STRATEGIC MANAGEMENT

BBM :462

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➢ TOPIC ONE:GENERAL OVERVIEW OF STRATEGY

Strategy - Definition and Features

- Strategy can be defined as a general direction set for the company and its various components to achieve a desired state in the future.
- Strategy is a well defined roadmap of an organization. It defines the overall mission, vision and direction of an organization. The objective of a strategy is to maximize an organizational€™s strengths and to minimize the strengths of the competitors.

Features of Strategy

1. Strategy is Significant because it is not possible to foresee the future. Without a perfect foresight, the firms must be ready to deal with the uncertain events which constitute the business environment.
2. Strategy deals with long term developments rather than routine operations, i.e. it deals with probability of innovations or new products, new methods of productions, or new markets to be developed in future.
3. Strategy is created to take into account the probable behavior of customers and competitors. Strategies dealing with employees will predict the employee behavior.

Strategic Management - An Introduction

- ➢ Strategic Management is the identification and description of the strategies that managers can carry so as to achieve better performance and a competitive advantage for their organization.
- ➢ Strategic management can also be defined as a bundle of decisions and acts which a manager undertakes and which decides the result of the firm's performance.
- ➢ An organization is said to have competitive advantage if its profitability is higher than the average profitability for all companies in its industry.
- ➢ The manager must have a thorough knowledge and analysis of the general and competitive organizational environment so as to take right decisions.
- ➢ They should conduct environmental analysis use of strategic tools i.e. SWOT Analysis (Strengths, Weaknesses, Opportunities, and Threats) and PESTEL analysis. They should make best possible utilization of strengths, minimize the organizational weaknesses, make use of arising opportunities from the business environment and should ignore the threats.

Strategic management is a continuous process that:

- Evaluates and controls the business and the industries in which an organization is involved;
- Evaluates its competitors and sets goals and strategies to meet all existing and potential competitors; and
- Reevaluates strategies on a regular basis to determine how it has been implemented and whether it was successful or does it needs replacement.

It the art of managing employees in a manner which maximizes the ability of achieving business objectives such as:-

- ▪ The employees become more trustworthy
- ▪ Improve commitment

- Improve job satisfaction as they can co-relate themselves very well with each organizational task.
- Understand the reaction of environmental changes on the organization and the probable response of the organization
- Enables the employees to judge the impact of such changes on their own job and can effectively face the changes.
- The managers and employees must do appropriate things in appropriate manner.
- Improve effectiveness as well as efficiency.

Major role of strategic management:-

- To incorporate various functional areas of the organization completely
- To ensure these functional areas harmonize and get together well.
- To keep a continuous eye on the goals and objectives of the organization.

Components of a Strategy Statement

The strategy statement of a firm sets the firm's long-term strategic direction and broad policy directions. It gives the firm a clear sense of direction and a blueprint for the firm's activities for the upcoming years.
The main constituents of a strategic statement are as follows:

1. Vision

- **A vision statement identifies where the organization wants or intends to be in future or where it should be to best meet the needs of the stakeholders.**

It describes dreams and aspirations for future.

E.g.:Microsoft's vision is "to empower people through great software, any time, any place, or any device.

- **A vision statement is for the organization and its members**, unlike the mission statement which is for the customers/clients.
- It contributes in effective decision making as well as effective business planning.
- It incorporates a shared understanding about the nature and aim of the organization and utilizes this understanding to direct and guide the organization towards a better purpose.
- It describes that on achieving the mission, how the organizational future would appear to be.

An effective vision statement must have the following features-

1. It must be unambiguous.
2. It must be clear.
3. It must harmonize with organizational culture and values.
4. The dreams and aspirations must be rational/realistic.
5. Vision statements should be shorter so that they are easier to memorize.

2. Mission Statement

- **Mission statement is the statement of the role by which an organization intends to serve its stakeholders**
- It describes why an organization is operating and thus provides a framework within which strategies are formulated.

Mission Statement describes:-

- What the organization does (i.e., present capabilities),
- Who all it serves (i.e., stakeholders) and
- What makes an organization unique (i.e., reason for existence).

A mission statement differentiates an organization from others by:-

i) Explaining its broad scope of activities,
ii) Its products, and
iii) Technologies it uses to achieve its goals and objectives.

Mission statements always exist at top level of an organization, but may also be made for various organizational levels.

Components of Mission statement:-

i) a statement of mission or vision of the company
ii) a statement of the core values that shape the acts
iii) behavior of the employees
iv) a statement of the goals and objectives.

Features of a Mission

- Mission must be feasible and attainable. It should be possible to achieve it.
- Mission should be clear enough so that any action can be taken.
- It should be inspiring for the management, staff and society at large.
- It should be precise enough, i.e., it should be neither too broad nor too narrow.
- It should be unique and distinctive to leave an impact in everyone's mind.
- It should be analytical, i.e. it should analyze the key components of the strategy.
- It should be credible, i.e., all stakeholders should be able to believe it.

3. Goals and objective

A goal is a desired future state or objective that an organization tries to achieve. Goals specify in particular what must be done if an organization is to attain mission or vision. Goals make mission more prominent and concrete. They co-ordinate and integrate various functional and departmental areas in an organization.

features-

1. These are precise and measurable.
2. These look after critical and significant issues.
3. These are realistic and challenging.
4. These must be achieved within a specific time frame.

5. These include both financial as well as non-financial components.

Objectives are defined as goals that organization wants to achieve over a period of time. These are the foundation of planning. Policies are developed in an organization so as to achieve these objectives. Formulation of objectives is the task of top level management. Effective objectives have following features-

1. These are not single for an organization, but multiple.
2. Objectives should be both short-term as well as long-term.
3. Objectives must respond and react to changes in environment, i.e., they must be flexible.
4. These must be feasible, realistic and operational.

4. Business Policy

Definition of Business Policy

- Business policies are the guidelines developed by an organization to govern its actions.
- They define the limits within which decisions must be made.
- Business policy also deals with acquisition of resources with which organizational goals can be achieved.
- Business policy is the study of the roles and responsibilities of top level management, the significant issues affecting organizational success and the decisions affecting organization in long-run.
- Business Policy defines the scope or spheres within which decisions can be taken by the subordinates in an organization.
- It permits the lower level management to deal with the problems and issues without consulting top level management every time for decisions.

Features of Business Policy

An effective business policy must have following features-

1) Specific- Policy should be specific/definite. If it is uncertain, then the implementation will become difficult.
2) Clear- Policy must be unambiguous. It should avoid use of jargons and connotations. There should be no misunderstandings in following the policy.
3) Reliable/Uniform- Policy must be uniform enough so that it can be efficiently followed by the subordinates.
4) Appropriate- Policy should be appropriate to the present organizational goal.
5) Simple- A policy should be simple and easily understood by all in the organization.
6) Inclusive/Comprehensive- In order to have a wide scope, a policy must be comprehensive.
7) Flexible- Policy should be flexible in operation/application. This does not imply that a policy should be altered always, but it should be wide in scope so as to ensure that the line managers use them in repetitive/routine scenarios.
8) Stable- Policy should be stable else it will lead to indecisiveness and uncertainty in minds of those who look into it for guidance.

Difference between Policy and Strategy

Policy	Strategy
Policy is a blueprint of the organizational activities which are repetitive/routine in nature	Strategy is concerned with those organizational decisions which have not been dealt/faced before in same form.
Policy formulation is responsibility of top level management	Strategy formulation is basically done by middle level

Policy deals with routine/daily activities essential for effective and efficient running of an organization.	While strategy deals with strategic decisions.
Policy is concerned with both thought and actions.	strategy is concerned mostly with action
A policy is what is, or what is not done	A strategy is the methodology used to achieve a target as prescribed by a policy.

Recommended Reading

Bradford, Robert W., Duncan, Peter J., Tarcy, Brian, *Simplified Strategic Planning: A No-Nonsense Guide for Busy People Who Want Results Fast!*

The Business Vision and Company Mission Statement

While a business must continually adapt to its competitive environment, there are certain core ideals that remain relatively steady and provide guidance in the process of strategic decision-making. These unchanging ideals form the **business vision** and are expressed in the company **mission statement**.

In their 1996 article entitled *Building Your Company's Vision*, James Collins and Jerry Porras provided a framework for understanding business vision and articulating it in a mission statement.
The mission statement communicates the firm's core ideology and visionary goals.

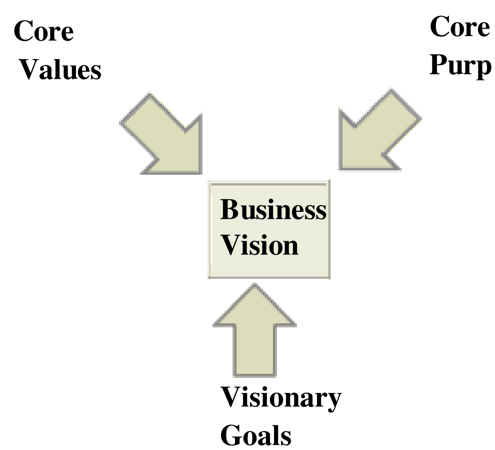
It consists of the following three components:

1. **Core values** to which the firm is committed
2. **Core purpose** of the firm
3. **Visionary goals** the firm will pursue to fulfill its mission

The firm's core values and purpose constitute its core ideology and remain relatively constant. They are independent of industry structure and the product life cycle.

The core ideology is not created in a mission statement; rather, the mission statement is simply an expression of what already exists. The specific phrasing of the ideology may change with the times, but the underlying ideology remains constant.

The three components of the business vision can be portrayed as follows:



➢ TOPIC TWO:

STRATEGIC ASSESSMENT

SWOT Analysis

SWOT is an acronym for Strengths, Weaknesses, Opportunities and Threats. By definition, Strengths (S) and Weaknesses (W) are considered to be internal factors over which you have some measure of control. Also, by definition, Opportunities (O) and Threats (T) are considered to be external factors over which you have essentially no control. A scan of the internal and external environment is an important part of the strategic planning process. Such an analysis of the strategic environment is referred to as a **SWOT analysis**.

SWOT Analysis is the most renowned tool for audit and analysis of the overall strategic position of the business and its environment. Its key purpose is to identify the strategies that will create a firm specific business model that will best align an organizational resources and capabilities to the requirements of the environment in which the firm operates. A consistent study of the environment in which the firm operates helps in forecasting/predicting the changing trends and also helps in including them in the decision-making process of the organization.

The SWOT analysis provides information that is helpful in matching the firm's resources and capabilities to the competitive environment in which it operates. As such, it is instrumental in strategy formulation and selection. The following diagram shows how a SWOT analysis fits into an environmental scan:

SWOT Analysi Framework

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                    Environmental Scan
              /                          \
     Internal Analysis           External Analysis
             / \                         / \
Strengths   Weaknesses   Opportunities   Threats
                           |
                      SWOT Matrix
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Strengths

Strengths are the qualities that enable us to accomplish the organizational mission. These are the basis on which continued success can be made and continued/sustained. A firm's strengths are its resources and capabilities that can be used as a basis for developing a competitive advantage.

Strengths can be either tangible or intangible. These are what you are well-versed in or what you have expertise in, the traits and qualities your employees possess (individually and as a team) and the distinct features that give your organization its consistency. Strengths are the beneficial aspects of the organization or the capabilities of an organization, which includes human competencies, process capabilities, financial resources, products and services, customer goodwill and brand loyalty.

Examples of organizational strengths are huge financial resources, broad product line, no debt, committed employees, patents, strong brand names, good reputation among customers, cost advantages from proprietary know- how, exclusive access to high grade natural resources, favorable access to distribution networks.

Weaknesses

Weaknesses are the qualities that prevent us from accomplishing our mission and achieving our full potential.
The absence of certain strengths may be viewed as a weakness. These weaknesses deteriorate influences on the organizational success and growth. Weaknesses are the factors which do not meet the standards we feel they should meet. Weaknesses in an organization may be depreciating machinery, insufficient research and development facilities, narrow product range, poor decision-making, etc. Weaknesses are controllable. They must be minimized and eliminated. For instance - to overcome obsolete machinery, new machinery can be purchased. Other examples of organizational weaknesses are huge debts, high employee turnover, complex decision making process, narrow product range, large wastage of raw materials, lack of patent protection, a weak brand name, poor reputation among customers, high cost structure, lack of access to the best natural resources, lack of access to key distribution channels, etc

In some cases, a weakness may be the flip side of a strength. Take the case in which a firm has a large amount of manufacturing capacity. While this capacity may be considered a strength that competitors do not share, it also may be considered a weakness if the large investment in manufacturing capacity prevents the firm from reacting quickly to changes in the strategic environment.

Opportunities

Opportunities are presented by the environment within which our organization operates. These arise when an organization can take benefit of conditions in its environment to plan and execute strategies that enable it to become more profitable. The external environmental analysis may reveal certain new opportunities for profit and growth. Organizations can gain competitive advantage by making use of opportunities. Organization should be careful and recognize the opportunities and grasp them whenever they arise. Selecting the targets that will best serve the clients while getting desired results is a difficult task. Opportunities may arise from market, competition, industry/government and technology. Increasing demand for telecommunications accompanied by deregulation is a great opportunity for new firms to enter telecom sector and compete with existing firms for revenue. Other examples of such opportunities include: an unfulfilled customer need, arrival of new technologies, loosening of regulations, removal of international trade barriers, etc.

Threats

Threats arise when conditions in external environment jeopardize the reliability and profitability of the organization’s business. They compound the vulnerability when they relate to the weaknesses. Changes in the external environmental present such threats to the firm. Threats are uncontrollable. When a threat comes, the stability and survival can be at stake. Examples of threats are - unrest among employees; ever changing technology; increasing competition leading to excess capacity, price wars and reducing industry profits, shifts in consumer tastes away from the firm's products, emergence of substitute products, new regulations, increased trade barriers

The SWOT Matrix

A firm should not necessarily pursue the more lucrative opportunities. Rather, it may have a better chance at developing a competitive advantage by identifying a fit between the firm's strengths and upcoming opportunities. In some cases, the firm can overcome a weakness in order to prepare itself to pursue a compelling opportunity.
To develop strategies that take into account the SWOT profile, a matrix of these factors can be constructed. The SWOT matrix (also known as a **TOWS Matrix**) is shown below:

SWOT / TOWS Matrix

	Strengths	**Weaknesses**
Opportunities	S-O strategies	W-O strategies
Threats	S-T strategies	W-T strategies

- **S-O strategies** pursue opportunities that are a good fit to the company's strengths.
- **W-O strategies** overcome weaknesses to pursue opportunities.
- **S-T strategies** identify ways that the firm can use its strengths to reduce its vulnerability to external threats.
- **W-T strategies** establish a defensive plan to prevent the firm's weaknesses from making it highly susceptible to external threats.

Advantages of SWOT Analysis

SWOT Analysis is instrumental in strategy formulation and selection. It is a strong tool, but it involves a great subjective element. It is best when used as a guide, and not as a prescription. Successful businesses build on their strengths, correct their weakness and protect against internal weaknesses and external threats. They also keep a watch on their overall business environment and recognize and exploit new opportunities faster than its competitors.

SWOT Analysis helps in strategic planning in following manner-

1. It is a source of information for strategic planning.
2. Builds organizational strengths.
3. Reverse its weaknesses.
4. Maximize its response to opportunities.
5. Overcome organizational threats.
6. It helps in identifying core competencies of the firm.
7. It helps in setting of objectives for strategic planning.
8. It helps in knowing past, present and future so that by using past and current data, future plans can be chalked out.

