula. However, people did not accept it under the original brand name 'Coke'. Therefore, within three months of the launch of the new formula, the company brought back the original product to retain its customer base. Coke's ability to recognize decision-making mistakes and take corrective measures is largely responsible for its growing strength.

Limitations of Rational Decision-making

i. It is difficult to make completely rational decisions since the decisions are made predicting the future, which is itself uncertain.

ii. It is sometimes difficult to determine the alternative courses of action to achieve a particular goal.

iii. Rational decision-making is difficult in those areas which have not been ventured into before.

iv. It may become difficult to arrive at rational decisions because of limitations of information, time, and lack of certainty.

v. Managers sometimes allow their tendency to avoid risks to disrupt rational decision-making process.

4. Managers as Decision-makers

The success of an organization depends greatly on the decisions that managers make. For this reason, managerial approaches to decision-making have been the subject of voluminous research. In this section, two major types of models regarding how managers make decisions are discussed in brief.

The Rational Model

The rational model of managerial decision-making has its roots in the economic theory of the firm. According to the rational model, managers engage in a decision-making process which is totally rational. They have all the relevant information needed to take decisions. They are also aware of different possible alternatives, outcomes and ramifications, and hence make rational decisions. This view has serious flaws, as it is quite difficult to obtain complete information and make "optimal" decisions in complex situations. In spite of its drawbacks, the rational view provides a benchmark against which actual managerial decision-making patterns can be compared.

Non-rational Models

Unlike the rational view, several non-rational models of managerial decision-making suggest that it is difficult for managers to make optimal decisions due to the limitations of information-gathering and processing. These are: (a) satisficing model, (b) incremental model, and (c) garbage-can model.

Satisficing model

In the 1950s, an economist, Herbert Simon studied the actual behaviors of managerial decision makers. On the basis of his studies, Simon propounded the concept of bounded rationality. This concept suggests that the managers may not always be perfectly rational in making decisions. Their decision-making ability may be limited by certain factors like cognitive capacity and time constraints. According to the concept of bounded rationality, the following factors commonly limit the degree to which managers are perfectly rational in making decisions:

i. Decision-makers may have inadequate information about the nature of the issue to be decided.

ii. The amount of information that can be gathered in regard to a particular decision is limited by time and cost factors.

iii. Decision-makers may overlook or ignore critical information because of their perceptions about the relative importance of various pieces of data.

iv. The degree to which decision-makers can determine optimal decisions is limited by the individual's capacity and intelligence.

v. The inability to remember large amounts of information is another factor that limits the ability of managers to make rational decisions.

Simon argues that instead of searching for the perfect or ideal decision, managers frequently settle for one that will adequately serve their purpose. He contends that managers accept the first satisfactory decision they uncover, rather than searching till they find the best possible decision. Simon calls this 'satisficing'. The *satisficing model* holds that managers seek alternatives only until they identify one that looks *satisfactory.*

The steps in the satisfying approach include: Recognize and Define the Problem; Analyze the Difficulties & Get the facts; Establish Criteria for Satisfactory Solution; Develop a Plan of Action (Specify Alternatives, Predict Consequence, Consider Options, Develop a Plan of Action); Initiate the Plan; and Assess the Results.

Incremental model

The incremental model states that managers put in the least possible effort – only enough to reduce the problem to a tolerable level. The manager here is concerned more with finding a short-term solution to the problem than making a decision that will facilitate the attainment of goals in the long-term. The incremental model does not require managers to process a great deal of information in order to take a decision. In this model only a small, limited set of alternatives is considered: all options are similar to the existing situation. Objectives are not necessary; the decision maker decides on an option, considers the consequences, and if reasonable, then moves down that path. If the difficulties subside, the path is continued. If the difficulties persist, then a different option is pursued and the direction changed. This form of trial and error (small incremental changes) is continued until noise subsides.

Garbage-can model

The garbage-can approach to decision-making holds that managers behave randomly while making non-programmed decisions. It assumes that organizational objectives emerge spontaneously and they are not set beforehand. Also, means and ends exist independently. That is, decision outcomes are chance occurrences and depend on such factors as the participants involved in the decision-making process, the problems about which they happen to be concerned at the moment, the opportunities they happen to identify and their favorite solutions or the solutions they use the most to solve most problems.

Check Your Progress

1. _______________ describes the process by which a course of action is selected to deal with a specific problem.

a. Decision-making
b. Strategic planning
c. Goal setting
d. Organization planning

2. The __________ model of decision-making is concerned more about achieving a short-term solution to a problem than making decisions that could facilitate the achievement of long-term goals.

a. Garbage-can

b. Incremental c.

