Notes by Amar Nath (amar.ncet@gmail.com)

Strategic Management as "The field that deals with the major intended and emergent initiatives taken by general managers on behalf of owners, involving utilization of resources to enhance the performance of the firm in their external environments." Strategy is about a firm's long term performance and competitive advantage.

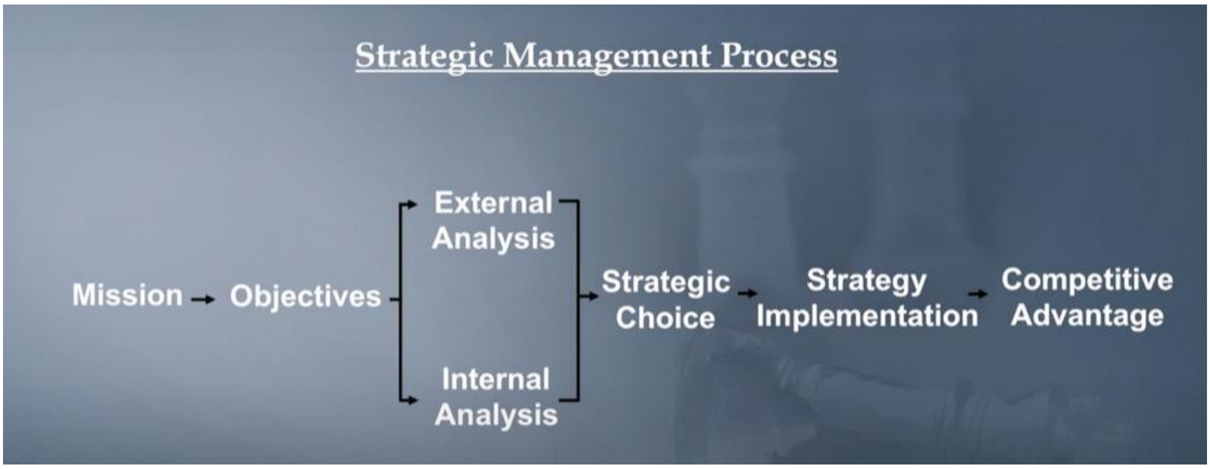
- The term 'Strategy' in an organizational context has a specific and precise meaning.
- In reality, a firm's strategy may be both deliberate as well as emergent.
- An organization's goals significantly guides its strategy.

Strategic decisions:

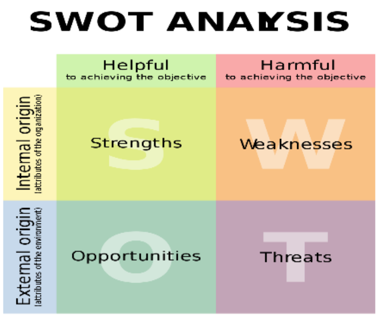
- Tend to have a long-term orientation.
- Focus on the "Big Picture".
- Have significant cross-functional implications.
- Involve a significant commitment of resources.
- Are not easily reversible.
- Involve a conscious choice of what to do and what not to do.

A decision is said to be strategic if it involves significant commitment of resources, is irreversible, and has a long-term impact on the organisation.

A change in strategy would have significant cross-functional implications.



One has to conduct an analysis. A tool that is fundamental to study strategic analysis is a SWOT analysis.



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A firm's mission states the organization's purpose why the organization exists?

While the organization's mission is a broad statement of what it intends to achieve, objectives are the actionable and measurable goals.