SWOT Analysis provide information that helps in synchronizing the firm resources and capabilities with the competitive environment in which the firm operates.

SWOT ANALYSIS FRAMEWORK
Limitations of SWOT Analysis

SWOT Analysis is not free from its limitations. It may cause organizations to view circumstances as very simple because of which the organizations might overlook certain key strategic contact which may occur. Moreover, categorizing aspects as strengths, weaknesses, opportunities and threats might be very subjective as there is great degree of uncertainty in market. SWOT Analysis does stress upon the significance of these four aspects, but it does not tell how an organization can identify these aspects for itself.

There are certain limitations of SWOT Analysis which are not in control of management. These include-

1) Price increase;
2) Input/raw materials;
3) Government legislation;
4) Economic environment;
5) Searching a new market for the product which is not having overseas market due to import restrictions; etc.

Internal limitations may include-

1. Insufficient research and development facilities;
2. Faulty products due to poor quality control;
3. Poor industrial relations;
4. Lack of skilled and efficient labour; etc

Recommended Reading
Bradford, Robert W., Duncan, Peter J., Tarcy, Brian, Simplified Strategic Planning: *A No-Nonsense Guide for Busy People Who Want Results Fast!*
Porter's Five Forces

PEST Analysis

A scan of the external macro-environment in which the firm operates can be expressed in terms of the following factors:

- **P**olitical
- **E**conomic
- **S**ocial
- **T**echnological

The acronym **PEST** (or sometimes rearranged as "STEP") is used to describe a framework for the analysis of these macro-environmental factors. A PEST analysis fits into an overall environmental scan as shown in the following diagram:

Environmental Scan

/ \

External Analysis **Internal Analysis**

/ \

Macro-environment **Microenvironment**

|

P.E.S.T

Political Factors

Political factors include government regulations and legal issues and define both formal and informal rules under which the firm must operate. Some examples include:

- tax policy
- employment laws
- environmental regulations
- trade restrictions and tariffs
- political stability

Economic Factors

Economic factors affect the purchasing power of potential customers and the firm's cost of capital. The following are examples of factors in the macroeconomy:

- economic growth
- interest rates
- exchange rates

- inflation rate

Social Factors

Social factors include the demographic and cultural aspects of the external macro environment. These factors affect customer needs and the size of potential markets. Some social factors include:

- health consciousness
- population growth rate
- age distribution
- career attitudes
- emphasis on safety

Technological Factors

Technological factors can lower barriers to entry, reduce minimum efficient production levels, and influence outsourcing decisions. Some technological factors include:

- R&D activity
- automation
- technology incentives
- rate of technological change

External Opportunities and Threats

The PEST factors combined with external microenvironmental factors can be classified as opportunities and threats in a SWOT analysis.

Competitor Analysis – Meaning, Objectives and Significance

Organizations must operate within a competitive industry environment. They do not exist in vacuum. Analyzing organizational competitors helps an organization to discover its weaknesses, to identify opportunities for and threats to the organization from the industrial environment. While formulating an organizational strategy, managers must consider the strategies of organizational competitors. Competitor analysis is a driver of an organizational strategy and effects on how firms act or react in their sectors. The organization does a competitor analysis to measure / assess its standing amongst the competitors.

Competitor analysis begins with identifying present as well as potential competitors. It portrays an essential appendage to conduct an industry analysis. An industry analysis gives information regarding probable sources of competition (including all the possible strategic actions and reactions and effects on profitability for all the organizations competing in the industry). However, a well-thought competitor analysis permits an organization to concentrate on those organizations with which it will be in direct competition, and it is especially important when an organization faces a few potential competitors.

Michael Porter in Porters Five Forces Model has assumed that the competitive environment within an industry depends on five forces- Threat of new potential entrants, Threat of substitute product/services, bargaining power of suppliers, bargaining power of buyers, Rivalry among current competitors. Th ese five forces should be used as a conceptual background for identifying an organizational competitive strengths and weaknesses and threats to and opportunities for the organization from its competitive environment.

The main objectives of doing competitor analysis can be summarized as follows:

- To study the market;
- To predict and forecast organizational demand and supply;
- To formulate strategy;
- To increase the market share;
- To study the market trend and pattern;
- To develop strategy for organizational growth;
- When the organization is planning for the diversification and expansion plan;
- To study forthcoming trends in the industry;
- Understanding the current stategy strength and weaknesses of a competitor can suggest opportunities and threats tha will merit a response.
- Insight into future competitor strategies may help in predicting upcoming threats and opportunities.

Competitors should be analyzed along various dimensions such as their size, growth and profitability, reputation, objectives, culture, cost structure, strengths and weaknesses, business strategies, exit barriers, etc.

INDUSTRY ANALYSIS

Michael Porter (Harvard Business School Management Researcher) designed various vital frameworks for developing an organizational strategy. One of the most renowned among managers making strategic decisions is the five competitive forces model that determines industry structure. According to Porter, the nature of competition in any industry is personified in the following five forces:

1. Threat of new potential entrants
2. Threat of substitute product/services
3. Bargaining power of suppliers
4. Bargaining power of buyers
5. Rivalry among current competitors

The model of pure competition implies that risk-adjusted rates of return should be constant across firms and industries. However, numerous economic studies have affirmed that different industries can sustain different levels of profitability; part of this difference is explained by industry structure.

Michael Porter provided a framework that models an industry as being influenced by five forces. The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates.

Diagram of Porter's 5 Forces

SUPPLIER POWER Supplier concentration Importance of volume to supplier
Differentiation of inputs
Impact of inputs on cost or differentiation
Switching costs of firms in the industry
Presence of substitute inputs
Threat of forward integration
Cost relative to total purchases in industry

BARRIERS TO ENTRY
Absolute cost advantages
Proprietary learning curve
Access to inputs
Government policy
Economies of scale
Capital requirements
Brand identity
Switching costs
Access to distribution
Expected retaliation
Proprietary products

RIVALRY

THREAT OF SUBSTITUTES
-Switching costs
-Buyer inclination to substitute
-Price-performance trade-off of substitutes

BUYER POWER
Bargaining leverage
Buyer volume
Buyer information
Brand identity
Price sensitivity
Threat of backward integration
Product differentiation
Buyer concentration vs. industry
Substitutes available
Buyers' incentives

DEGREE OF RIVALRY
-Exit barriers
-Industry concentration
-Fixed costs/Value added
-Industry growth
-Intermittent overcapacity
-Product differences
-Switching costs
-Brand identity
-Diversity of rivals
-Corporate stakes

I. Rivalry

Rivalry among current competitors: Rivalry refers to the competitive struggle for market share between firms in an industry. Extreme rivalry among established firms poses a strong threat to profitability. The strength of rivalry among established firms within an industry is a function of following factors:

- Extent of exit barriers
- Amount of fixed cost
- Competitive structure of industry
- Presence of global customers
- Absence of switching costs
- Growth Rate of industry
- Demand condition

In the traditional economic model, competition among rival firms drives profits to zero. But competition is not perfect and firms are not unsophisticated passive price takers. Rather, firms strive for a competitive advantage over their rivals. The intensity of rivalry among firms varies across industries, and strategic analysts are interested in these differences.

Economists measure rivalry by indicators of industry concentration. The Concentration Ratio (CR) is one such measure. The Bureau of Census periodically reports the CR for major Standard Industrial Classifications (SIC's). The CR indicates the percent of market share held by the four largest firms (CR's for the largest 8, 25, and 50 firms in an industry also are available). A high concentration ratio indicates that a high concentration of market share is held by the largest firms - the industry is concentrated. With only a few firms holding a large market share, the competitive landscape is less competitive (closer to a monopoly). A low concentration ratio in dicates that the industry is characterized by many rivals, none of which has a significant market share. These *fragmented* markets are said to be competitive. The concentration ratio is not the only available measure; the trend is to define industries in terms that convey more information than distribution of market share.

If rivalry among firms in an industry is low, the industry is considered to be disciplined. This discipline may result from the industry's history of competition, the role of a leading firm, or informal compliance with a generally understood code of conduct. Explicit *collusion* generally is illegal and not an option; in low-rivalry industries competitive moves must be constrained informally. However, a maverick firm seeking a competitive advantage can displace the otherwise disciplined market.

When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage. In pursuing an advantage over its rivals, a firm can choose from several competitive moves:

- Changing prices - raising or lowering prices to gain a temporary advantage.
- Improving product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself.
- Creatively using channels of distribution - vertical integration or using a distribution channel that is novel to the industry. For example, with high end jewelry stores reluctant to carry its watches, Timex moved into drugstores and other non-traditional outlets and cornered the low to mid-price watch market.
- Exploiting relationships with suppliers - for example, from the 1950's to the 1970's Sears, Roebuck and Co. dominated the retail household appliance market. Sears set high quality standards and required suppliers to meet its demands for product specifications and price.

The intensity of rivalry is influenced by the following industry characteristics:

1. **A larger number of firms** increases rivalry because more firms must compete for the same customers and resources. The rivalry intensifies if the firms have similar market share, leading to a struggle for market leadership.
2. **Slow market growth** causes firms to fight for market share. In a growing market, firms are able to improve revenues simply because of the expanding market.
3. **High fixed costs** result in an economy of scale effect that increases rivalry. When total costs are mostly fixed costs, the firm must produce near capacity to attain the lowest unit costs. Since the firm must sell this large quantity of product, high levels of production lead to a fight for market share and results in increased rivalry.
4. **High storage costs or highly perishable products** cause a producer to sell goods as soon as possible. If other producers are attempting to unload at the same time, competition for customers intensifies.
5. **Low switching costs** increases rivalry. When a customer can freely switch from one product to another there is a greater struggle to capture customers.
6. **Low levels of product differentiation** is associated with higher levels of rivalry. Brand identification, on the other hand, tends to constrain rivalry.
7. **Strategic stakes are high** when a firm is losing market position or has potential for great gains. This intensifies rivalry.
8. **High exit barriers** place a high cost on abandoning the product. The firm must compete. High exit barriers cause a firm to remain in an industry, even when the venture is not profitable. A common exit barrier is asset specificity. When the plant and equipment required for manufacturing a product is highly specialized, these assets cannot easily be sold to other buyers in another industry. Litton Industries' acquisition of Ingalls Shipbuilding facilities illustrates this concept. Litton was successful in the 1960's with its contracts to build Navy ships. But when the Vietnam war ended, defense spending declined and Litton saw a sudden decline in its earnings. As the firm restructured, divesting from the shipbuilding plant was not feasible since such a large and highly specialized investment could not be sold easily, and Litton was forced to stay in a declining shipbuilding market.
9. **A diversity of rivals** with different cultures, histories, and philosophies make an industry unstable. There is greater possibility for mavericks and for misjudging rival's moves. Rivalry is volatile and can be intense. The hospital industry, for example, is populated by hospitals that historically are community or charitable institutions, by hospitals that are associated with religious organizations or universities, and by hospitals that are for-profit enterprises. This mix of philosophies about mission has lead occasionally to fierce local struggles by hospitals over who will get expensive diagnostic and therapeutic services. At other times, local hospitals are highly cooperative with one another on issues such as community disaster planning.
10. **Industry Shakeout.** A growing market and the potential for high profits induces new firms to enter a market and incumbent firms to increase production. A point is reached where the industry becomes crowded with competitors, and demand cannot support the new entrants and the resulting increased supply. The industry may become crowded if its growth rate slows and the market becomes saturated, creating a situation of excess capacity with too many goods chasing too few buyers. A shakeout ensues, with intense competition, price wars, and company failures.

BCG founder Bruce Henderson generalized this observation as the Rule of Three and Four: a stable market will not have more than three significant competitors, and the largest competitor will have no more than four times the market share of the smallest. If this rule is true, it implies that:

- If there is a larger number of competitors, a shakeout is inevitable
- Surviving rivals will have to grow faster than the market
- Eventual losers will have a negative cash flow if they attempt to grow
- All except the two largest rivals will be losers
- The definition of what constitutes the "market" is strategically important.

Whatever the merits of this rule for stable markets, it is clear that market stability and changes in supply and demand affect rivalry. Cyclical demand tends to create cutthroat competition. This is true in the disposable diaper industry in which demand fluctuates with birth rates, and in the greeting card industry in which there are more predictable business cycles.

II. Threat of Substitutes

Substitute products refer to the products having ability of satisfying customer's needs effectively. Substitutes pose a ceiling (upper limit) on the potential returns of an industry by putting a setting a limit on the price that firms can charge for their product in an industry. Lesser the number of close substitutes a product has, greater is the opportunity for the firms in industry to raise their product prices and earn greater profits (other things being equal).

In Porter's model, substitute products refer to products in other industries. To the economist, a threat of substitutes exists when a product's demand is affected by the price change of a substitute product. A product's price elasticity is affected by substitute products - as more substitutes become available, the demand becomes more elastic since customers have more alternatives. A close substitute product constrains the ability of firms in an industry to raise prices.

The competition engendered by a Threat of Substitute comes from products outside the industry. The price of aluminum beverage cans is constrained by the price of glass bottles, steel cans, and plastic containers. These containers are substitutes, yet they are not rivals in the aluminum can industry. To the manufacturer of automobile tires, tire retreads are a substitute. Today, new tires are not so expensive that car owners give much consideration to retreading old tires. But in the trucking industry new tires are expensive and tires must be replaced often. In the truck tire market, retreading remains a viable substitute industry. In the disposable diaper industry, cloth diapers are a substitute and their prices constrain the price of disposables.

While the threat of substitutes typically impacts an industry through price competition, there can be other concerns in assessing the threat of substitutes. Consider the substitutability of different types of TV transmission: local station transmission to home TV antennas via the airways versus transmission via cable, satellite, and telephone lines. The new technologies available and the changing structure of the entertainment media are contributing to competition among these substitute means of connecting the home to entertainment. Except in remote areas it is unlikely that cable TV could compete with free TV from an aerial without the greater diversity of entertainment that it affords the customer.

III. Buyer Power

Buyers refer to the customers who finally consume the product or the firms who distribute the industry's product to the final consumers. Bargaining power of buyers refer to the potential of buyers to bargain down the prices charged by the firms in the industry or to increase the firms cost in the industry by demanding better quality and service of product. Strong buyers can extract profits out of an industry by lowering the prices and increasing the costs. They purchase in large quantities. They have full information about the product and the market. They emphasize upon quality products. They pose credible threat of backward integration. In this way, they are regarded as a threat.

The power of buyers is the impact that customers have on a producing industry. In general, when buyer power is strong, the relationship to the producing industry is near to what an economist terms a **monopsony** - a market in which there are many suppliers and one buyer. Under such market conditions, the buyer sets the price. In reality few pure monopsonies exist, but frequently there is some asymmetry between a producing industry and buyers. The following tables outline some factors that determine buyer power.