Satisficing

d. Rational

3. __________is a key concept of the satisficing model of decision-making, which suggests that the ability of managers to be completely rational when making decisions is limited by certain factors.

a. Rationality

b. Irrationality

c. Bounded rationality

d. Bonded rationality

4. Managers using the ________ model of decision-making arrives at an optimal decision after obtaining and understanding all the information that is relevant to their decisions.

a. Garbage-can

b. Satisficing

c. Incremental

d. Rational

5. Which of the following is not a non-rational model of decision making?

a. Garbage-can

b. Strategic planning

c. Satisficing

d. Incremental

6. The concept of bounded rationality suggests that managers are not perfectly rational in making decisions at all times and that their decision-making capability is limited by factors like cognitive capacity and _______________.

a. Monetary constraints

b. Mental constraints

c. Time constraints

d. Intellectual constraints

5. Decision-making Process

Decision-making is a systematic process which basically involves seven steps (Refer to Figure 7.1 for decision-making process). The steps are:

Identifying the Problem: This is the first step in the decision-making process and it involves three stages: scanning, categorization and diagnosis. In the scanning stage, the work environment is monitored for changes that may indicate the emergence of a problem. The categorization stage attempts to understand the performance gap between the expected and actual performance levels. In the diagnosis stage, facts pertaining to the problem are gathered.

Identifying Resources and Constraints: Resources that can be used to solve the problem like people, money, materials, time, equipment, expertise and information are identified in this step. Constraints are the factors that cause a hindrance to problem solving. Managers should identify the resources and constraints relevant to the problem.

Generating Alternative Solutions: The next step in the decision-making process is to generate possible alternative solutions to the problem. Generating a number of alternatives increases the chances of making an effective decision. Managers can use the brainstorming technique to generate such alternatives.

Evaluating Alternatives: At this step, each alternative is evaluated for its advantages and disadvantages.

Selecting an Alternative: This step involves selecting the best alternative. To do this, three approaches are used: i) past experience, ii) experimentation, and iii) research and analysis.

Implementing the Decision: The selected alternative must be implemented properly to achieve the objective for which it was selected, and this in turn, depends on effective planning. Successful implementation of a decision usually depends on two factors – careful planning, and sensitivity to those who will implement the decision and/or those who will be affected by it.

Monitoring the Decision: Monitoring the implementation is necessary to ensure that it is in accordance with the plan. Feedback is an important component of the decision-making process. In order to evaluate the effectiveness of a decision,

Activity: You are planning to purchase a luxury car. You have to decide on a number of factors before the actual purchase. Explain the steps in the decision-making process that you will follow for making the purchase.

Answer:

____

____

____

____

____

there should be a set of standards against which actual performance can be compared. A second requirement is the availability of performance data for comparison with the set of standards. Finally, a data analysis strategy, which includes a formal plan outlining how the data will be used, should be developed.

Check Your Progress

7. In which of the following steps of the decision-making process is the brainstorming technique used?

a. Generating alternative solutions

b. Evaluating alternatives

c. Identifying resources and constraints

d. Selecting an alternative

8. _______is the first step in the decision-making process.

a. Identifying resources and constraints

b. Determining the problem

c. Generating alternative solutions

d. Selecting an alternative

9. The first step in the decision-making process is identifying the problem. This involves all the following stages except _____________.

a. Scanning

b. Categorization

c. Problem existence

d. Diagnosis

10. When an organization does not achieve its goals, there is a performance gap between the expected and actual performance. Which stage of the problem identification process helps managers understand this performance gap?

a. Scanning

b. Categorization

c. Diagnosis

d. Alternative selection

11. In the second stage of the decision-making process, anything that can be used to solve a problem is known as a ____________.

a. Constraint

b. Strategy

c. Resource

d. Solution

12. Careful planning and sensitivity to those who are affected by the decision contribute to the successful _______________.

a. Generation of alternative solutions

b. Evaluation of alternatives

c. Selection of alternatives

d. Implementation of the decision

6. Types of Managerial Decisions

The decisions which managers make fall into the category of either programmed or non-programmed decisions.

Programmed Decisions

Decisions that deal with simple, common, frequently occurring problems and demand well-established and understood solutions are called programmed decisions. Programmed decisions are mostly made by lower-level managers because the problems they deal with are recurring and well-structured (Refer to figure 7.1 for the decision-making process and figure 7.2 for nature of problems and decision-making in organizations). Programmed decisions consume less time and are consistent and inexpensive in nature.