Strategic management process involves the following steps:

1. The firm has to decide on its mission

2. The purpose why it exists and state its objectives

3. The actionable and measurable goals

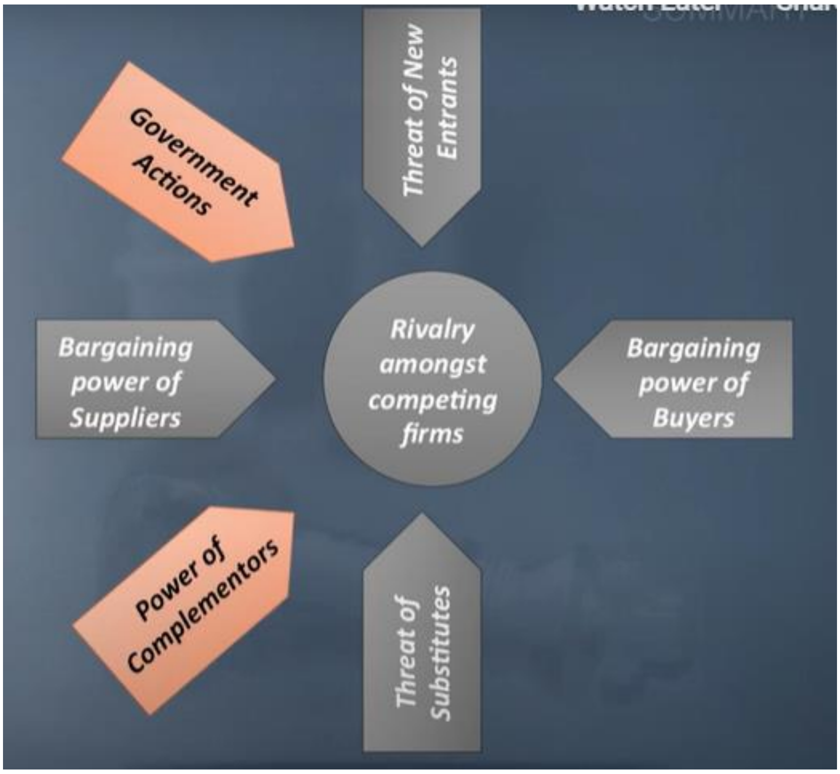
A firm is said to possess competitive advantage when it is able to deliver superior performance on a parameter of its choice compared to its competitors. But remember the goal of strategy is not just to create competitive advantage, the goal is to create a sustained competitive advantage. A firm is said to have sustained competitive advantage when the advantage that the firm has over its rivals is sustained over a long time and exists despite attempts by competitors to neutralize it.

- A firm's strategy should be formulated with careful consideration of its strengths, weaknesses, along with opportunities and threats that the external environment possess.
- It is extremely important to consider the *implementation* of a strategy at the strategy *formulation* phase itself.
- A firm would need to choose its *competitive position* having considered a multitude of factors, and not merely optimize on a single factor.

The essence of strategy is about a firm's ability to create value for its customers, and capture some of that value that it creates to ensure its own survival and growth and to do this year on year, endlessly. That is a source of sustainable competitive advantage and therefore, superior performance.

EXTERNAL ANAYSIS

Industry Analysis: A firm generates value for its customers and captures a portion of this value. Often, the focal firm is not the only player in its industry, competitive and other forces in the industry ensure that only a portion of the created value is captured. The structure of the industry in which a firm operates includes – suppliers, buyers, rivals, new entrants, substitutes, complementors and governments.



Threat of New Entrants
Incumbent firms in an industry would like to restrict the entry of new firms which would increase the pressure on its profitability.

Barriers to entry will increase if....

- High supply side economies of scale
- High demand side benefits of scale
- High switching costs for customers
- High capital requirements
- Incumbency advantages
- Unequal access to distribution channels
- Restrictive government policies
- High level of expected retaliation

Threats to entry are evaluated by looking at entry barriers. Entry barriers protect an industry from newcomers

Buyer Power: A firm's ability to capture value from its customers is contingent on a number of factors. Two factors drive buyer power:

1. The Intrinsic leverage they exercise over you.

2. The price sensitivity

Intrinsic leverage increases...

- High buyer concentration vis-a-vis firm concentration.
- Buyer Purchase in high volumes
- Low switching costs for buyer relative to industry's
- High levels of buyer information/expertise
- Buyers credibly threatens to integrate backwards
- Undifferentiated industry products

Price sensitivity increases...