Buyers are Powerful if:	**Example**
Buyers are concentrated - there are a few buyers with significant market share	DOD purchases from defense contractors
Buyers purchase a significant proportion of output - distribution of purchases or if the product is standardized	Circuit City and Sears' large retail market provides power over appliance manufacturers
Buyers possess a credible backward integration threat - can threaten to buy producing firm or rival	Large auto manufacturers' purchases of tires

Buyers are Weak if:	**Example**
Producers threaten forward integration - producer can take over own distribution/retailing	Movie-producing companies have integrated forward to acquire theaters
Significant buyer switching costs - products not standardized and buyer cannot easily switch to another product	IBM's 360 system strategy in the 1960's
Buyers are fragmented (many, different) - no buyer has any particular influence on product or price	Most consumer products
Producers supply critical portions of buyers' input - distribution of purchases	Intel's relationship with PC manufacturers

IV. Supplier Power

Suppliers refer to the firms that provide inputs to the industry. Bargaining power of the suppliers refer to the potential of the suppliers to increase the prices of inputs(labour, raw materials, services, etc) or the costs of industry in other ways. Strong suppliers can extract profits out of an industry by increasing costs of firms in the industry. Supplier's products have a few substitutes. Strong supplier's products are unique. They have high switching cost. Their product is an important input to buyer's product. They pose credible threat of forward integration. Buyers are not significant to strong suppliers. In this way, they are regarded as a threat.

A producing industry requires raw materials - labor, components, and other supplies. This requirement leads to buyer-supplier relationships between the industry and the firms that provide it the raw materials used to create products. Suppliers, if powerful, can exert an influence on the producing industry, such as selling raw materials at a high price to capture some of the industry's profits. The following tables outline some factors that determine supplier power.

Suppliers are Powerful if:	**Example**
Credible forward integration threat by suppliers	Baxter International, manufacturer of hospital supplies, acquired American Hospital Supply, a distributor
Suppliers concentrated	Drug industry's relationship to hospitals
Significant cost to switch suppliers	Microsoft's relationship with PC manufacturers
Customers Powerful	Boycott of grocery stores selling non-union picked grapes
Suppliers are Weak if:	**Example**
Many competitive suppliers - product is standardized	Tire industry relationship to automobile manufacturers
Purchase commodity products	Grocery store brand label products
Credible backward integration threat by purchasers	Timber producers relationship to paper companies
Concentrated purchasers	Garment industry relationship to major department stores
Customers Weak	Travel agents' relationship to airlines

V. Barriers to Entry / Threat of Entry

Risk of entry by potential competitors: Potential competitors refer to the firms which are not currently competing in the industry but have the potential to do so if given a choice. Entry of new players increases the industry capacity, begins a competition for market share and lowers the current costs. The threat of entry by potential competitors is partially a function of extent of barriers to entry. The various barriers to entry are-

- Economies of scale
- Brand loyalty
- Government Regulation
- Customer Switching Costs
- Absolute Cost Advantage
- Ease in distribution
- Strong Capital base

It is not only incumbent rivals that pose a threat to firms in an industry; the possibility that new firms may enter the industry also affects competition. In theory, any firm should be able to enter and exit a market, and if free entry and exit exists, then profits always should be nominal. In reality, however, industries possess characteristics that protect the high profit levels of firms in the market and inhibit additional rivals from entering the market. These are ***barriers to entry***.

Barriers to entry are more than the normal equilibrium adjustments that markets typically make. For example, when industry profits increase, we would expect additional firms to enter the market to take advantage of the high profit levels, over time driving down profits for all firms in the industry. When profits decrease, we would expect some firms to exit the market thus restoring a market equilibrium. Falling prices, or the expectation that future prices will fall, deters rivals from entering a market. Firms also may be reluctant to enter markets that are extremely uncertain, especially if entering involves expensive start-up costs. These are normal accommodations to market conditions. But if firms individually (collective action would be illegal collusion) keep prices artificially low as a strategy to prevent potential entrants from entering the market, such **entry-deterring pricing** establishes a barrier.

Barriers to entry are unique industry characteristics that define the industry. Barriers reduce the rate of entry of new firms, thus maintaining a level of profits for those already in the industry. From a strategic perspective, barriers can be created or exploited to enhance a firm's competitive advantage.

Barriers to entry arise from several sources:

1. **Government creates barriers.** Although the principal role of the government in a market is to preserve competition through anti-trust actions, government also restricts competition through the granting of monopolies and through regulation. Industries such as utilities are considered natural monopolies because it has been more efficient to have one electric company provide power to a locality than to permit many electric companies to compete in a local market. To restrain utilities from exploiting this advantage, government permits a monopoly, but regulates the industry. Illustrative of this kind of barrier to entry is the local cable company. The franchise to a cable provider may be granted by competitive bidding, but once the franchise is awarded by a community a monopoly is created. Local governments were not effective in monitoring price gouging by cable operators, so the federal government has enacted legislation to review and restrict prices.
   The regulatory authority of the government in restricting competition is historically evident in the banking industry. Until the 1970's, the markets that banks could enter were limited by state governments. As a result, most banks were local commercial and retail banking facilities. Banks competed through strategies that emphasized simple marketing devices such as awarding toasters to new customers for opening a checking account. When banks were deregulated, banks were permitted to cross state boundaries and expand their markets. Deregulation of banks intensified rivalry and created uncertainty for banks as they attempted to maintain market share. In the late 1970's, the strategy of banks shifted from simple marketing tactics to mergers and geographic expansion as rivals attempted to expand markets.
2. **Patents and proprietary knowledge serve to restrict entry into an industry.** Ideas and knowledge that provide competitive advantages are treated as private property when patented,

preventing others from using the knowledge and thus creating a barrier to entry. Edwin Land introduced the Polaroid camera in 1947 and held a monopoly in the instant photography industry. In 1975, Kodak attempted to enter the instant camera market and sold a comparable camera. Polaroid sued for patent infringement and won, keeping Kodak out of the instant camera industry.

3. **Asset specificity inhibits entry into an industry.** Asset specificity is the extent to which the firm's assets can be utilized to produce a different product. When an industry requires highly specialized technology or plants and equipment, potential entrants are reluctant to commit to acquiring specialized assets that cannot be sold or converted into other uses if the venture fails. Asset specificity provides a barrier to entry for two reasons: First, when firms already hold specialized assets they fiercely resist efforts by others from taking their market share. New entrants can anticipate aggressive rivalry. For example, Kodak had much capital invested in its photographic equipment business and aggressively resisted efforts by Fuji to intrude in its market. These assets are both large and industry specific. The second reason is that potential entrants are reluctant to make investments in highly specialized assets.
4. **Organizational (Internal) Economies of Scale.** The most cost efficient level of production is termed **Minimum Efficient Scale** (MES). This is the point at which unit costs for production are at minimum - i.e., the most cost efficient level of production. If MES for firms in an industry is known, then we can determine the amount of market share necessary for low cost entry or cost parity with rivals. For example, in long distance communications roughly 10% of the market is necessary for MES. If sales for a long distance operator fail to reach 10% of the market, the firm is not competitive.

   The existence of such an economy of scale creates a barrier to entry. The greater the difference between industry MES and entry unit costs, the greater the barrier to entry. So industries with high MES deter entry of small, start-up businesses. To operate at less than MES there must be a consideration that permits the firm to sell at a premium price - such as product differentiation or local monopoly.

Barriers to exit work similarly to barriers to entry. Exit barriers limit the ability of a firm to leave the market and can exacerbate rivalry - unable to leave the industry, a firm must compete. Some of an industry's entry and exit barriers can be summarized as follows:

Easy to Enter if there is: • Common technology • Little brand franchise • Access to distribution channels • Low scale threshold	**Difficult to Enter if there is:** • Patented or proprietary know-how • Difficulty in brand switching • Restricted distribution channels • High scale threshold
Easy to Exit if there are: • Salable assets • Low exit costs • Independent businesses	**Difficult to Exit if there are:** • Specialized assets • High exit costs • Interrelated businesses

The power of Porters five forces varies from industry to industry. Whatever be the industry, these five forces influence the profitability as they affect the prices, the costs, and the capital Investment essential for survival and competition in industry. This five forces model also help in making strategic decisions as it is used by the managers to determine industry's competitive structure.

The five forces mentioned above are very significant from point of view of strategy formulation. The potential of these forces differs from industry to industry. These forces jointly determine the profitability of industry because they shape the prices which can be charged, the costs which can be borne, and the investment required to compete in the industry. Before making strategic decisions, the managers should use the five forces framework to determine the competitive structure of industry.

Porter ignored, however, a sixth significant factor- **Complementaries.** This term refers to the reliance that develops between the companies whose products work is in combination with each other. Strong complementors might have a strong positive effect on the industry. Also, the five forces model overlooks the role of innovation as well as the significance of individual firm differences. It presents a stagnant view of competition.

DYNAMIC NATURE OF INDUSTRY RIVALRY

Our descriptive and analytic models of industry tend to examine the industry at a given state. The nature and fascination of business is that it is not static. While we are prone to generalize, for example, list GM, Ford, and Chrysler as the "Big 3" and assume their dominance, we also have seen the automobile industry change. Currently, the entertainment and communications industries are in flux. Phone companies, computer firms, and entertainment are merging and forming strategic alliances that re-map the information terrain. Schumpeter and, more recently, Porter have attempted to move the understanding of industry competition from a static economic or industry organization model to an emphasis on the interdependence of forces as dynamic, or *punctuated equilibrium*, as Porter terms it.

In Schumpeter's and Porter's view the dynamism of markets is driven by innovation.

GENERIC STRATEGIES

Strategy can be formulated on three levels:

- corporate level
- business unit level
- functional or departmental level.

The business unit level is the primary context of industry rivalry. Michael Porter identified three generic strategies (*cost leadership*, *differentiation*, and *focus*) that can be implemented at the business unit level to create a competitive advantage. The proper generic strategy will position the firm to leverage its strengths and defend against the adverse effects of the five forces.

Recommended Reading

Porter, Michael E., *Competitive Strategy: Techniques for Analyzing Industries and Competitors*

Competitive Strategy is the basis for much of modern business strategy. In this classic work, Michael Porter presents his five forces and generic strategies, then discusses how to recognize and act on market signals and how to forecast the evolution of industry structure. He then discusses competitive strategy for emerging, mature, declining, and fragmented industries. The last part of the book covers strategic decisions related to vertical integration, capacity expansion, and entry into an industry. The book concludes with an appendix on how to conduct an industry analysis.

Porter's Generic Strategies

If the primary determinant of a firm's profitability is the attractiveness of the industry in which it operates, an important secondary determinant is its position within that industry. Even though an industry may have below- average profitability, a firm that is optimally positioned can generate superior returns.

A firm positions itself by leveraging its strengths. Michael Porter has argued that a firm's strengths ultimately fall into one of two headings: cost advantage and differentiation. By applying these strengths in either a broad or narrow scope, three generic strategies result: *cost leadership*, *differentiation*, and *focus*. These strategies are applied at the business unit level. They are called generic strategies because they are not firm or industry dependent. The following table illustrates Porter's generic strategies:

Porter's Generic Strategies

Target Scope	*Advantage*	
	Low Cost	**Product Uniqueness**
Broad (Industry Wide)	**Cost Leadership Strategy**	**Differentiation Strategy**
Narrow (Market Segment)	**Focus Strategy** (low cost)	**Focus Strategy** (differentiation)

The Value Chain

To analyze the specific activities through which firms can create a competitive advantage, it is useful to model the firm as a chain of value-creating activities. Michael Porter identified a set of interrelated generic activities common to a wide range of firms. The resulting model is known as the **value chain** and is depicted below:

Primary Value Chain Activities

Inbound Logistics > Operations > Outbound Logistics > Marketing & Sales > Service

The goal of these activities is to create value that exceeds the cost of providing the product or service, thus generating a profit margin.

- **Inbound logistics** include the receiving, warehousing, and inventory control of input materials.
- **Operations** are the value-creating activities that transform the inputs into the final product.
- **Outbound logistics** are the activities required to get the finished product to the customer, including warehousing, order fulfillment, etc.
- **Marketing & Sales** are those activities associated with getting buyers to purchase the product, including channel selection, advertising, pricing, etc.
- **Service** activities are those that maintain and enhance the product's value including customer support, repair services, etc.

Any or all of these primary activities may be vital in developing a competitive advantage. For example, logistics activities are critical for a provider of distribution services, and service activities may be the key focus for a firm offering on-site maintenance contracts for office equipment.

These five categories are generic and portrayed here in a general manner. Each generic activity includes specific activities that vary by industry.

Support Activities

The primary value chain activities described above are facilitated by support activities. Porter identified four generic categories of support activities, the details of which are industry-specific.

- **Procurement** - the function of purchasing the raw materials and other inputs used in the value-creating activities.
- **Technology Development** - includes research and development, process automation, and other technology development used to support the value-chain activities.
- **Human Resource Management** - the activities associated with recruiting, development, and compensation of employees.
- **Firm Infrastructure** - includes activities such as finance, legal, quality management, etc.

Support activities often are viewed as "overhead", but some firms successfully have used them to develop a competitive advantage, for example, to develop a cost advantage through innovative management of information systems.

Value Chain Analysis

In order to better understand the activities leading to a competitive advantage, one can begin with the generic value chain and then identify the relevant firm-specific activities. Process flows can be mapped, and these flows used to isolate the individual value-creating activities.

Once the discrete activities are defined, linkages between activities should be identified. A linkage exists if the performance or cost of one activity affects that of another. Competitive advantage may be obtained by optimizing and coordinating linked activities.

The value chain also is useful in outsourcing decisions. Understanding the linkages between activities can lead to more optimal make-or-buy decisions that can result in either a cost advantage or a differentiation advantage.

The Value System

The firm's value chain links to the value chains of upstream suppliers and downstream buyers. The result is a larger stream of activities known as the *value system*. The development of a competitive advantage depends not only on the firm-specific value chain, but also on the value system of which the firm is a part.

Recommended Reading

Porter, Michael E., *Competitive Advantage: Creating and Sustaining Superior Performance* In *Competitive Advantage*, Michael Porter introduces the value chain as a tool for developing a competitive advantage. Topics include:

- Sharing of value chain activities among business units.
- Using value chain analysis to develop low-cost and differentiation strategies.
- Interrelationships between value chains of different industry segments.
- Applying the value chain to understand the role of technology in competitive advantage.

The book concludes by considering the implications for offensive and defensive competitive strategy, including how to identify vulnerabilities and initiate an attack on the industry leader.