Figure 7.1: The Process of Decision-making

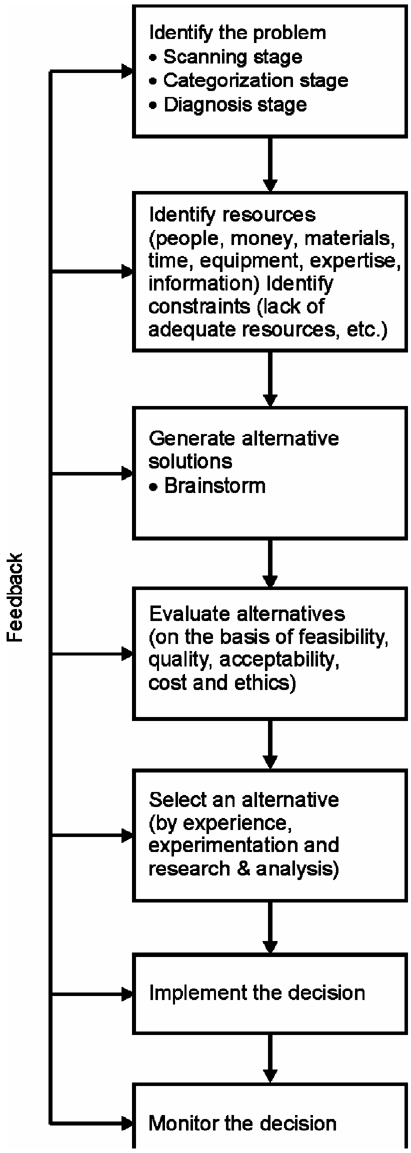
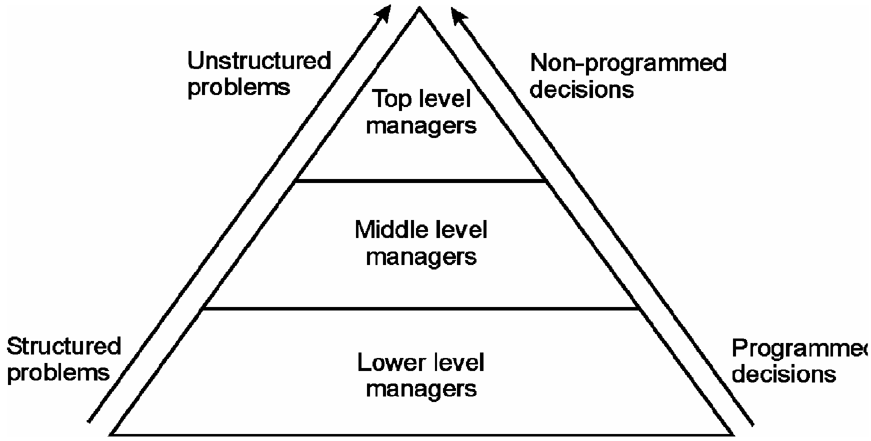


Figure 7.2: Nature of Problems and Decision-making in Organizations



Non-programmed Decisions

Decisions developed to deal with unusual or exceptional problems are known as non-programmed decisions. Since non-programmed decisions involve situations that are unstructured, it is impractical to have predetermined decision rules for them. Most of the important decisions that managers make fall into the non-programmed category. Decisions that involve strategies to deal with mergers, acquisitions, takeovers and organization design, are non-programmed by nature.

Managers face a lot of uncertainty in making non-programmed decisions as they have to choose a course of action without knowing what the consequences of its implementation will be. The skill of making a non-programmed decision is most essential for top level managers. Hence, the top management is taught to analyze problems systematically and to make logical decisions through management development programs.

Check Your Progress

13. Non-programmed decisions usually involve a lot of _________, a condition in which the decision-maker must choose a course of action without having complete knowledge of the consequences that will follow the implementation of the decision.

a. Certainty
b. Stability
c. Opportunity
d. Uncertainty

14. Most of the important decisions that managers make are______decisions.

a. Functional
b. Programmed
c. Non-programmed
d. Tactical

15. The decisions made by managers usually fall into one of the following categories: _______.

a. Programmed and Non-programmed
b. Rational and Irrational
c. Strategic and Non-strategic
d. Strategic and Tactical

16. Decisions that deal with strategies for mergers, acquisitions, and takeovers are ______________in nature.

a. Programmed
b. Non-programmed
c. Operational
d. Tactical

Activity: List out some of the decisions that you have taken during the past month and categorize them into programmed and non-programmed decisions.