- Purchase is a high percentage of total expenditure
- Buyer group itself earns low profits
- Impact on quality/performance for buyer is low
- Weak brand identity and small product differences

Supplier Power: Bargaining power of suppliers

Not every firm can build its products on its own, it would have to work with suppliers to create value. These suppliers under some conditions could erode the value you attempt to capture.

Supplier power increases if...

- High supplier concentration
- Low dependence on industry for revenues
- High switching cost for industry participants
- Highly differentiated inputs with strong impact on cost
- Few or no substitutes for supplier's inputs
- High threat of forward integration by suppliers relative to threat of backward integration by industry

Rivalry amongst competing firms

Often, an industry is populated with multiple firms competing by providing similar value to customers. The presence of such rivals poses significant challenges to the focal firm in the industry.

Rivalry will increase if...

- Many competitors roughly equal in size and power
- Diversity of competitors approaches
- Non-homogenous competitors
- High ratio of fixed costs. Low marginal costs
- High storage costs or perishable products
- Low Product differences / Weak brand identity
- Intermittent excess capacity

Exit may be difficult because...

- Highly Specialized assets
- Government and social restrictions
- Strategic interrelationships

- High emotional barriers

Threats from Substitutes: Substitutes to the products offered by the focal firm offer alternatives to the end customer.

Threats of substitutes will increase if….

- High Price performance of substitutes
- Low switching costs for buyers
- High buyer propensity to substitute
- High profitability of producers of substitutes

Complementor Power: Complementors increase the value created by the focal firm. However, if the focal firm is reliant on the complementor heavily, then it faces the threat of not being able to appropriate the value being created.

Complementor power will increase if...

- Relative buyer power
- Relative concentration
- Asymmetric integration threats
- Ease of unbundling
- Complementor drives customer choice in purchasing bundle
- Relative switching costs
- Rate of growth of the profit opportunity

Government Actions: The larger context of businesses are influenced by the acts of governments. How can a government ensure the firm finds it attractive?
Government's actions increase industry attractiveness by regulating through licensing, pricing controls, taxes and subsidies, tariffs or new regulations such as pollution control, etc. In short, governments are all-powerful, can make or break your industry by their actions.

Groups of firms that employ similar dimensions or business models to compete in the market place are called as strategic groups. In a sense, you can call them proximate competition.

PESTLE Analysis

The external environment is the context in which a firm operates - a relevant framework to perform the analysis here is - the PESTLE (Political, Economic, Socio-Cultural, Technological, Legal and Ecological) framework.

INTERNAL ANALYSIS

The resource-based view of the firm considers each organization's resources to be unique and the heterogeneity among organizations with regard to their possession of these resources as being the underlying basis for the firm's differential performance or competitive advantage.

Jay Barney, defines resources as"… all assets, capabilities, competencies, organizational processes, firm attributes, information, knowledge, and so forth, that are controlled by a firm that enable the firm to conceive of and implement strategies designed to improve its efficiency and effectiveness."

Having defined resources, it's useful to categorize these into:

(1) Tangible resources

(2) Intangible resources

Tangible resources include:

(a) Physical resources such as Land, Location, Building, Plant Equipment etc.

(b) Financial resources such as Cash, Accounts Receivable, Shareholder Equity, Borrowing Capacity etc.

(c) Organizational resources such as Evaluation and Reward Systems, Company Planning processes, Training procedures etc.

(d) Technological resources such as Patents, Copyrights, Trade Secrets etc. Intangible resources: Dess, Lumpkin and Eisner define 'Intangible resources' as those that are: '…embedded in unique routines and practices that have evolved and accumulated over time.. .'

Drawing on their categorization, Intangible resources include:

(a) Human resources such as capability of employees, experience, judgement, work team relationships and trust among employees etc.

(b) Innovation resources such as technical and scientific expertise, ideas etc.

(c) Reputation resources such as brand name, the organization's reputation with customers for reliability and quality, its reputation with suppliers for fairness, the organization's reputation for its 'code of conduct' and its responsibility to society and the environment.

(d) Finally, the organization's culture which embodies its shared beliefs, values and which dictates how its employees behave is an important intangible resource.