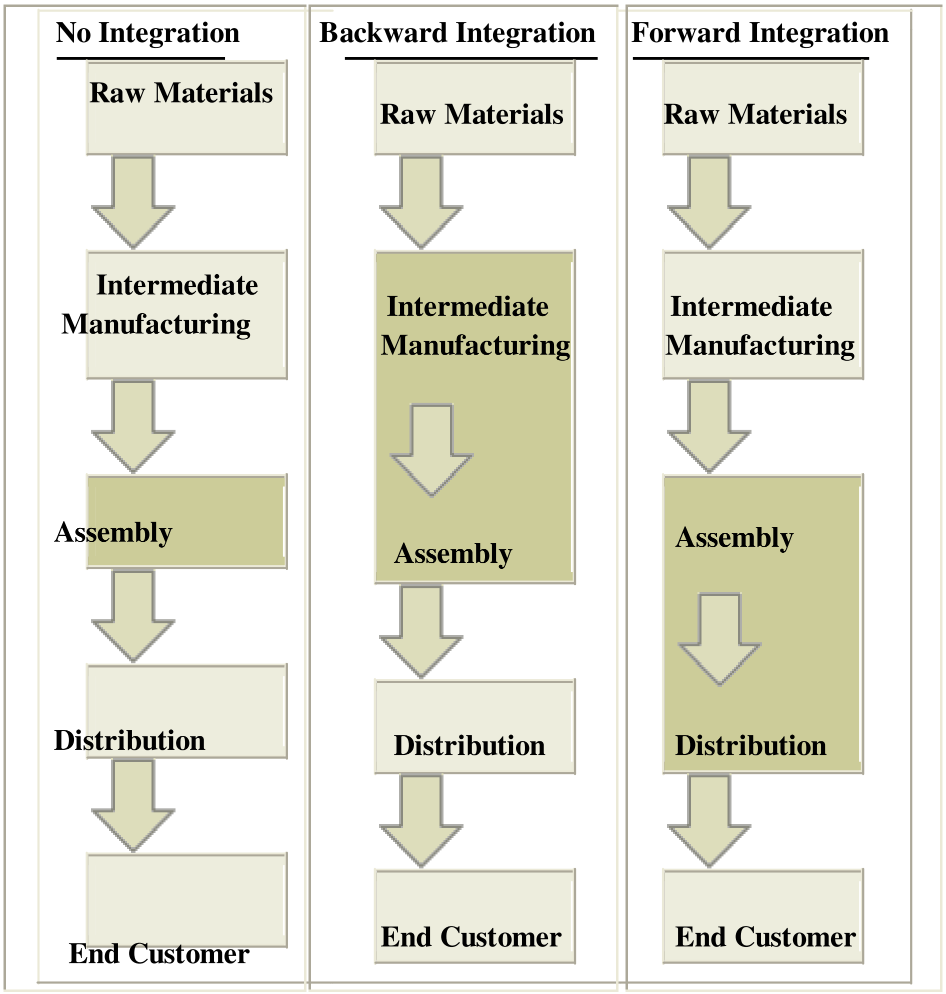
Vertical Integration

The degree to which a firm owns its upstream suppliers and its downstream buyers is referred to as **vertical integration**. Because it can have a significant impact on a business unit's position in its industry with respect to cost, differentiation, and other strategic issues, the vertical scope of the firm is an important consideration in corporate strategy.

Expansion of activities downstream is referred to as *forward integration*, and expansion upstream is referred to as *backward integration.*

The concept of vertical integration can be visualized using the value chain. Consider a firm whose products are made via an assembly process. Such a firm may consider backward integrating into intermediate manufacturing or forward integrating into distribution, as illustrated below:

Example of Backward and Forward Integration



Two issues that should be considered when deciding whether to vertically integrate is cost and control. The cost aspect depends on the cost of market transactions between firms versus the cost of administering the same activities internally within a single firm. The second issue is the impact of asset control, which can impact barriers to entry and which can assure cooperation of key value-adding players.

The following benefits and drawbacks consider these issues.

Benefits of Vertical Integration

Vertical integration potentially offers the following advantages:

- Reduce transportation costs if common ownership results in closer geographic proximity.
- Improve supply chain coordination.
- Provide more opportunities to differentiate by means of increased control over inputs.
- Capture upstream or downstream profit margins.
- Increase entry barriers to potential competitors, for example, if the firm can gain sole access to a scarce resource.
- Gain access to downstream distribution channels that otherwise would be inaccessible.
- Facilitate investment in highly specialized assets in which upstream or downstream players may be reluctant to invest.
- Lead to expansion of core competencies.

Drawbacks of Vertical Integration

While some of the benefits of vertical integration can be quite attractive to the firm, the drawbacks may negate any potential gains. Vertical integration potentially has the following disadvantages:

- Capacity balancing issues. For example, the firm may need to build excess upstream capacity to ensure that its downstream operations have sufficient supply under all demand conditions.
- Potentially higher costs due to low efficiencies resulting from lack of supplier competition.
- Decreased flexibility due to previous upstream or downstream investments. (Note however, that flexibility to coordinate vertically-related activities may increase.)
- Decreased ability to increase product variety if significant in-house development is required.
- Developing new core competencies may compromise existing competencies.
- Increased bureaucratic costs.

Factors Favoring Vertical Integration

The following situational factors tend to favor vertical integration:

- Taxes and regulations on market transactions.
- Obstacles to the formulation and monitoring of contracts.
- Strategic similarity between the vertically-related activities.
- Sufficiently large production quantities so that the firm can benefit from economies of scale.
- Reluctance of other firms to make investments specific to the transaction.

Factors Against Vertical Integration

The following situational factors tend to make vertical integration less attractive:

- The quantity required from a supplier is much less than the minimum efficient scale for producing the product.
- The product is a widely available commodity and its production cost decreases significantly as cumulative quantity increases.
- The core competencies between the activities are very different.
- The vertically adjacent activities are in very different types of industries. For example, manufacturing is very different from retailing.
- The addition of the new activity places the firm in competition with another player with which it needs to cooperate. The firm then may be viewed as a competitor rather than a partner

Alternatives to Vertical Integration

There are alternatives to vertical integration that may provide some of the same benefits with fewer drawbacks. The following are a few of these alternatives for relationships between vertically-related organizations:

- Long-term explicit contracts
- Franchise agreements
- joint ventures
- co-location of facilities
- implicit contracts (relying on firms' reputation)

Recommended Reading

Greaver, Maurice F., ***Strategic Outsourcing*** *: A Structured Approach to Outsourcing Decisions and Initiatives*

Horizontal Integration

The acquisition of additional business activities at the same level of the value chain is referred to as **horizontal integration**. This form of expansion contrasts with vertical integration by which the firm expands into upstream or downstream activities. Horizontal growth can be achieved by internal expansion or by external expansion through mergers and acquisitions of firms offering similar products and services. A firm may diversify by growing horizontally into unrelated businesses.

Some examples of horizontal integration include:

- The Standard Oil Company's acquisition of 40 refineries.
- An automobile manufacturer's acquisition of a sport utility vehicle manufacturer.
- A media company's ownership of radio, television, newspapers, books, and magazines.

Advantages of Horizontal Integration

The following are some benefits sought by firms that horizontally integrate:

- Economies of scale - acheived by selling more of the same product, for example, by geographic expansion.
- Economies of scope - achieved by sharing resources common to different products. Commonly referred to as "synergies."
- Increased market power (over suppliers and downstream channel members)
- Reduction in the cost of international trade by operating factories in foreign markets.

Sometimes benefits can be gained through customer perceptions of linkages between products. For example, in some cases synergy can be achieved by using the same brand name to promote multiple products. However, such extensions can have drawbacks, as pointed out by Al Ries and Jack Trout in their marketing classic, *Positioning*.

Pitfalls of Horizontal Integration

Horizontal integration by acquisition of a competitor will increase a firm's market share. However, if the industry concentration increases significantly then anti-trust issues may arise.

Aside from legal issues, another concern is whether the anticipated economic gains will materialize. Before expanding the scope of the firm through horizontal integration, management should be sure that the imagined benefits are real. Many blunders have been made by firms that broadened their horizontal scope to achieve synergies that did not exist, for example, computer hardware manufacturers who entered the software business on the premise that there were synergies between hardware and software. However, a connection between two products does not necessarily imply realizable economies of scope.

Finally, even when the potential benefits of horizontal integration exist, they do not materialize spontaneously. There must be an explicit horizontal strategy in place. Such strategies generally do not arise from the bottom-up, but rather, must be formulated by corporate management.

Recommended Reading

Mark N. Clemente and David S. Greenspan, *Winning at Mergers and Acquisitions : The Guide to Market Focused Planning and Integration*

Ansoff Matrix

To portray alternative corporate growth strategies, Igor Ansoff presented a matrix that focused on the firm's present and potential products and markets (customers). By considering ways to grow via existing products and new products, and in existing markets and new markets, there are four possible product-market combinations. Ansoff's matrix is shown below:

Ansoff Matrix

	Existing Products	**New Products**
Existing Markets	**Market Penetration**	**Product Development**
New Markets	**Market Development**	**Diversification**

Ansoff's matrix provides four different growth strategies:

- **Market Penetration** - the firm seeks to achieve growth with existing products in their current market segments, aiming to increase its market share.
- **Market Development** - the firm seeks growth by targeting its existing products to new market segments.
- **Product Development** - the firms develops new products targeted to its existing market segments.
- **Diversification** - the firm grows by diversifying into new businesses by developing new products for new markets.

Selecting a Product-Market Growth Strategy

The **market penetration** strategy is the least risky since it leverages many of the firm's existing resources and capabilities. In a growing market, simply maintaining market share will result in growth, and there may exist opportunities to increase market share if competitors reach capacity limits. However, market penetration has limits, and once the market approaches saturation another strategy must be pursued if the firm is to continue to grow.

Market development options include the pursuit of additional market segments or geographical regions. The development of new markets for the product may be a good strategy if the firm's core competencies are related more to the specific product than to its experience with a specific market segment. Because the firm is expanding into a new market, a market development strategy typically has more risk than a market penetration strategy.

A **product development** strategy may be appropriate if the firm's strengths are related to its specific customers rather than to the specific product itself. In this situation, it can leverage its strengths by developing a new product targeted to its existing customers. Similar to the case of new market development, new product development carries more risk than simply attempting to increase market share.

Diversification is the most risky of the four growth strategies since it requires both product and market development and may be outside the core competencies of the firm. In fact, this quadrant of the matrix has been referred to by some as the "suicide cell". However, diversification may be a reasonable choice if the high risk is compensated by the chance of a high rate of return. Other advantages of diversification include the potential to gain a foothold in an attractive industry and the reduction of overall business portfolio risk.

Recommended Reading

<u>*Harvard Business Review on Strategies for Growth*</u> *(Harvard Business Review Series)*

BCG Growth-Share Matrix

Boston Consulting Group (BCG) Matrix is a four celled matrix (a 2 X 2 matrix) developed by BCG, USA. It is the most renowned corporate portfolio analysis tool. It provides a graphic representation for an organization to examine different businesses in its portfolio on the basis of their related market share and industry growth rates. It is a two dimensional analysis on management of SBUs (Strategic Business Units). In other words, it is a comparative analysis of business potential and the evaluation of environment.

According to this matrix, business could be classified as high or low according to their industry growth rate and relative market share.

Relative Market Share = SBU Sales this year leading competitors sales this year.

Market Growth Rate = Industry sales this year - Industry Sales last year.

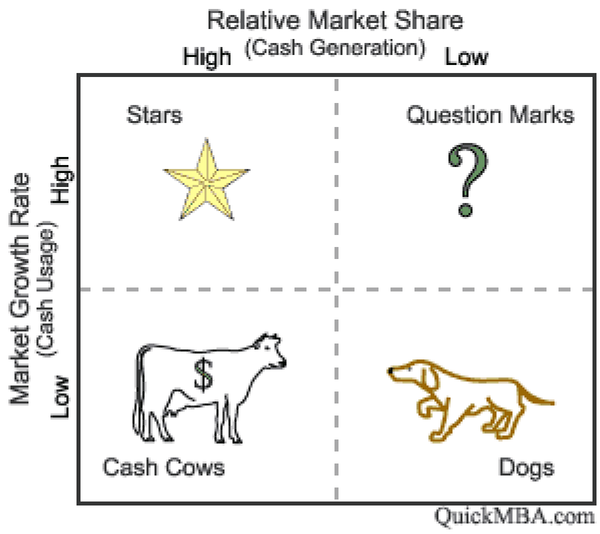
The analysis requires that both measures be calculated for each SBU. The dimension of business strength, relative market share, will measure comparative advantage indicated by market dominance. The key theory underlying this is existence of an experience curve and that market share is achieved due to overall cost leadership.

BCG matrix has four cells, with the horizontal axis representing relative market share and the vertical axis denoting market growth rate. The mid-point of relative market share is set at 1.0. If all the SBUs are in same industry, the average growth rate of the industry is used. While, if all the Subs are located in different industries, then the mid- point is set at the growth rate for the economy.

Resources are allocated to the business units according to their situation on the grid. The four cells of this matrix have been called as stars, cash cows, question marks and dogs. Each of these cells represents a particular type of business.

Companies that are large enough to be organized into strategic business units face the challenge of allocating resources among those units. In the early 1970's the Boston Consulting Group developed a model for managing a portfolio of different business units (or major product lines). The **BCG growth-share matrix** displays the various business units on a graph of the **market growth rate** vs. **market share** relative to competitors:

BCG Growth-Share Matrix



Resources are allocated to business units according to where they are situated on the grid as follows:

1. **Stars**

Stars represent business units having large market share in a fast growing industry. They may generate cash but because of fast growing market, stars require huge investments to maintain their lead. Net cash flow is usually modest. SBUs located in this cell are attractive as they are located in a robust industry and these business units are highly competitive in the industry. If successful, a star will become a cash cow when the industry matures.

A business unit that has a large market share in a fast growing industry. Stars may generate cash, but because the market is growing rapidly they require investment to maintain their lead. If successful, a star will become a cash cow when its industry matures.

2. **Cash Cow**

Cash Cows represents business units having a large market share in a mature, slow growing industry. Cash cows require little investment and generate cash that can be utilized for investment in other business units. These SBUs are the corporation's key source of cash, and are specifically the core business. They are the base of an organization. These businesses usually follow stability strategies. When cash cows loose their appeal and move towards deterioration, then a retrenchment policy may be pursued.

A business unit that has a large market share in a mature, slow growing industry. Cash cows require little investment and generate cash that can be used to invest in other business units.

3. **Question Mark (or Problem Child)**

Is a business unit that has a small market share in a high growth market. Question marks represent business units having low relative market share and located in a high growth industry. They require huge amount of cash to maintain or gain market share. They require attention to determine if the venture can be viable. Question marks are generally new goods and services which have a good commercial prospective. There is no specific strategy which can be adopted. If the firm thinks it has dominant market share, then it can adopt expansion strategy, else retrenchment strategy can be adopted. Most businesses start as question marks as the company tries to enter a high growth market in which there is already a market-share. If ignored, then question marks may become dogs, while if huge investment is made, and then they have potential of becoming stars.
These business units require resources to grow market share, but whether they will succeed and become stars is unknown.

4. **Dog**

Is a business unit that has a small market share in a mature industry? Dogs represent businesses having weak market shares in low-growth markets. They neither generate cash nor require huge amount of cash. Due to low market share, these business units face cost disadvantages. Generally retrenchment strategies are adopted because these firms can gain market share only at the expense of competitors/rival firms. These business firms have weak market share because of high costs, poor quality, ineffective marketing, etc. Unless a dog has some other strategic aim, it should be liquidated if there are fewer prospects for it to gain market share. Number of dogs should be avoided and minimized in an organization.

A dog may not require substantial cash, but it ties up capital that could better be deployed elsewhere. Unless a dog has some other strategic purpose, it should be liquidated if there is little prospect for it to gain market share.

The BCG matrix provides a framework for allocating resources among different business units and allows one to compare many business units at a glance. However, the approach has received some negative criticism for the following reasons:

- The link between market share and profitability is questionable since increasing market share can be very expensive.
- The approach may overemphasize high growth, since it ignores the potential of declining markets.
- The model considers market growth rate to be a given. In practice the firm may be able to grow the market.

Limitations of BCG Matrix

The BCG Matrix produces a framework for allocating resources among different business units and makes it possible to compare many business units at a glance. But BCG Matrix is not free from limitations, such as-

1) BCG matrix classifies businesses as low and high, but generally businesses can be medium also. Thus, the true nature of business may not be reflected.

2) Market is not clearly defined in this model.