Answer:

7. Decision-making under Certainty, Risk and Uncertainty

Every decision making situation falls into one of the three categories: 1) certainty, 2) risk or 3) uncertainty.

Decision-making under Certainty

When a decision maker knows with reasonable certainty the conditions associated with each alternative and the outcome of each alternative, then a condition of certainty exists. Under conditions of certainty, accurate, measurable, and reliable information on which to base decisions is available. The future is highly predictable in conditions of certainty. Decision making under certainty is done for routine and repetitive decisions, i.e. for the day-to-day operations of a business.

Decision-making under Risk

Risk arises due to lack of accurate information and information asymmetry. While making decisions under conditions of risk, managers must determine the probability associated with each alternative on the basis of available information and also based on their experience.

Decision-making under Uncertainty

Most significant decisions made in today's complex environment are formulated under a state of uncertainty. A condition of uncertainty exists when the future is unpredictable. The decision maker is not aware of all the available alternatives, the risks associated with each, the consequences of each alternative or their probabilities. Some of the modern approaches to decision making under uncertainty are: i) Risk analysis, ii) Preference theory.

Risk analysis: Risk analysis involves quantitative and qualitative risk assessment, risk management and risk communication. The decision represents a trade-off between the risks and the benefits associated with a particular course of action under conditions of uncertainty.

Preference or utility theory: Preference theory is another approach to decision-making under conditions of uncertainty. This approach is based on the notion that individual attitudes towards risk vary.

Example: Decision making Under Risk

GSA Cycles Ltd. manufactures bicycles for domestic consumption. Rajeshwar, CEO of the company, plans to expand the company operations through exports. He can adopt one of the two strategies: i) introduce the company's products in developed markets where demand is increasing due to environmental awareness or ii) explore developing and underdeveloped markets where the demand is more due to the affordability factor. The company should collect all possible information in both the cases, analyze the risks involved and the probability of success in each. This will help in deciding where to introduce the product to gain maximum profits.

Check Your Progress

17. A situation of information asymmetry gives rise to ________________.

a. Certainty

b. Uncertainty

c. Risk

d. Stability

18. Under ____________, accurate, measurable, reliable information is available for taking decisions.

a. Conditions of certainty

b. Conditions of stability

c. Conditions of uncertainty

d. Conditions of risk

19. The most significant decisions made in today's complex environment are taken under conditions of ________.

a. Risk

b. Uncertainty

c. Certainty

d. Stability

20. Which of the following is not a modern technique for taking decisions under conditions of uncertainty?

a. Risk analysis b.
Decision trees

c. Structure trees

d. Preference theory

8. The Systems Approach to Decision-making

Many elements of the planning environment extend beyond the boundaries of an enterprise. Hence, it is not possible to make decisions in a closed-system environment. Moreover, since each department or unit of an enterprise is a subsystem of the entire enterprise, managers of the organizational units must be responsive to the policies and programs of other organizational units and of the whole enterprise.

Even in a closed-system model, a manager has to make several assumptions regarding the environmental forces that influence the organization. However, while taking into account the various elements, the manager does not give up his role as decision-maker. It is not advisable to make the decision process unnecessarily democratic. Subordinates or others may have an immediate or remote interest in any decision to be taken. The manager is the decision-maker who must select a course of action from among the alternatives, taking into account the events and forces in the environment.

Information is the key to effective managerial decision-making in both open as well as closed systems. The following sections will focus on how MIS and DSS act as a means to successful decision-making.

Management Information System

Managers at all levels require information to be provided to them with speed, brevity, precision, and economy to enable them to carry out their functions effectively. This need is satisfied by means of a management information system. A Management Information System (MIS) is a system that gathers comprehensive data, organizes and summarizes it in a form that is of value to functional managers, and provides them with information they need to carry out their work. MIS is used to transform data into useful information in order to support managerial decision-making with structured decisions or programmed decisions. In simple words, a MIS is a computer-based information system which assists managers in decision-making and control and in planning more effectively.

The typical MIS is made up of four major components – data gathering, data entry, data transformation, and information utilization. The modern MIS is based on a centralized database of raw data.

MIS offers a wide spectrum of services at all levels and for all functional areas of the organization. It provides the top management with information pertaining to the external environment. To the middle management, it provides information useful for operational plans and to the first-level managers, it provides internal information useful for operations control.