VRIO

Resources are assessed to determine if they are (1) Valuable, (2) Rare, (3) Inimitable and Non-substitutable (4) Exploited by the Organization. This is popularly referred to as VRIO.

Is the resource valuable?

A valuable resource is one which

- Enables the firm to exploit or leverage opportunities
- Enables the firm to neutralize or mitigate the threats
- Reduces firms' net costs
- Increases the customer's willingness to pay

Firms that do not possess valuable resources typically suffer a competitive disadvantage

Is the resource rare?

A firm's resource may be valuable, but if it is not rare, then it is unlikely to serve as a source of competitive advantage for any of the firms. Valuable, but easily available resources therefore result in the mitigation of competitive advantage and result in firms attaining competitive parity.

Therefore, if the firm's resources are both valuable and rare, it has the potential to be a source of temporary competitive advantage.

Is the resource inimitable (difficult to copy)?

A firm's resource may be valuable and rare, but the resource is likely to provide a sustained competitive advantage only when other firms are unable to copy the resource or it is prohibitively expensive to replicate the resources of the firm which possesses the valuable and rare resource.

Isolating mechanisms for a resource to be inimitable:

- Unique historical conditions
- Legal restrictions
- Social Complexity: interpersonal relations of managers
- Causal Ambiguity: causal linkage between resources possessed by the firm and its impact on the firm's competitive advantage
- Superior access to inputs and customers
- Network Effects
- Early mover advantages and learning curve effects

Is the resource non-substitutable?

If a firm's resource cannot be imitated, it may still be subject to resource substitution. Competitive advantage, therefore, requires the resource to be nonsubstitutable. If a firm possesses resources for which no strategically equivalent substitutes exist or whose advantages cannot be trumped by another resource, the firm is said to possess nonsubstitutable resources.

Is the resource organizationally exploitable?

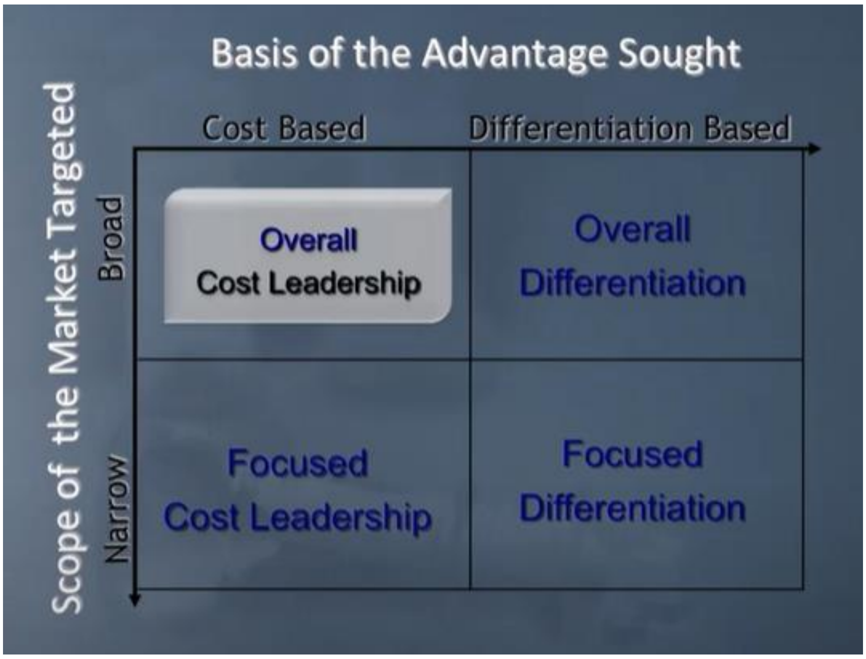
A resource may be valuable, rare, inimitable and non-substitutable, but in order to fully harness the potential of this resource, it needs to be exploited by the organization.