3) High market share does not always leads to high profits. There are high costs also involved with high market share.

4) Growth rate and relative market share are not the only indicators of profitability. This model ignores and overlooks other indicators of profitability.

5) At times, dogs may help other businesses in gaining competitive advantage. They can earn even more than cash cows sometimes.

6) This four-celled approach is considered as to be too simplistic.

Recommended Reading

The Boston Consulting Group, *Perspectives on Strategy*

Perspectives on Strategy contains Bruce Henderson's original writings on the BCG growth-share matrix. Specific articles include:

- **The Product Portfolio** - introduces the growth-share matrix and its dynamics, including the success sequence and the disaster sequence.
- **Cash Traps** - explains why the majority of products are cash traps.
- **The Star of the Portfolio** - and why market share is so important.
- **Anatomy of the Cash Cow** - including the buying and selling of market share for cash cows.
- **The Corporate Portfolio** - discussing the advantages of diversified companies.
- **Renaissance of the Portfolio** - after the portfolio concept's falling out of favor, this article makes the case for its return.

GE / McKinsey Matrix

These issues are addressed by the GE / McKinsey Matrix, which considers market growth rate to be only one of many factors that make an industry attractive, and which considers relative market share to be only one of many factors describing the competitive strength of the business unit.

In consulting engagements with General Electric in the 1970's, McKinsey & Company developed a nine-cell portfolio matrix as a tool for screening GE's large portfolio of strategic business units (SBU). This business screen became known as the **GE/McKinsey Matrix** and is shown below:

GE / McKinsey Matrix

		Business Unit		
		High	**Medium**	**Low**
Industry Attractiveness	**High**			
	Mediu			
	Low			

The GE / McKinsey matrix is similar to the BCG growth-share matrix in that it maps strategic business units on a grid of the industry and the SBU's position in the industry. The GE matrix however, attempts to improve upon the BCG matrix in the following two ways:

- The GE matrix generalizes the axes as "Industry Attractiveness" and "Business Unit Strength" whereas the BCG matrix uses the market growth rate as a proxy for industry attractiveness and relative market share as a proxy for the strength of the business unit.
- The GE matrix has nine cells vs. four cells in the BCG matrix.

Industry attractiveness and business unit strength are calculated by first identifying criteria for each, determining the value of each parameter in the criteria, and multiplying that value by a weighting factor.

The result is a quantitative measure of industry attractiveness and the business unit's relative performance in that industry.

Industry Attractiveness

The vertical axis of the GE / McKinsey matrix is industry attractiveness, which is determined by factors such as the following:

- Market growth rate
- Market size
- Demand variability
- Industry profitability
- Industry rivalry
- Global opportunities
- Macroenvironmental factors (PEST)

Each factor is assigned a weighting that is appropriate for the industry. The industry attractiveness then is calculated as follows:

$$
\begin{aligned}
\text{Industry attractiveness} \quad = \quad & \text{factor value1} \times \text{factor weighting1} \\
+ \; & \text{factor value2} \times \text{factor weighting2} \\
& . \\
& . \\
& . \\
+ \; & \text{factor valueN} \times \text{factor weightingN}
\end{aligned}
$$

Business Unit Strength

The horizontal axis of the GE / McKinsey matrix is the strength of the business unit. Some factors that can be used to determine business unit strength include:

- Market share
- Growth in market share
- Brand equity
- Distribution channel access
- Production capacity
- Profit margins relative to competitors

The business unit strength index can be calculated by multiplying the estimated value of each factor by the factor's weighting, as done for industry attractiveness.

Plotting the Information

Each business unit can be portrayed as a circle plotted on the matrix, with the information conveyed as follows:

- Market size is represented by the size of the circle.
- Market share is shown by using the circle as a pie chart.
- The expected future position of the circle is portrayed by means of an arrow.

The following is an example of such a representation:

The shading of the above circle indicates a 38% market share for the strategic business unit. The arrow in the upward left direction indicates that the business unit is projected to gain strength relative to competitors, and that the business unit is in an industry that is projected to become more attractive. The tip of the arrow indicates the future position of the center point of the circle.

Strategic Implications

Resource allocation recommendations can be made to grow, hold, or harvest a strategic business unit based on its position on the matrix as follows:

- **Grow** strong business units in attractive industries, average business units in attractive industries, and strong business units in average industries.
- **Hold** average businesses in average industries, strong businesses in weak industries, and weak business in attractive industries.
- **Harvest** weak business units in unattractive industries, average business units in unattractive industries, and weak business units in average industries.

There are strategy variations within these three groups. For example, within the harvest group the firm would be inclined to quickly divest itself of a weak business in an unattractive industry, whereas it might perform a phased harvest of an average business unit in the same industry.

While the GE business screen represents an improvement over the more simple BCG growth -share matrix, it still presents a somewhat limited view by not considering interactions among the business units and by neglecting to address the core competencies leading to value creation. Rather than serving as the primary tool for resource allocation, portfolio matrices are better suited to displaying a quick synopsis of the strategic business units.

Recommended Reading

David J. Collis, Andrew Campbell, Michael Goold, *Harvard Business Review on Corporate Strategy (Harvard* Business Review Paperback Series)
Core Competencies

Environmental Scanning - Internal & External Analysis of Environment

Organizational environment consists:-

- External environment
- Internal environment

- Environment must be scanned so as to determine development and forecasts of factors that will influence organizational success.
- **Environmental scanning refers to possession and utilization of information about** occasions, patterns, trends, and relationships within an organizational internal and external environment.
- **It helps the managers to decide the future path of the organization**. Scanning must identify the **threats and opportunities** existing in the environment.
- Strategy formulation, an organization **must take advantage of the opportunities** and **minimize the threats.** A threat for one organization may be an opportunity for another.
- Internal analysis of the environment is the first step of environment scanning. Organizations should observe the internal organizational environment.

Internal analysis consists of analyzing:-

- Employee interaction with other employees
- Employee interaction with management
- Manager interaction with other managers
- Management interaction with shareholders
- Access to natural resources
- Brand awareness
- Organizational structure
- Main staff
- Operational potential, etc.

- Discussions, interviews, and surveys can be used to assess the internal environment. Analysis of internal environment helps in identifying strengths and weaknesses of an organization.
- As business becomes more competitive, and there are rapid changes in the external environment, information from external environment adds crucial elements to the effectiveness of long-term plans.
- As environment is dynamic, it becomes essential to identify competitors' moves and actions. Organizations have also to update the core competencies and internal environment as per external environment.
- Environmental factors are infinite, hence, organization should be agile and vagile to accept and adjust to the environmental changes. e.g. Monitoring might indicate that an original forecast of the prices of the raw materials that are involved in the product are no more credible, which could imply the requirement for more focused scanning, forecasting and analysis to create a more trustworthy prediction about the input costs.
- In a similar manner, there can be changes in factors such as competitors' activities, technology, market tastes and preferences.

In External analysis, three correlated environment should be studied and analyzed:-

- Immediate/ industry environment
- National environment
- Broader socio-economic environment / macro-environment

Examining the industry environment needs an appraisal of:-

i. The competitive structure of the organizational industry.
ii. The competitive position of a particular organization and its main rivals.
iii. An assessment of the nature, stage, dynamics and history of the industry.
iv. Evaluating the effect of globalization on competition within the industry.

- Analyzing the national environment needs an appraisal of whether the national framework helps in achieving competitive advantage in the globalized environment.

Analysis of macro-environment includes-

- Exploring macro-economic environment
- Social factors
- The government
- Legal issues
- Technological factors
- International factors

➢ The analysis of organizational external environment reveals opportunities and threats for an organization.

➢ Strategic managers must not only recognize the present state of the environment and their industry but also be able to predict its future positions.

Core Values

The core values are a few values (no more than five or so) that are central to the firm. Core values reflect the deeply held values of the organization and are independent of the current industry environment and management fads.

One way to determine whether a value is a core value to ask whether it would continue to be supported if circumstances changed and caused it to be seen as a liability. If the answer is that it would be kept, then it is core value. Another way to determine which values are core is to imagine the firm moving into a totally different industry. The values that would be carried with it into the new industry are the core values of the firm.

Core values will not change even if the industry in which the company operates changes. If the industry changes such that the core values are not appreciated, then the firm should seek new markets where its core values are viewed as an asset.

For example, if innovation is a core value but then 10 years down the road innovation is no longer valued by the current customers, rather than change its values the firm should seek new markets where innovation is advantageous.

The following are a few examples of values that some firms have chosen to be in their core:

- excellent customer service
- pioneering technology
- Creativity
- Integrity
- social responsibility

Core Purpose

The core purpose is the reason that the firm exists. This core purpose is expressed in a carefully formulated mission statement. Like the core values, the core purpose is relatively unchanging and for many firms endures for decades or even centuries. This purpose sets the firm apart from other firms in its industry and sets the direction in which the firm will proceed.

The core purpose is an idealistic reason for being. While firms exist to earn a profit, the profit motive should not be highlighted in the mission statement since it provides little direction to the firm's employees. What is more important is *how* the firm will earn its profit since the "how" is what defines the firm.

Initial attempts at stating a core purpose often result in too specific of a statement that focuses on a product or service. To isolate the core purpose, it is useful to ask "why" in response to first-pass, product-oriented mission statements. For example, if a market research firm initially states that its purpose is to provide market research data to its customers, asking "why" leads to the fact that the data is to help customers better understand their markets. Continuing to ask "why" may lead to the revelation that the firm's core purpose is to assist its clients in reaching their objectives by helping them to better understand their markets.

The core purpose and values of the firm are not selected - they are discovered. The stated ideology should not be a goal or aspiration but rather, it should portray the firm as it really is. Any attempt to state a value that is not already held by the firm's employees is likely to not be taken seriously.

Recommended Reading

Jeffrey Abrahams, *The Mission Statement Book: 301 Corporate Mission Statements from America's Top Companies*

Features 300 mission statements from companies such as:

- American Express
- AT&T Corp.
- Ben & Jerry's Homemade, Inc.
  Blockbuster Inc.
- Coca-Cola
- Exxon
- FedEx Corporation
- Ford Motor Company
- General Electric Company
- IBM
- Johnson & Johnson
- Kellogg Company
- Levi Strauss & Co.
- Microsoft Corporation
- Nike
- Southwest Airlines Co.
- Tootsie Roll Industries, Inc.
- United Parcel Service
- Washington Mutual Inc.
- Kenya Airways
- Safaricom Limited
- Airtell
- Moi University
- Mount Kenya Universi

➢ TOPIC 3: STRATEGY FORMULATION

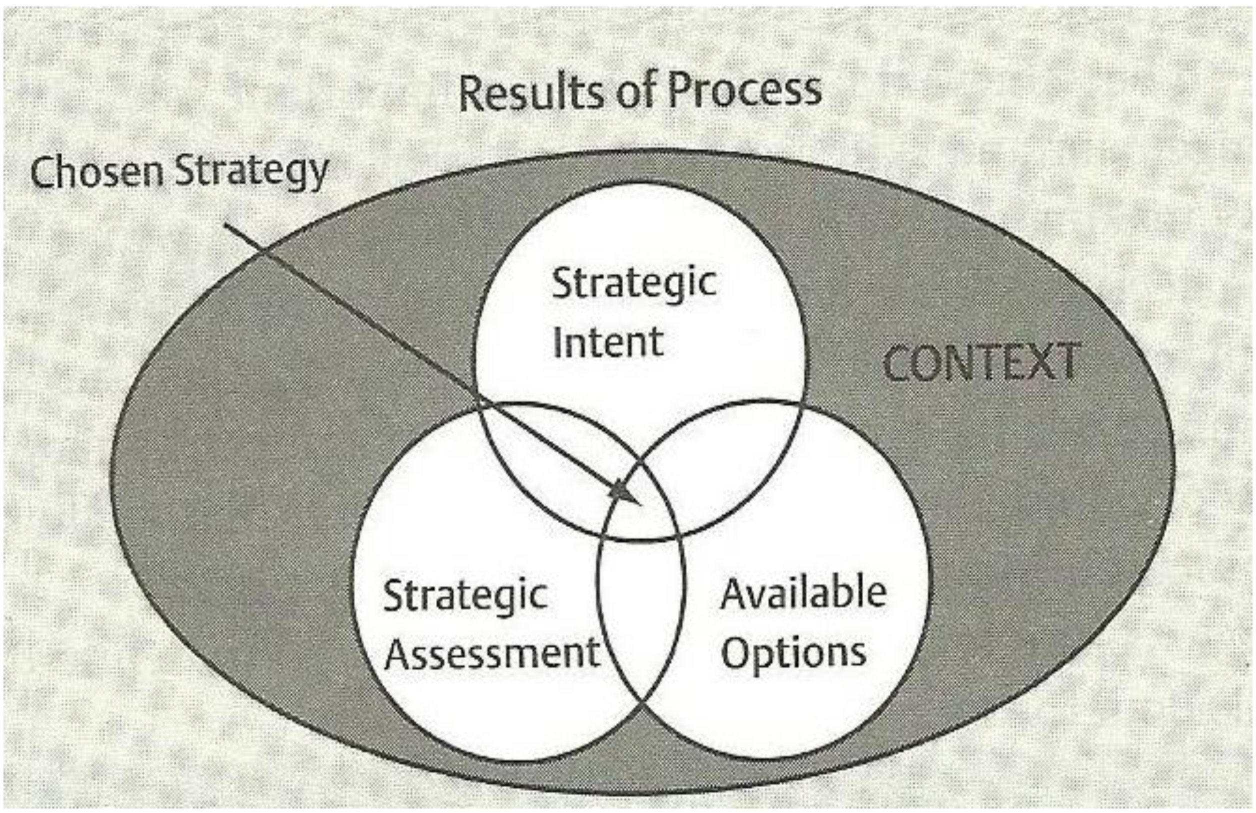
STRATEGIC CHOICES

Strategic choice is the third logical element of the strategy formation process. Choice is at the center of strategy formation. If there are no choices to be made, there can be little value in thinking about strategy at all. Choice and strategic choice refer to the process of selecting one option for implementation.