Decision Support System

Decision Support System (DSS) is a computer-based information system that supports the process of managerial decision-making in situations that are not well structured. Such systems do not actually provide “answers” or point to optimal decisions for managers. Rather, they attempt to improve the decision-making process by providing tools that help managers to analyze the situations more clearly. Thus DSS does not replace managerial decision-making but supports it and makes the process more effective. DSS has become increasingly popular because of advances in computer software and hardware.

A typical DSS consists of an MIS that supports several methodologies for accessing and summarizing data, a sophisticated database that allows information to be accessed in various ways, a user-friendly interface that allows the user to use simple commands rather than technical computer terms when communicating with the DSS, a database built from both external and internal sources so that the manager can relate internal events to external forces, and rapid response time, which makes DSS an easy and rewarding system to use.

According to Hogue and Watson, the unique executive user configuration of the DSS is based on the following characteristics:

1. *Executive decisions are the focal points:* The data for the DSS and associated models are organized around the executive’s decisions rather than around existing databases.
2. *Specialize in easy-to-use software:* The DSS specializes in easy-to-use software that uses simple English commands rather than technical computer terms.
3. *Employs interactive processing:* The rapid response time of a DSS permits interactive processing.
4. *Use and control rests with the user:* The use and control of the DSS rests with the user and not the central information management department.
5. *Flexible and adaptable:* The DSS is flexible and adaptable to change in the executive’s style or in the external environment.

A DSS is a specialized MIS designed to support a manager’s skills at all stages of decision-making, namely identifying the problem, choosing the relevant data, selecting the approach to be used in making the decision, and evaluating the alternative courses of action.

Although there are similarities between a MIS and a DSS, there are also certain differences. In comparison to a MIS, a typical DSS provides more advanced analysis and greater access to various models that can be used by managers to examine a situation more thoroughly. Moreover, a DSS tends to be more interactive than a MIS. Finally, a DSS often relies on information from external sources as well as from the internal sources that are largely the domain of the MIS.

9. Group Decision-making

Large and complex organizations practice group decision-making. Since several members contribute their ideas in this kind of decision-making, the decision outputs are often better than individual decisions. A major reason why group decision-making is more effective than decision-making by individuals is that more information is available in a group setting. In group decision-making, several individual members contribute their ideas before a decision is made. One of the major strengths of group decision-making is that the decisions can be implemented with ease. However, it is a time consuming process.

Forms of Group Decision-making

Interacting groups

In this type of decision-making, members openly discuss alternatives and this leads to an accumulation of pooled information. The best possible alternative is then agreed upon. This method helps in the development of new ideas due to the interaction among decision makers. The influence of political factors, could, however, prove to be a limitation of this method.

Delphi groups

This technique uses the views of a panel of experts with a consensus being developed based on their opinions. The opinions of all the experts are collected to calculate an average. The major disadvantage of this method is that it is time consuming and expensive.

Nominal groups

This technique is used for creative or innovative ideas. Knowledgeable people are given an outline of the problem and are asked to come up with possible solutions. The group members then evaluate the ideas openly and rank them to decide on the best alternative.

10. Decision-making Techniques

There are a number of techniques that are used in the decision-making process. Some of them are discussed below:

Marginal Analysis: Marginal analysis is defined as the extra output that results from adding one extra unit of any input variable (e.g. raw material, machine, worker etc.), other factors remaining constant. This is a very useful tool for evaluating the alternatives in the decision-making process.

Financial Analysis: This is used to estimate the profitability of an investment, to calculate the payback period and also to analyze cash inflows and outflows.

Ratio Analysis: This helps in interpreting financial statements to determine the strengths and weaknesses of a firm and also in evaluating past performance and the present financial condition.

Break-even Analysis: This uses parameters like price, fixed cost and variable cost per unit to evaluate when the company reaches break-even point, i.e. no profit, no loss.

Operations Research Techniques

Operations research tools are the most significant tools available for decision-making. They use the application of quantitative methods for decision-making. The most commonly used operations research techniques are:

Linear programming: This is a quantitative technique used to make the optimum allocation of an organization's scarce resources to achieve a particular objective. This technique can be applied in situations where two or more activities compete for limited resources and there is a linear relationship among situations. Linear programming can be applied for product mix decisions, for determining the optimal scale of operations, for inventory management problems, for allocation of scarce resources under conditions of uncertain demand and for scheduling production facilities and maintenance.

Queuing or waiting-line method: This quantitative technique is used for balancing the services provided and the waiting lines. Queuing occurs when there is a difference between the demand and supply of a product. Organizations should work towards striking a balance between the two.