Is the resource valuable ?	Is the resource rare ?	Is the resource difficult to imitate & substitute?	Is the resource organizationally exploitable?	Implications for competitiveness
YES	NO	NO	NO	Competitive Parity
YES	YES	NO	NO	Temporary Competitive Advantage
YES	YES	YES	NO	Temporary Competitive Advantage
YES	YES	YES	YES	Sustainable Competitive Advantage

Competitive Positioning

Generic strategies are:

- Cost leadership Strategy: Competing on the basis of cost
- Differentiation Strategy: competing on superior values (both tangible and intangible)
- Focus: Segmentation



Cost leadership calls for…

- Leveraging economies of scale to lower production cost.
- Taking start-up losses to increase market share.
- Creating efficient organizational systems & structures.
- Tight control on costs and overheads.

When does a low-cost strategy work best….

- Standardized product is available from multiple sources
- Opportunities for enhancing customer benefits limited
- Potentially high economies of scale
- Price sensitive customers
- Search goods rather than an experience goods
- Industry newcomers use low prices

Functional strategies for cost leadership…

- Product and marketing strategies
  - Standardized products
  - Price below or equal to that of competitors
  - Little or modest advertising and promotion
  - Avoidance of less profitable accounts
- Production or operations strategies
  - Investment in large size plants and facilities for economies of scale
  - Do not hesitate in buying the most modern automated machinery and equipment that would reduce cost
  - Capacity additions match up demand growth
  - Tight inventory controls

- Engineering and R&D strategies
  - Redesign products to reduce the manufacturing costs
  - Strong process engineering capabilities
  - Emphasise on process innovation
- Organization and control strategies
  - Tight budgeting and control procedures
  - Incentives and bonuses that reward productivity
  - Simple, functional organization with few layers of hierarchy

When does a Differentiation strategy work best?

- Buyers needs and uses are diverse and there exist many ways to differentiate a product
- Opportunities for achieving a cost advantage over competitors are low
- The product is an experience good.
- Technological change and product innovation are fast paced.

Focus...

- Competes in a well-defined segment of the market
- Either a cost leader or differentiator or both
- Focus may be on buyer group / product segment / geographic market

Generic Strategies: Risks

Cost leadership – Risk

- Technological change nullifies past investment and learning.
  - Investments which become obsolete if the technology changes.
  - New firms may have a cost advantage over older firms in case of a technology change.
- Single minded pursuit of low cost leading to foresee product-market changes.
- Low-cost learning by new comers/ followers
- Inflation in costs increases attractiveness of differentiators.

Differentiation: Risks

- Uniqueness not valued and customers unwilling to pay more.
- Imitation narrows perceived differentiation
- Imitation by competitors.
- Competitors lure buyer away.
- Dilution of brand through product-line extensions

Focus: Risks

- Risks associated with cost leadership and differentiation apply to focus as well.
- Focusers must resist the temptation to dilute focus by serving many segments.
- Focuser must continually evaluate the future potential of its served market
- High-cost differential leads to the erosion of cost advantages

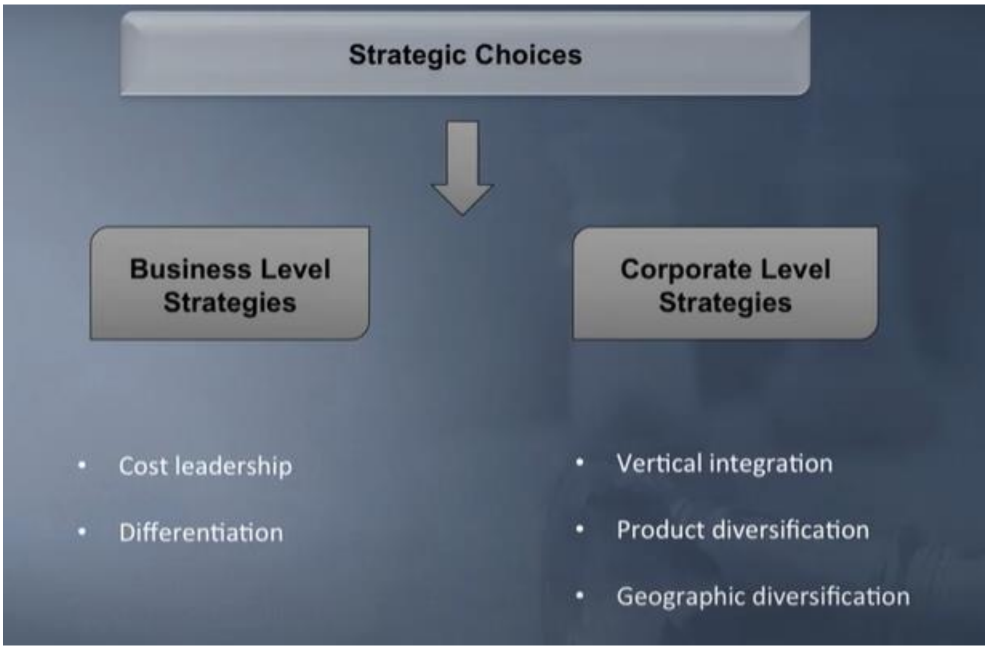
Risk of dual advantage: Stuck in the middle.