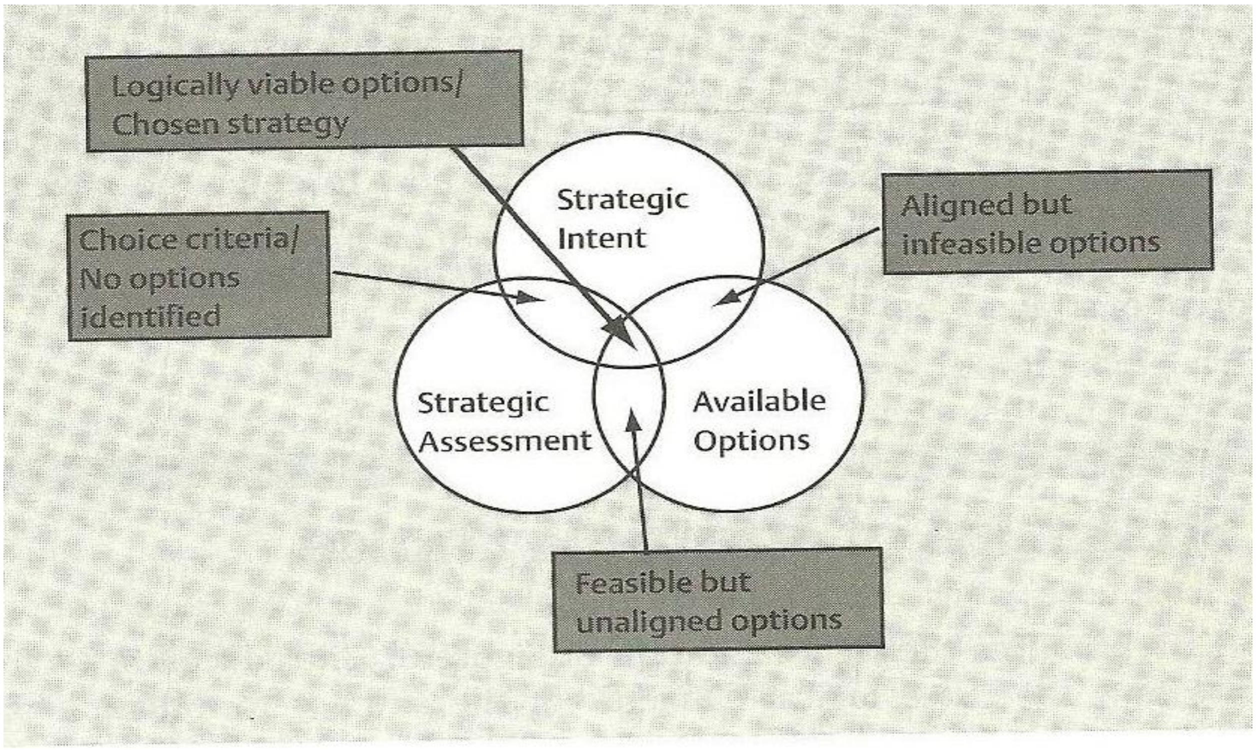
An option is a course of action that it appears possible to take. The simplest form of choice is therefore between taking an option and not taking it.

A strategy option is a set of related options (typically combining options for product/markets and resources) for a potential strategy. Chosen strategy is the strategic option that has been chosen.

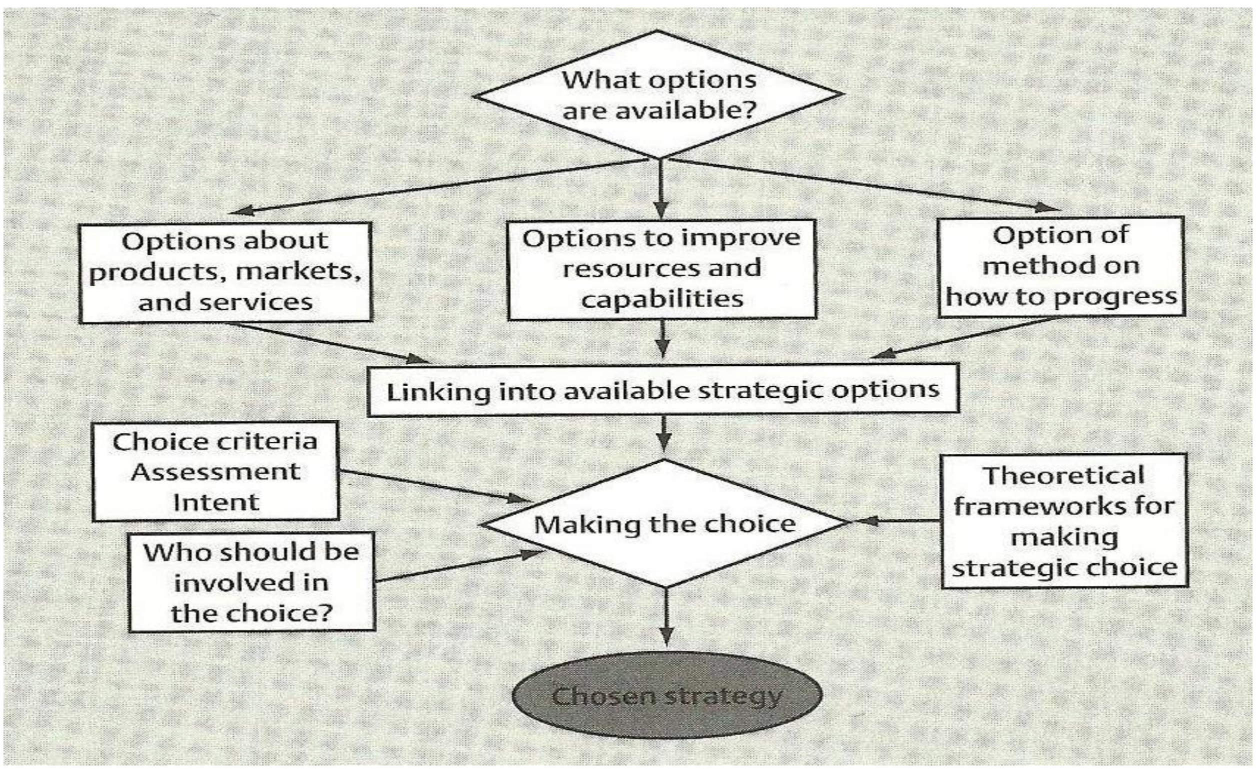
Results of the strategy formulation process



Choosing a strategy from among strategic options



Structure for making strategic choice



Examples of options

Options for markets and products/services.

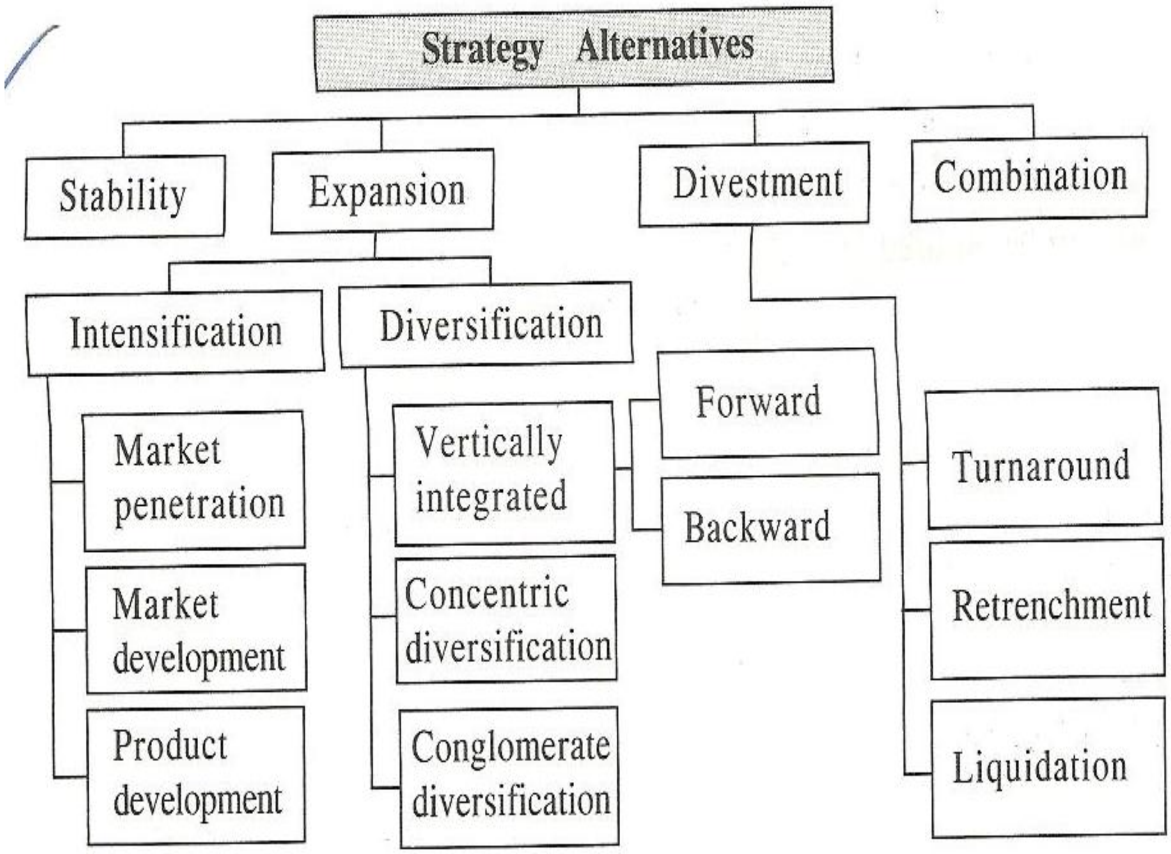
-Michael porters' Generic strategy

Options for building resources, capability and competence.

Options in methods of implementation.

Grand strategies/directional strategies

Various strategy alternatives are available to a firm for achieving its growth objective. The corporate strategies a firm can adopt have been classified into four broad categories: stability, expansion, divestment and combination. Grand strategies, which are often called master or business strategies, are intended to provide basic direction for strategic actions.



The basic features of the various grand strategies have been summarized in table below:

Strategy	Basic feature
Stability	The firm stays with its current businesses and product-markers; maintains the existing le is satisfied with incremental growth

Expansion	Here, the firm seeks significant growth – maybe within the current businesses; may be e business that are unrelated to existing businesses.
Divestment	The firm retrenches some of the activities in a given business(es), or drops the business sell-out or liquidation
Combination	The firm combines the above strategic alternatives in some permutation/combination so specific requirement of the firm.

Major reasons for organizations adopting different grand strategies:

Stability strategy is adopted because:

- It is less risky, involves less changes and people feel comfortable with things as they are.
- The environment faced is relatively stable.
- Expansion may be perceived as being threatening.
- Consolidation is sought through stabilizing after a period of rapid expansion.

Expansion strategy is adopted because:

- It may become imperative when environment demands increase the pace of activities.
- Psychologically, strategists may feel more satisfied with the prospects of growth from expansion; chief executives may take pride in presiding over organizations perceived to be growth-oriented.
- Increasing size may lead to more control over the market *vis-à-vis* competitors.

  Advantages from the experience curve and scale of operations may accrue

Divestment strategy is adopted because:

- The management no longer wishes to remain in business either partly or wholly due to continuous losses and the business and the business not being viable.
- The environment faced is threatening.
- Stability can be ensured by reallocation of resources from unprofitable to profitable businesses.
- Stability can be ensured by reallocation of resources from unprofitable to profitable businesses.

Combination strategy is adopted because:

- The organization is large and faces a complex environment.

The organization is composed of different businesses, each of which lies in a different industry requiring a different response

General test of strategic options

Each strategic option has then to pass two tests. It must be:

Aligned in that it conforms to strategic internet. This test answers the question "Does this option take us toward where we want to go?"

Feasible in that the capabilities and resources necessary for success can be made available. This answers the questions will it work.

Acceptable in that will the option win the approval of both those who will have it approve it and those who will have to implement it.

If more than one strategic option passes these tests, they may have to be compared with each other to choose the "best". The judgment has to take into account both tangible characteristics such as risk and return and less tangible matters such as match to values and culture.

BUSINESS LEVEL STRATEGY

Product Differentiation

Definition

It is a business strategy where by firms attempt to gain a competitive advantage by increasing the perceived value of their products or services relative to the perceived value of other firms` products or services e.g. Rolex attempts to differentiate its watches from Timex and Casio watches by manufacturing them with solid gold cases. Mercedes attempts to differentiate its cars from Hyundai's cars through sophisticated engineering and high performance. Key strategic challenge here is "How do I persuade consumers that I have a superior product".

Product differentiation is always a matter of customer perceptions, but firms can take a variety of action to influence these perceptions. These actions can be thought of as different bases of product differentiation

Bases of Product Differentiation

To differentiate its products, a firm can focus directly on the attributes of its products or services:

1. Product features
2. Product complexity
3. Timing of product introduction
4. Location

Or on relationships between itself and its customers:

5. Product customization
6. Consumer marketing
7. Product reputation

   Or, on linkages within or between firms:

8. Linkages among functions within a firm
9. Linkages with other firms
10. Product mix
11. Distribution channels
12. Service and support

In summary there are three elements of production differentiation triangle:

A. The product itself, together with its attributes
B. The customer wants and needs and their definition of the market.
C. The capabilities and core competence which define what the enterprise can do and where the enterprise is able to position itself.

Attributes of Products/Services

Product features

Enterprise can differentiate its product by altering features of the products they sell e.g. automobile industry, General motors (GM) introduce the "on star" system which instantly connects drivers to GM operators 24 hours a day, while Mercedes Benz continued to develop its "Crumple zone" system to ensure passenger safety in a crash. Mazda continues to tinker with the motor suspension of its sporty Miata. Toyota comes up with new model on a continuous basis e.g. Rav 4.

Product complexity

Special case of altering product features and this vary significantly.
The complexity must be convincing to the consumers

Timing of product introduction

Introduce a product at the right time First mover – introduce before others do Being first in emerging industries can enable a firm to set important technological standards, preempt strategically valuable assets and develop customer switching costs. These first mover advantages can create a perception among customers that the products or services of the first-moving firm are somehow more valuable than the products or services of others firms.
A firm can still be a later mover in a industry but introduce products or services at just the right time and thereby gain a competitive advantage. This can happen when the ultimate success of a product or service depends on the availability of complementary products or technologies e.g. the domination of Microsoft`s MS-DOS operating system and thus ultimately the domination of windows, was only possible because IBM introduce its version of the personal computer. Without the

IBM PC, it would have been difficult for any operating system including MS-DOS to have such a large market presence.

Location

Strategic location allows ease of accessibility. Also, one stop shop is key

Focusing on the relationship between a firm and its customers

Product customization

Products can be differentiated by the extent to which they are customized for a particular customer application e.g. enterprise software such as SAP and Oracle. Although these firms sell basic software packages, most firms find it necessary to customize these basic packages to meet their specific needs.

The ability to build complex software packages that can also be customized to meet the specific needs of a particular customer is an important basis of product differentiation in this marketplace. In bicycle industry people can spend as little or as much e.g. bicycle for children, ordinary people and sports etc.

Consumer marketing

Through advertising and other consumer marketing efforts, firms attempt to alter the perceptions of current and potential customers, whether or not specific attributes of a firm`s products or services are actually altered e.g. Mountain Dew a product of Pepsi CO – was originally marketed as a fruity, lightly carbonated drink that tested “as light as a morning Dew in mountains”. “However, beginning in the late 1990s, mountain Dew`s marketing efforts changed dramatically, as light as a morning Dew in the mountains” became “Do the Dew” and this is because Mountain Dew focused its marketing efforts on young, mostly male, extreme sports-oriented consumers. The company also started sponsoring a wide variety of extreme sports

Reputation

A firm’s reputation is really no more than a socially complex relationship between a firm and its customers. Once developed, a firm`s reputation can last a long time, even if the basis for that reputation no longer exists

Focusing on links within and between firms

Linkages between functions

Architectural competence – ability to use organizational structure to facilitate coordination among scientific disciplines to conduct research. Ability to coordinate across functions is an important source of competitive advantage.

Links with other firms

Differentiation is based on linkages between one firm`s products and the products or services of other firms. This is an example of cooperative strategic alliance strategies

Product mix

Outcome of links among functions within a firm and links between firms can be changes in the mix of products a firm brings to the market. This can be source of product differentiation especially when-those products or services are technologically linked or when a single set of customers purchases several of a firm`s products or services e.g. shopping Mall –customers prefer one stop shop.

Distribution channels

Linkage within and between firms can also have an impact on how a firm chooses to distribute its products e.g. in the soft drink industry Coca-Cola, PepsiCo and 7-Up all distribute their dinks through a network of independent and company-owned bottlers.