Game theory: Game theory is a mathematical method of decision-making in which a competitive situation is analyzed to determine the optimal course of action. It is a key element in the process of decision making and improves the negotiation and decision making skills of an individual. It predicts the outcome of various decision-making processes.

One of the principal aims of game theory is to determine the optimum strategy for dealing with a given situation or confrontation. It is based on the assumption that every player (a competitor) in the game (decision situation) is perfectly rational and seeks to win the game. This can involve such goals as maximizing one's gains, maximizing the probability that a specific goal can be reached, minimizing one's risks or losses, or inflicting the greatest possible damage on adversaries. Minimizing the maximum loss (minimax) and maximizing the minimum gain (maximin) are two concepts used in game theory. Game theory has direct applications in economics, sociology, and psychology. The games can range from simple personal or small group encounters or problems to major confrontations between corporations or superpowers.

Simulation: This technique is used to solve complex problems and involves building a model that represents a real or existing system. Different variables and their inter-relationships are put into the model and the model is programmed through the computer, which gives a set of outputs. This model is used to develop price strategies, distribution strategies, resource allocation, logistics etc.

Decision tree: This is a sophisticated mathematical tool that enables a decision maker to select the best alternative from among the available courses of action. The decision tree is a graphical representation of the alternative courses of action.

Check Your Progress

21. A/an ________is a computer-based information system that supports the process of managerial decision-making in situations that are not well structured.

a. Management information system

b. Decision support system

c. Expert system

d. Transaction support system

22. ____________gives managers access to more information and knowledge.

a. Individual decision-making

b. Strategic decision-making

c. Operational decision-making

d. Group decision-making

23. Which of the following decision-making techniques involves the application of quantitative methods to decision-making?

a. Ratio analysis

b. Operations research

c. Financial analysis

d. Break-even analysis

11. Summary

- Decision-making is the process of identifying and choosing alternative courses of action in a manner appropriate to the demands of the situation.
- The rational model of managerial decision-making has its roots in the economic theory of the firm. Non-rational models of managerial decision-making like satisficing model, incremental model, and garbage-can model, suggest that it is difficult for managers to make optimal decisions due to the limitations of information-gathering and processing.
- The decision-making process consists of seven steps: identifying the problem, identifying resources and constraints, generating alternative solutions, evaluating the alternatives, selecting an alternative, implementing the decision, and monitoring the decision.

- Managerial decisions can be categorized into two types: programmed and non-programmed decisions. Programmed decisions are made for simple, common and frequently occurring problems. Non-programmed decisions deal with unusual or exceptional problems.
- Based on the degree of uncertainty involved, decision making situations fall into one of the three categories: certainty, risk and uncertainty. Under conditions of certainty, the decision-maker knows with reasonable certainty the available alternatives, conditions associated with each alternative and the outcome of each alternative. Under conditions of risk, the manager has incomplete information about available alternatives but has a fair idea of the probability of success of each alternative. Conditions of uncertainty exist when the future is unpredictable. Modern approaches to decision making under uncertainty are: i) Risk analysis and ii) Preference theory.
- Managers at all levels require information with speed, brevity, precision and economy for carrying out their various functions effectively. An MIS gathers comprehensive data, organizes and summarizes it in a form that is of value to functional managers and provides them with information they need to carry out their work. A DSS is an interactive computer system that is easily accessible and operated by all managers to collect information which helps them in planning and decision making.
- Large organizations use group decision-making instead of individual decision-making. The different forms of group decision-making are: interacting groups, Delphi groups, and nominal groups.
- A number of sophisticated techniques or tools which are useful in the decision-making process include marginal analysis, financial analysis, break-even analysis, ratio analysis, and various operations research techniques.

12. Glossary

Bounded Rationality: A concept that suggests that the ability of managers to be perfectly rational in making decisions is limited by such factors as cognitive capacity and time constraints.

Brainstorming: Technique used to bring forth many alternative solutions; it involves a group of people brought together to generate as many novel ideas as possible on a given topic without evaluating them.

Certainty: Decision situation in which sufficient information exists to determine the results of each alternative prior to its implementation.

Database: A set of data organized efficiently in a central location so that it can serve a number of information system applications.

Decision Support System: A computer-based information system that supports the process of managerial decision-making in situations that are not well structured.

Decision Tree: A quantitative decision-making tool based on a graphic model that displays the structure of a sequence of alternative courses of action and usually shows the payoffs associated with various paths and the probabilities associated with potential future conditions.