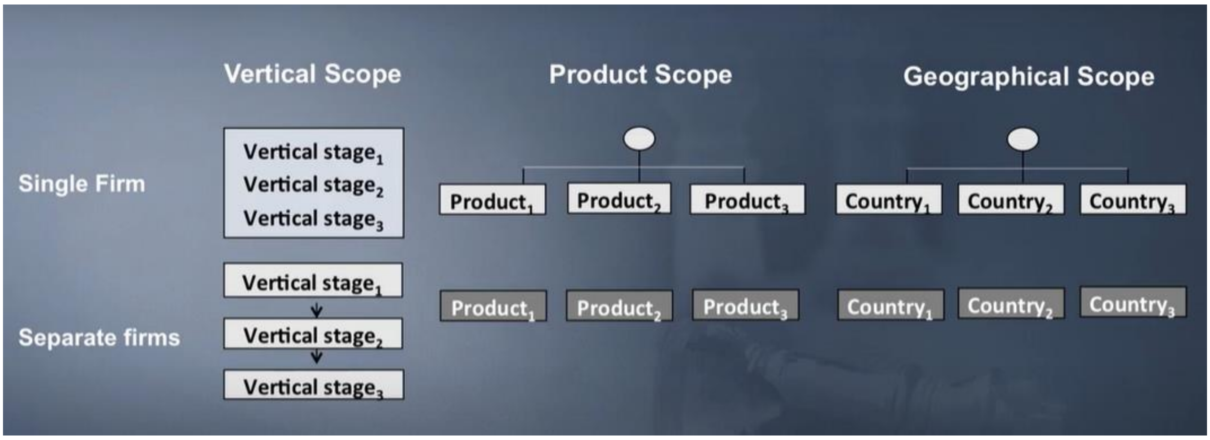
Value Chain Analysis: The value chain analysis considers the firm as a sequential process of activities which are value creating.

The value chain analysis facilitates a deeper understanding of the determinants of the competitive advantage of the firm obtained through the firm's positioning as a cost leader or a differentiator by examining these determinants at a fairly granular level in the organization by breaking down the processes in the entire firm into various activities.

Managing a multi-business firm

Corporate Strategy





According to transaction cost economics or TCE, the make or buy decision depends upon whether transaction costs - the costs of organizing a transaction in the market are higher or lower than the administrative costs of organizing the same within a firm. What is a transaction? A transaction occurs whenever something is being exchanged or traded. These transactions have costs associated with them. They include the costs of searching for an appropriate supplier, the costs of negotiating a contract and the costs of monitoring and enforcing the contracts. The basic logic is then straight forward if transaction cost in the market are higher than administrative cost within the firm then a firm should make and if transaction cost in the market are lower than administrative cost within the firm then firm should buy.