Service and support

Level of service is critical.

The value of Product Differentiation

In order to be valuable, bases of product differentiation must enable a firm to neutralize its threats and or exploit its opportunities.

Product Differentiation and Environmental Threats

Successful product differentiation helps a firm respond to each of the environmental threats identified in the five forces framework. The threat of new entry can be reduced by forcing potential entrants to an industry to absorb not only the standard costs of beginning business, but also the additional costs associated with overcoming incumbent firm's product differentiation advantages

Product differentiation reduces the threat of rivalry because each firm in an industry attempts to carve out its own unique product niche: Rivalry is not reduced to zero, because these products still compete with one another for a common set of customers, but it is somewhat attenuated because the customers each firm seeks are different.

Product differentiation also helps firms reduce the threat of substitutes by making a firm`s current products appear more attractive than substitute products.

Product differentiation can also reduce the threat of powerful suppliers. Powerful suppliers can raise the prices of the products or services they provide. Often, these increased supply costs must be passed on to a firm`s customers in the form of higher differentiated product may find it difficult to pass its increased costs on to customers, because these customers will have numerous other ways to purchase similar products or services from a firm`s competitors.

However, a firm with a highly differentiated product may have loyal customers or customers who are unable to purchase similar products or services from other firms. These types of customers are more likely to accept increased prices. Thus, a powerful supplier may be able to raise its prices, but, up to some point, these increases will not reduce the profitability of a firm selling a highly differentiated product. When a firm sells a highly differentiated product, it enjoys a "quasi-monopoly" in that segment of the market.

Buyers interested in purchasing this particular product must buy it from a particular firm. Any potential buyer power is reduced by the ability of a firm to withhold highly valued products or services from a buyer.

Product Differentiation and Environmental Opportunities

Product differentiation can also help a firm take advantage of environmental opportunities e.g. in fragmented industries firms can use product differentiation strategies to help consolidate a market. By being a first mover in these industries, firms can gain product differentiation advantages based on perceived technological leadership, preemption of strategically valuable assets, and buyer loyalty due to high switching costs. In mature industries, product differentiation efforts often switch from attempt to introduce radically new technologies to product refinement as a basis of product differentiation. Product differentiation can also be an important strategic option in a declining industry.

Product-differentiating firms may be able to become leaders in this kind of industry (based on their reputation, unique product attributes, or some other product differentiation basis).

Alternatively, highly differentiated firms may be able to discover a viable market niche that will enable them to survive despite the overall decline in the market. Finally, the decision to implement a product differentiation strategy can have a significant impact on how a firm act in a global industry.

Product Differentiation and Sustained Competitive Advantage

Product differentiation strategies add value by enabling firms to charge prices for their products or services that are greater than their average total cost. Firms that implement this strategy successfully can reduce a variety of environmental threats and exploit a variety of environmental opportunities. The ability of a strategy to add value to a firm must be linked with rare and costly-to-imitate organizational strengths in order to generate a sustained competitive advantage.

Cost Leadership

This is business level strategy Firm focuses on gaining advantages by reducing its costs to below those of all its competitors e.g. Hyundai - spend time in advertising its product but its advertisement tends to emphasize its sporty styling and high gas mileage.

Sources of Low Cost

- Size differences and economies of scale
- Size differences and diseconomies of scale
- Experience differences and learning curve economies

- Differential low-cost access to productive inputs
- Technological advantages independent of scale
- Policy choices

The Value of Cost Leadership

Value is created if a firm manages to neutralize its external threats and exploits its external opportunities. Reduce threat of new entrants by creating cost-based barriers to entry. Threats of rivalry is reduced through pricing strategies that low-cost firms can engage in and through their relative impact or the performance of low-cost firm and its higher rivals. Cost leaders have the ability to keep their products and services attractive relative to substitutes. While high-cost firms may have to change high prices to cover their costs, thus making substitutes more attractive, cost leaders can keep their prices low and still earn normal economic profits.

Suppliers can become a threat to a firm by charging higher prices for the goods or services they supply or reducing the quality of those goods or services. However, when a supplier sells to a cost leader, that firm has greater flexibility in absorbing the higher-cost supplies than does a high-cost firms but still allow a cost leader firm to earn an above-normal profit cost leadership based on large volume of production and economies of scale can also reduce the threat of suppliers. Large volume of production implies large purchases of raw materials and other suppliers.

Cost leadership can also reduce threat of buyers. Powerful buyers are a threat to firms when they insist on low prices or higher quality and service from their suppliers. Lower prices threaten firms' revenues, higher quality can increase a firm`s cost. Cost leaders can have their revenues reduced by buyer threat and still have normal or above-normal performance. These firms can also absorb greater costs on increased quality of service and still have a cost advantage over competition. If cost leadership is based on large volumes of production, then threat of buyers may be reduced, because buyers may depend on just a few firms for the goods or services they purchase. This dependence reduces the willingness of buyers to threaten a selling firm.

TABLE 5.5 The Organizational Requirements for Implementing Cost Leadership and Product Differentiation Strategies

Cost leadership	Product differentiation
Organizational structure	**Organizational structure**
1. Few layers in the reporting structure	1. Cross-divisional/cross-functional product development teams
2. Simple reporting relationships	2. Willingness to explore new structures to exploit new opportunities
3. Small corporate staff	3. Isolated pockets of intense creative efforts
4. Focus on narrow range of business functions	
Management control systems	**Management control systems**
1. Tight cost-control systems	1. Broad decision-making guidelines
2. Quantitative cost goals	2. Managerial freedom within guidelines
3. Close supervision of labor, raw material, inventory, and other costs	3. Policy of experimentation
4. A cost leadership philosophy	
Compensation policies	**Compensation policies**
1. Reward for cost reduction	1. Rewards for risk-taking, not punishment for failures
2. Incentives for all employees to be involved in cost reduction	2. Rewards for creative flair
	3. Multidimensional performance measurement

CORPORATE LEVEL STATEGY

Mergers and Acquisition

The growth of the firm can occur either internally or externally. When the firm builds a new plant, it is growing internally. Alternatively, the firm may grow by purchasing the assets of another firm (i.e. growth by acquisition) or by agreeing to join with that other firm under single ownership (i.e. growth by merger).

Merger

Definition

It is amalgamation and integration of two or more companies against shares. Previous companies are therefore dissolved and assets and liabilities are amalgamated. The purpose of merging is to gain economies of scale and scope. The relationship is friendly and leads to formation of a new entity.

Types of mergers

Mergers are typically divided into three categories: -

- Horizontal
- Vertical
- Conglomerate

Horizontal Mergers

Involve firms that directly compete for sales of similar products and services

Vertical Mergers

Occur when firms that had been operating at different stages in the production and distribution of a product combine to form a single firm. Vertical mergers may consist of a firm acquiring a seller of its output e.g. IBM purchasing a chain of computer stores that sell the firm`s computers. Sometimes referred to as downstream integration. Another example of vertical is the acquisition by a firm of a supplier of resources or components needed to make its products e.g. IBM purchasing a manufacturer of computer chips or disk drives. Mergers with suppliers often are referred to as upstream integration.

Conglomerate Mergers

Involves the joining of firms producing unrelated products e.g. an equipment assembly firm and a bakery.

There are four basic steps namely:

A. Identification of merger partner:
   Size of the prospective merger partner is paramount. Usually a merger with a small firm is easier than with a larger firm because fewer money will be involved. Also, possible competition laws favor the acquisition of small firms. If the participants in a horizontal merger control a substantial share of the market, the combination may be prohibited by the courts.
B. The expected reaction of the owners and managers of the target firm.
   - Friendly takeover is preferred than hostile acquisition.
C. The extent that resources and facilities of a target firm complement those of the acquiring firm.

- A firm needing a stable cash flow to finance expansion of modernization of its facilities may seek a merger partner with substantial cash reserves. Also, a firm that perceives that it has an important gap in its product line will be attracted to a producer of a product that fills that gap. Similarly, firms requiring specific resources are likely to select the owners of those resources as targets for acquisition.

D. Acquiring firms tend to select merger partners that appear to be good bargains. It may be possible to purchase a firm at a price substantially below its potential value if its owner wants to retire or if the firm has encountered financial difficulties because of poor management or unfavorable economic condition.

Valuation of the target firm

Mergers take place because of an anticipated synergism between the two firms. The value of the target firm to the acquiring firm may be considerably greater than the present value of its profits as an independent entity. An acquiring firm may be willing to pay a premium price. Maximum price however is based on an analysis of the present value of profits.

Acquisition

These are actions through which companies seek economies of scale, efficiency and enhanced market visibility. Acquisition involve one firm purchasing another. There is no exchange of stock or consolidation as a new company. Sometimes they are found to be hostile

Distinction between Mergers and Acquisitions

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things.

When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded. A merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals."

Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition. Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

Synergy

Synergy is the magic forces that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

A. Increase market power

   A merger between two competing firms can result in increased market power for the combined firms. In some cases, this increased market power stems from the elimination of an aggressive competition. In other situations, a horizontal merger my increase market power by eliminating excess capacity in an industry.

B. Technical economies of scale

   If technological conditions in industry result in increasing returns to scale, firms with large production facilities will be able to produce at lower average cost per unit than smaller firms. Thus, small firms that merge may be able to reduce per unit costs by expanding the scale of their operation. Such technical economies of scale may result from increased specification of labour, greater use of automated production techniques, and or sharing of overhead and management expenses.

C. Pecuniary economies of scale

Those cost savings that result from increased money power of larger firms.

D. Reduced transaction costs

Vertical mergers may reduce transaction costs to the acquiring firm and lead to establishment of permanent linkages.

E. Risk spreading

Conglomerate mergers may be a means of spreading risk. By diversifying its product line, managers can reduce fluctuation in profit rates.

Question

What are three strategies a firm might use to avoid being acquired by another company

Retrenchment and Restructuring Strategies

A retrenchment strategy aims at the contraction of the organization's activities to improve performance. It is implemented to find out the problem areas and the steps to take to resolve them. This strategy is adopted when an organization suffers continuous loses.

Eternal forces which lead to organization suffering loses are as follows:

1. New dominant technology
2. New business models
3. Strict government rules and regulation
4. Changing customer needs and preferences
5. Availability of substitute products

The internal factors because of which an organization suffers loses are:

1. Ineffective top management
2. Inappropriate strategies
3. Excess liabilities
4. High costs
5. Ineffective sales and marketing
6. Poor quality of functional management

When an organization suffers losses, it faces the following consequences

Falling sales

Increasing debts

Diminishing profitability

Shrinking market share

Loss of goodwill and credulity

<u>Types of Retrenchment strategies</u>

There are three types namely:

1. Turnaround Strategies which refers to the strategy that involve reversal of a negative trend. The indicators that call for turnaround are:

- **Negative cash flows**
- **Negative Profits**
- **Declining market share**
- **Mismanagement**
- **Inadequate physical facilities**
- **Overstaffing**
- **High employee turnover**

Turnaround Strategies can be handled in the following ways:

Handling the entire turnaround strategy with the help of a specialized consultants. The success of this strategy depends upon the credibility of top management with the banks and financial institutions. Recruiting an external consultant or turnaround specialist to take the actions.

Merging the organization with a healthy organization for expansion or earning gains. This involves replacement of the existing team esp. top management.

Divestment Strategies which is defined as the sale or liquidation of a portion of a business. This strategy is adopted when turnaround has failed. The reasons for adoption of divestment is as follows:

- Predicting that continuing of the business is unviable.
- Increasing financial problems because of negative cashflows.
- Increasing competition and inability of the organization to cope with it.
- Mismatching of resources
- Failure to invest in technological advancements.
- There is an opportunity to invest in a better alternative.

Liquidation Strategy involves closing down an organization and selling its assets. This is a last resort strategy. According to companies act 1956, liquidation or winding up may be done in the following 3 ways:

- Compulsory winding up under the supervision of the court.
- Voluntary winding up

Voluntary winding up under supervision of the court

Corporate Restructuring

Corporate restructuring is defined as an activity that involves changes in the business, organizational, or financial structure of an organization.
Business restructuring involves changes in the composition of the organization's structure to create a profitable enterprise.
Financial restructuring involves changing the equity and debt structure
Organizational restructuring includes changes in the structure of the organization by reducing the no of employees and redesigning positions.

Vertical Integration

A firm`s level of vertical integration is simply the number of steps in the value chain that a firm accomplishes within its boundaries. Firms that are more vertically integrated accomplish more stages of the value chain within its boundaries than firms that are less vertically integrated

Types of vertical Integration

a) Backward vertical integration:
A firm engages in backward vertical integration when it incorporates more stages of the value chain within its boundaries and those stages bring it closer to the beginning of the value chain i.e. closer to gaining access to raw materials e.g. computer companies developing all their own software.

b) Forward vertical integration
A firm engages in forward vertical integration when it incorporates more stages of the value chain within its boundaries and those stages bring it closer to the end of the value chain i.e. closer to interacting directly with final customers.

Value of Vertical Integration

Vertical integration can be used to reduce the threat of opportunism. Opportunism exists when a firm is unfairly exploited in an exchange when one of its exchange partners behaves opportunistically, this reduces the economic value of a firm. The firms should introduce market exchanges within their boundaries when the cost of the vertical integration is less than the cost of opportunism. Research has shown that the threat of opportunism is great when a party to an exchange has made transaction - specific investment.

A transaction specific investment is any investment in an exchange that has significantly more value in the current exchange than it does in alternative exchange

Firms will benefit if they vertically integrate into those business activities where they possess valuable, rare, and costly-to-imitate resources and capabilities. Also, firms should desist vertical integration into business activities where they do not possess the resources necessary to gain competitive advantage.

A third perspective on vertical integration focuses on the impact of this decision on a firm`s flexibility. Flexibility refers to how costly it is for a firm to alter its strategic and organizational decision. Flexibility is high when the cost of changing strategic choices is low; flexibility is low when the cost of changing strategic choices is high. Vertical integration should be rare and give competitive advanta.ge

Limitation of vertical integration

Direct duplication of vertical integration.

Substitutes for vertical integration

Strategic Alliances

A Strategic alliance exists whenever two or more independent organizations cooperate in the development, manufacture, or sale of products or services. Strategic alliance can be grouped into three broad categories.

Non-Equity Alliance

Cooperating firms agree to work together to develop, manufacture or sell products or services, but they do not take equity positions in each other or forcing an independent organizational unit to manage their cooperative effects. Cooperative relations are managed through the use of various contracting, licensing agreement (where one firm allows others to use its brand name to sell products) supply agreements (where one firm agrees to supply others), and distribution agreements (where one firm agrees to distribute the products of others).

Equity Alliance

Cooperating firms supplement contracts with equity holdings in alliance partners.

Joint Venture

Cooperating firms create a legally independent firm in which they invest and from which thy share any profits that are created.

How do strategic Alliance create value?

- Strategic alliances create value by exploiting opportunities and neutralizing threats facing a firm.

a) Used to improve performance of its current operations e.g.

- Exploiting economics of scale
- Leaning from competition
- Facilitating entry and exist
- Low cost industries and new industry segment
- Low cost exists from industries and industry segments
- Managing uncertainty
- Low – cost entry into new markets.