Decision-making: The process of identifying and selecting a course of action to solve a specific problem.

Financial Analysis: The use of specific techniques to analyze a firm's financial statements in controlling the liquidity, profitability, and overall financial health of the organization.

Functional Managers: Managers who have responsibility for a specific, specialized area of the organization and supervise mainly individuals with expertise and training in that area.

Game Theory: A technique for determining the strategy that is likely to produce maximum profits in a competitive situation.

Garbage-can Model: A non-rational model of managerial decision-making stating that managers behave in a virtually random pattern while making non-programmed decisions.

Income Statement: Summary of the organization's financial performance over a given interval of time.

Incremental Changes: Subsystem adjustments required to keep the organization on course.

Informal Organizational Structure: The undocumented and officially unrecognized relationships between members of an organization that inevitably emerge out of the personal and group needs of employees.

Linear Programming: A mathematical technique used to find the best solution to a given problem from a set of feasible solutions.

Managerial Decisions: Decisions related to the coordination and support of the core activities of the organization.

Negative Entropy: The ability for a system to repair itself, survive, and grow by importing resources from its environment and transforming them into outputs.

Non-programmed Decisions: Decisions that deal with unusual or novel problems.

Non-rational Models: Models of managerial decision-making which suggest that information gathering and processing limitations make it difficult for managers to make optimal decisions.

Power: The capacity to affect the behavior of others.

Probability: The likelihood of occurrence of some uncertain event or condition.

Queuing Model: Quantitative planning tools based on mathematical models that describe the operating characteristics of queuing situations, in which service is provided to persons or units waiting in line; it helps in determining the appropriate balance between the cost of providing extra service and the cost of having people, machines, or material wait.

Rational Model: A model of managerial decision-making which suggests that managers engage in completely rational decision processes, ultimately make optimal decisions, and process and understand all information relevant to their decisions at the time they make them.

Satisficing: The term used by Hermon Simon to describe the way modern managers must, out of necessity, make decisions with incomplete information by choosing from among the few most likely alternatives.

Simulation: A quantitative planning technique that uses mathematical models to imitate reality.

Uncertainty: An aspect of non-programmed decisions, that is, a condition in which the decision-maker must choose a course of action without complete knowledge of the consequences that will follow implementation.

13. Self-Assessment Test

1) What do you understand by decision-making? Explain the significance and limitations of rational decision-making?
2) Explain the rational model and non-rational models of decision-making.
3) Describe briefly the decision-making process.
4) Explain the difference between programmed and non-programmed decision situations.
5) Based on the degree of certainty involved, every decision-making situation falls into one of three categories: (1) certainty, (2) risk, and (3) uncertainty. Explain.
6) How do individual decisions differ from group decisions? What are the different techniques used in group decision-making?
7) Describe the various techniques of decision-making in detail.
8) What is a decision tree? How does it help in decision making? Discuss its limitations.

14. Suggested Readings/Reference Material

- Chapter 8: Decision-making, Harold Koontz and Heinz Weihrich. *Management: A Global Perspective*. Tenth edition. Singapore: McGraw-Hill, 1994.
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15. Model Answers

15.1 Model Answers to Check Your Progress Questions

Following are the model answers to the Check Your Progress questions given in the Unit.

1. **(a) Decision-making**

   Decision-making describes the process by which a course of action is selected to deal with a specific problem. Managers make decisions dealing with both problems and opportunities. The quality of managers' decision is the yardstick of their effectiveness and value to the organization.

2. **(b) Incremental**

   According to the incremental decision-making model, managers put in the least possible effort when taking a decision to solve a problem. They only put in enough effort to reduce the problem to a tolerable level.

3. **(c) Bounded rationality**

   The concept of bounded rationality suggests that managers are not always rational when making decisions and that their abilities are limited by factors like cognitive capacity and time constraints.

4. **(d) Rational**

   Managers using the rational decision-making model are likely to come up with high quality solutions. They have a clear idea of alternative courses of action for achieving a goal under a specific set of circumstances.

5. **(b) Strategic planning**

   According to the non-rational model of decision making, managers may find it difficult to make optimal decisions due to limitation of information-gathering and processing. Garbage-can, satisficing, and incremental are models of non-rational decision making processes. The rational model of decision making is similar to the process of formal strategic planning.

6. **(c) Time constraints**

   Time constraints limit the amount of information that can be gathered in relation to a particular decision. Likewise, individual capacity and intelligence limits the extent to which decision-makers can take optimal decisions.