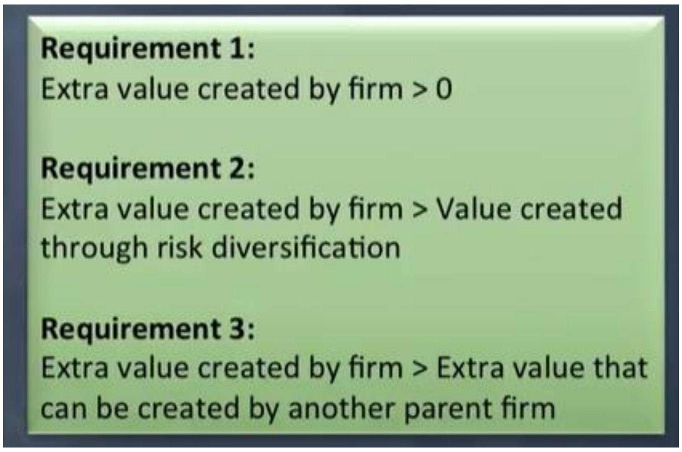
Make outperforms buy when there are transaction-specific investments. These are investments that are valuable for a specific transaction but less useful for other transactions.

Issues with Vertical Integrations:

- differences in the optimal scale between two vertical stages
- Competencies difference in two vertical stages
- vertical integration can make a firm less flexible

Product Diversification:

A company should diversify into industries that are attractive, i.e., industries in which the threats of the five forces are low. A diversified firm is said to have a corporate advantage when the value of the firm is greater than the sum of its individual parts.



Types: Focused, Related diversification, Unrelated diversification

Benefit: Economies of scope (Bring down the unit cost – By sharing activities, Sharing resources)

Dominant logic - "way in which managers conceptualize the business and make critical resource allocation decisions-be it in technologies, product development, distribution, advertising, or in human resource management." It can be thought of as a cognitive mindset about what managers believe are the important business problems and how these problems should be addressed. The dominant logic for a business is built up over time through the experiences of managers.

Cost of diversification: Increased complexity, Coordination between businesses, Firms bureaucratic and rigid,

The costs of diversification that we discussed so far are likely to be even higher when the relatedness between businesses is low. When relatedness is low, there are fewer economies of scope that can be realized. The differences between the two businesses can also make it difficult to achieve coordination between them.

Geographic diversification

geographic diversification also has to satisfy the logic of corporate advantage. That is, geographic diversification is justified when a firm that is present in multiple countries has advantages compared to a firm that is in only a single country. There are many benefits of geographic diversification, the most prominent one being the sharing, leveraging, and transfer of resources and capabilities. The costs of geographic diversification may also be high due to the differences that exist between countries. Thus, firms should be cautious when engaging in geographic diversification.

Managing Multi business firms

The cooperative form is appropriate when the firm is diversified into businesses that are highly related. To make sure that businesses coordinate with each other, the corporate office also has to exert a higher level of control, both financially and operationally.

Strategic Business Unit (SBU) form is more appropriate when the relatedness among all of a firm's businesses is lower. The Corporate Office is also smaller since there are fewer activities, resources, and capabilities that need to be shared. The Corporate Office also exerts a lower level of control in that more decisions are made at the level of the SBU.

The competitive form is appropriate when the firm is highly diversified into unrelated businesses. Their divisions in this case "compete" for financial resources. Since the businesses are unrelated, integrative mechanism are nonexistent and the corporate office is much smaller. The corporate office exerts control mainly through financial controls with the expectation that divisions that do not meet financial goals will not receive additional capital for expansion or may even be divested.

Diversification in Emerging Economies

Institutional dimension	United States	India
Capital markets	Well developed; many sources of funding including venture capital	Under developed; easier for firms associated with a business group to raise capital
Labor markets	Well developed; large pool of trained managers	Shortage of skilled employees despite a large population; easier for firms associated with a business group to hire managers
Product markets	Well developed; consumer protection high	Weak protection for consumers; brand name of a reputed business group is very valuable
Government regulation	Low; relatively free of corruption	High; easier for firms associated with a business group to deal with the government
Contract enforcement	Predictable; firms can rely on courts in case of dispute with a business partner	Unpredictable; easier for firms associated with a business group to build reputation as a reliable partner