7. **(a) Generating alternative solutions**

   Brainstorming is a group decision-making technique. This technique encourages the members to develop as many ideas as possible on a particular topic. These ideas are recorded for future evaluation.

8. **(b) Determining the problem**

   The prerequisite to determining a problem is to recognize the existence of a problem. Determining a problem involves scanning, categorization, and diagnosis.

9. **(c) Problem existence**

   The three stages in problem identification are scanning, categorization, and diagnosis. Problem existence occurs before the identification of the problem.

10. **(b) Categorization**

    The three stages in problem identification are scanning, categorization, and diagnosis. The categorization stage attempts to understand the performance gap and categorize the situation as problematic or non-problematic.

11. **(c) Resource**

    Once the problem is identified and diagnosed, the manager should identify the resources and constraints relevant to the problem. Resources include money, time, people, equipment, materials, information, and expertise.

12. **(d) Implementation of the decision**

    Successful implementation of a decision usually depends on two factors careful planning, and sensitivity to those who will implement the decision and/or those who will be affected by it.

13. **(d) Uncertainty**

    Uncertainty arises when it is not possible to predict future environmental factors. Non-programmed decisions generally deal with unstructured problems under conditions of uncertainty.

14. **(c) Non-programmed**

    Non-programmed decisions generally deal with unstructured problems under conditions of uncertainty. Managers require a lot of information about the external environment when making non-programmed decisions.

15. **(a) Programmed and Non-programmed**

    Programmed decisions deal with simple, common, frequently occurring problems with well established and clear solutions. Non-programmed decisions, however, deal with unusual or exceptional problems.

16. **(b) Non-programmed**

    Non-programmed decisions are not recurring in nature. Since non-programmed decisions involve situations that are novel and/or ill-structured, predetermined decision rules are impractical for such decisions. Experience and intuition play an important role in taking non-programmed decisions.

17. (c) Risk

Risk arises when a manager lacks complete information about alternatives. Therefore, managers need to determine the probability of an outcome for each alternative with the available information.

18. (a) Conditions of certainty

A condition of certainty exists when the decision-maker is aware of the available alternatives, the conditions associated with each alternative, and the outcome or result of each alternative. Conditions of certainty generally exist in the day-to-day operations of a business.

19. (b) Uncertainty

Managers often have to deal with unstructured problems under conditions of uncertainty. They do not possess enough information when taking decisions under conditions of uncertainty and do not have knowledge of the available alternatives, the risks associated with each of the alternatives, and the outcome or consequences of each alternative. They make certain assumptions and depend on their judgment and experience for taking effective decisions.

20. (c) Structure trees

Uncertainty arises when the future environment is unpredictable. Risk analysis, decision trees, and preference or utility theory are modern techniques for taking decisions under conditions of uncertainty.

21. (b) Decision support system

Decision support systems (DSS) provide managers with tools for analyzing problem situations. A DSS supports and makes the process of managerial decision-making more effective.

22. (d) Group decision-making

The group involved in the decision-making process consists of people with varied experience and interests. As a result, the group can present different perspectives for analyzing and solving a problem. Participation in this process can be a training ground for people with less experience.

23. (b) Operations research

The operations research technique of decision-making uses scientific, logical or mathematical means to arrive at realistic solutions to problems.

Principles of Management

Course Components

BLOCK I	**Introduction to Management**
Unit 1	Management: An Overview
Unit 2	Evolution of Management Thought
Unit 3	Social and Ethical Responsibilities of Management
BLOCK II	**Planning**
Unit 4	Fundamentals of Planning
Unit 5	Management by Objectives
Unit 6	Strategies, Policies and Planning Premises
Unit 7	Managerial Decision Making
BLOCK III	**Organizing**
Unit 8	Fundamentals of Organizing
Unit 9	Strategic Organization Design
Unit 10	Strategic Organization Structure
Unit 11	Effective Organizing and Organizational Culture
BLOCK IV	**Staffing**
Unit 12	Human Resource Management and Staffing
Unit 13	Performance Appraisal and Career Strategy
Unit 14	Organizational Change and Organization Development
BLOCK V	**Leading**
Unit 15	Managing and the Human Factor
Unit 16	Motivating Employees for Job Performance
Unit 17	Leadership
Unit 18	Managing Communications
BLOCK VI	**Controlling**
Unit 19	The Control Function
Unit 20	Control Techniques
Unit 21	Productivity and Operations Management
Unit 22	Management Information Systems