- Creating a competitive environment favourable to superior performance
- Facilitating the development of technology standards
- Facilitating tacit collusion

b) Creating a favourable competitive environment

- Firms use alliances to help set technology standards in an industry

Another incentive for cooperating in strategic alliances is that such activities may facilitate the development of tacit collusion

c) Facilitating entry and exit

- Entry into an industry can require skills, abilities and products that a potential entrant does not possess.
- Strategic alliances can help a firm enter a new industry by avoiding the high costs of creating these skills, abilities and products.
- Some firms use strategic alliance as a mechanism to withdraw from industries or industry segments in a low-cost way.
- Firms may use strategic alliance to manage uncertainty.

Alliance Threats

Alliances can lead to cheating in the following way: -

- Adverse selection: - potential parties misrepresent the value of the skills and abilities they bring to the alliance.
- Moral hazard; partners provide to the alliance skills and abilities of lower quality than they promised.
- Hold-up: - partners exploit the transaction specific investments made by others in the alliance.

Business Process Reengineering

Andy Grove, Intel corporations stated "You have no choice but to operate in a world shaped by globalization and information revolution; there are two options; Adopt or die".

- John Collins "Competing in the marketplace is like war. You have injuries and casualties, and the best strategy wins".
- Will Rogers, Humorist "Even if you`re on the right track, you`ll get run over if you just sit there"

BPR Defined

Business Process Reengineering (BPR) refers to the analysis and redesign of workflows and process both within and between organizations. The orientation of the redesign effort is radical, i.e. it is a total deconstruction and rethinking of a business process in its entirely, unconstrained by its existing structure and pattern. Its objective is to obtain quantum gains in the performance of the process in terms of time, cost, output, quality, and responsiveness to customers.

The redesign effort aims at simplifying and streamlining a process by eliminating all redundant and non-value adding steps, activities and transactions, reducing drastically the number of stages or transfer points of work, and speeding up the work-flow through the use of IT systems.

What is a process?

A process is a set of logically related tasks or activities oriented towards achieving a specified outcome. A process is a collection of activities which create an output of value to the customer and often transcend departmental or functional boundaries. For example, one common process found in almost every organization is order fulfilment. Order fulfilment begins with procuring an order and ends with delivery of goods to the customer. It also includes all other related activities in between

Likewise, other basic processes may include developing a new product or service, launching a new product in the market, procuring goods from suppliers, preparing the organization`s budget, processing and paying insurance claims, and so on.

What is a business process?

A business process comprises a combination of a number of independent or interdependent processes such as:

- Developing new products
- Customer order processing
- Bill payment system

Typically, a business process involves a number of steps performed by different people in different departments. The structural elements that constitute a process provide the basis for its analysis, appraisal and redesign for achieving higher levels of efficiency and effectiveness, economy and speed, and quality and output. A set of interconnected processes comprise a business system. The performance of a business firm is thus the outcome of the interrelated operation of its constituent work processes. The redesign of processes, therefore, provides a powerful basis for improving the performance of a business enterprise.

What is a core business process?

Some processes turn out to be extremely critical for the success and survival of the enterprise. BPR focuses on such critical business processes, out of the many processes that are carried out in any company. These are the core business processes of the company. A core business process creates value by the capabilities it provides to the competitiveness. Core business processes are critical in a company`s evaluation by its customers.

They are vital for success in the industry sector within which the company is positioned and are crucial for generating competitive advantages for a firm in the marketplace. While some core business processes are easily identifiable, others may

not always be immediately apparent. The following instances serve to show that core process need to be identified carefully in terms of their bearing on a firm`s competitiveness:
In the insurance industry, the actual work that leads to a balance of competitive premium for customers, and profit after claims for the company is a core business process. In the banking industry, the activities that help mobilize deposits and generate funds for advances to customers, are core business processes. In a fast-moving consumer goods industry marketing and brand management is a core process. In the electronics and semi-conductor industries, new product development is a core process.
The core processes of a company may change over a period of time according to the shifting requirements of its competitiveness. Since the objective of reengineering is to provide competitive advantage to the enterprise, it is extremely important to identify those core processes which need to be focused upon for achieving excellence. In order to do this, we have to necessarily start from the organization`s business vision, and derive from there the processes that have to be the best in the world in order to realize that vision. We must remember that, most of the existing work processes were developed before the advent of computers and the IT revolution. Even after the massive penetration of information technology, most organizations have usually applied the technology only in a limited way, to automate their existing work methods or to speed up the isolated or narrow components of a larger existing work process. This has only resulted in some sort of mechanization of the existing work methods without bringing in any appreciable change in the process and output. Examples from established Japanese industries as well as new entrepreneurial ventures in Japan proves that it is possible to achieve a much higher level of process performance by redesigning the process. It has been possible to double the speed of normal production, utilize assets several times more productively and respond to customers` needs and expectations much more rapidly. This could be achieved by effecting a total change in the process instead of piecemeal changes. It is, therefore, imperative for many organizations on the decline to change or redesign the process, as this may be the only viable alternative for a turn around. They must break free from primitive and archaic work processes that drag them down. Issues that emerge from the foregoing discussions on the need for change from the underlying premises of Business Process Reengineering (BPR). They may be briefly outlined as follows:

- The operational excellence of a company is a major basis for its competitiveness
- The business strategy of a company should be oriented towards leveraging its operational excellence into the marketplace.
- A customer-focused organization needs to be denationalized and realigned in terms of a process orientation.

Process need to managed, not functions.

To consider totally new ways of redesigning processes, each and every concept, assumption, purpose and principle, needs to abandoned temporarily. Continuous improvement is a deficient approach when a company is far behind the industry standards, and needs rapid quantum leaps to improve its performance. Dramatic improvement in performance is the prerequisite for overcoming competition. How to compete is more important than deciding about where to compete.

Definition of BPR

Business process reengineering means starting all over from scratch." reengineering, in other words, means putting aside many of the age-old practices and procedures of carrying out an operation. Which may have been developed through years of management experience. It implies forgetting how work has been done so far, and deciding how it can best be done now. Reengineering begins with fundamental rethinking. In reengineering people must ask the most basic questions about their organization and operations. Answers to such questions as, "why do we do what we do? Why do we do it the way we do?" are needed. An attempt to determine the answers to such questions my reveal that certain rules, assumptions and operational processes are obsolete and redundant. In reengineering there are no initial assumptions or perceived notions, it begins with a clean slate. Reengineering first determines what a company must do, and then it decides on how to do it. It ignores the existing processes and concentrates on what should be done. If something is not required to be done it is discarded outright.

Another key element in reengineering involves radical redesigning of processes. Radical redesigning means getting to the root of the problem areas and not to making any superficial changes. Radical redesign involves completely discarding all existing structures and procedures and evolving completely new ways of doing the work "Reengineering is about business reinvention – not business improvement, business enhancement, or business modification."

The next key concept that lies behind reengineering is that it aims at achieving dramatic improvement in performance. If an organization feels the need for marginal improvement in any area of operation at any point of time, the same can be achieved by conventional methods of adjustments in operating process and reengineering is not required. Reengineering is meant for replacement of old process by altogether new ones to achieve a dramatic improvement in performance.

A five step approach to business process reengineering

Davenport (1992) prescribes a five-step approach to the business process reengineering model:

- **Develop the business vision and process objectives:** The BPR method is driven by a business vision which implies specific business objectives such as cost reduction, time reduction, output quality improvement.
- **Identify the business processes to be redesigned:** Most firms use the 'high-impact' approach which focuses on the most important processes or those that conflict the most with the business vision. A lesser number of firms use the 'exhaustive approach' that attempts to identify all the processes within an organization and then prioritize them in order of redesign urgency.
- **Understand and measure the existing processes:** To avoid repeating of old mistakes and to provide a baseline for future improvements. Compare: Scientific Management.
- **Identify IT levers:** Awareness of IT capabilities can and should influence BPR.
- **Design and build a prototype of the new process:** The actual design should not be viewed as the end of the BPR process. Rather, it should be viewed as a prototype, with successive iterations. The metaphor of prototype aligns the business process reengineering approach with quick delivery of results, and the involvement and satisfaction of customers.

As an additional 6th step of the BPR method, it is sometimes necessary to adapt the organizational structure and the governance model, to the newly designed primary process.

The role of information technology in BPR

The accelerating pace at which information technology has develop during the past few years has had a very large impact in the transformation of business processes. Various studies have conclusively established the role of information technology in the transformation of business processes.

A reengineered business process, characterized by IT-assisted speed, accuracy, adaptability and integration of data and service points, is focused on meeting customer needs and expectations, quickly and adequately, thereby enhancing their level of satisfaction. Globalization and competition call for better management, faster response to change and adherence to globally accepted standards of quality and services. The impact of IT systems is identified as:

Compression of time

Overcoming restrictions of geography and/or distance

Restructuring relationships

IT initiatives thus provide business values in three distinct areas:

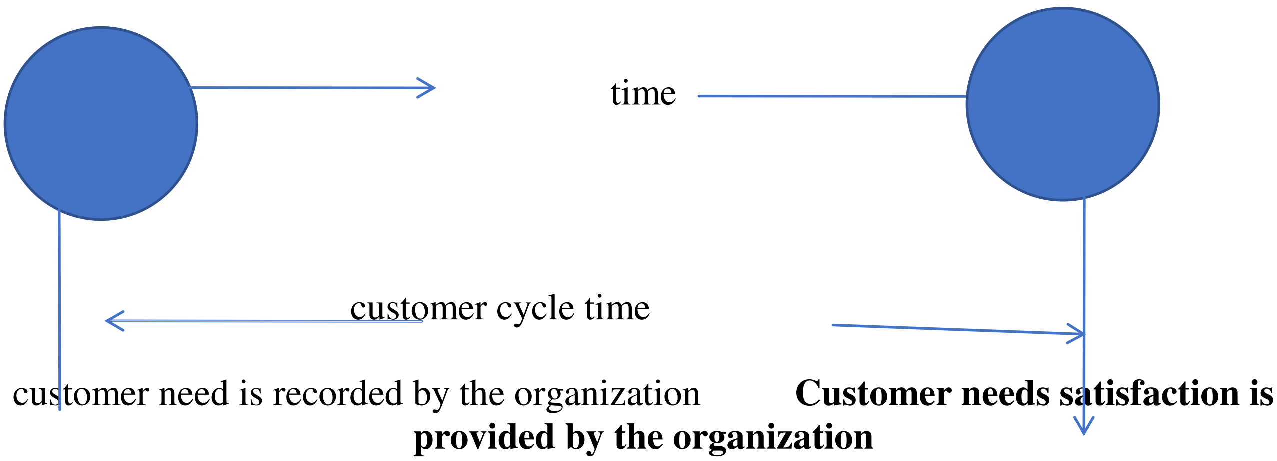
Efficiency – by way of increased productivity

Effectiveness – by way of better management

Innovation – by way of improved products and services.

Central thrust of BPR

Improvement in quality and cost follows after improvement in thrust areas. BPR is a continuous improvement process. Although BPR is a multi-dimensional approach in improving the business performance its thrust area may be identified as "the reduction of the total cycle time of a business process.” BPR aims at reducing the cycle time of process by eliminating unwanted and redundant steps, by simplifying the systems and procedures and by eliminating the transit and waiting times as far as possible. Even after redesigning a process. BPR maintains a continuous effort for more and more improvement.



Reengineering does not mean partial modification or marginal improvement in the existing work processes. Reengineering is a revolutionary approach towards radical and total redesigning of the business processes. While reengineering may lead to restructuring of organization, any restructuring does not necessarily mean reengineering. The basic principles that differentiate reengineering from any other drive to improve organizational efficiency may be briefly summarized as follows:
At the core of reengineering lies the concept of discontinuous thinking. Reengineering does not have any scope for any partial modification or marginal improvement in the existing business processes. It aims at achieving excellence and breakthrough to performance by redesigning the process entirely and radically. Obviously, it requires challenging the necessity of existing rules and procedures and discarding the same to evolve altogether new processes
BPR approach recognizes that most of the existing rules and procedures of work methods are based on certain assumptions about technology, people and the goals of the organization, which may no longer be valid. Besides many these systems and procedures may have failed to reap the benefits of massive development in information technology during the past few years. BPR recognized “the vast and expanding potential of IT for the most rational, simple and efficient redesign of work structure.” BPR aims at utilizing information technology for evolving a new process, instead of automating the existing process. “BPR efforts involve managing massive organizational change.” reengineering is not just changing the process. The change in process is almost always accompanied by many changes in other areas too. Work changes form task oriented to process oriented. People have the choice of making their own decisions instead of being directed. “Functional departments may

become redundant. Practically every aspect of the organization changes beyond recognition."

In view of the massive organizational changes involved in reengineering, it is imperative that a reengineering drive is supported by the vision and commitment of the organization`s top leadership to see it to its successful completion.

Critics of the BPR approach

Reengineering has earned a bad reputation because such projects have often resulted in massive layoff. BPR assumes that the factor that limits an organization`s performance is the ineffectiveness of its processes. This may or may not always be true. Also, BPR offers no means to validate this assumption. PR assumes the need to start the process of performance improvement with a "clean slate", i.e. total disregard of the status quo. Sometimes, or maybe quite often, a gradual and incremental change (such as Kaizen) may be a better approach. PR is culturally biased towards the American way of thinking.

Benchmarking as competitive advantage

Benchmarking is a process of continuous improvement in search of a competitive advantage. It measures a company`s products, services and practices against those of its competitors or other acknowledged leaders in their field.

Firms can use the benchmarking process to achieve improvement in a diverse range of management functions such as: -

Maintenance operations
Assessment of total manufacturing costs
Product development
Customer services
Plant utilization levels
Human resource management

Strategic Memo 9.3

"... benchmarking ... [is] ...the process of identifying, understanding, and adapting outstanding practices and processes from organizations anywhere in the world to help your organization improve its performance."

—American Productivity & Quality Centre

"... benchmarking ... [is]... an on-going outreach activity; the goal of the outreach is identification of best operating practices that, when implemented, produce superior performance."

—Bogan and English, *Benchmarking for Best Practices*

The benchmarking processes

The six major steps in benchmarking are as follows:

Step 1: Deciding what to benchmark
Step 2: Planning the benchmarking project (make the team)
Step 3: Understanding one`s own performance
Step 4: Studying others (not limited only to competitors)
Step 5: Learning from data (performance gaps)
Step 6: Using the findings

The benchmarking process is as follows

Establish the benchmarking subject: define the function in the operation to be benchmarked.
Identify benchmarking partners: Establish the companies or individuals that will provide the necessary information, comparable operations within the service industry, in dissimilar industries and where best practices occur.

Form a benchmarking team: Generally carried out by a team but within the team individual roles and responsibilities are assigned.

Determine, design and execute the data collection process: Information can be collected by telephone interviews, postal surveys, face-to-face interviews as well as by secondary data sources.

Analyze and implement, where appropriate, the findings and the study: one should be impartial, carry out a SWOT analysis of the company and its benchmarking partners and then establish the performance gap between the firm`s specified practices and its leaders.

Use the study findings within the organizations: making good use of the findings of the study is most likely and most frequent, if the people who are using their skills are promptly identified.

Questions

1. How far can the `customers` of a public service exercise consumer influence over the services they receive?

2. Discuss the proposition that “to succeed in business it is more important to know what competition you are up against than to know what your customers want

➢TOPIC 5: STRATEGY IMPLEMENTATION

Strategy implementation refers to putting the formulated strategies into action to achieve the organizational objectives.

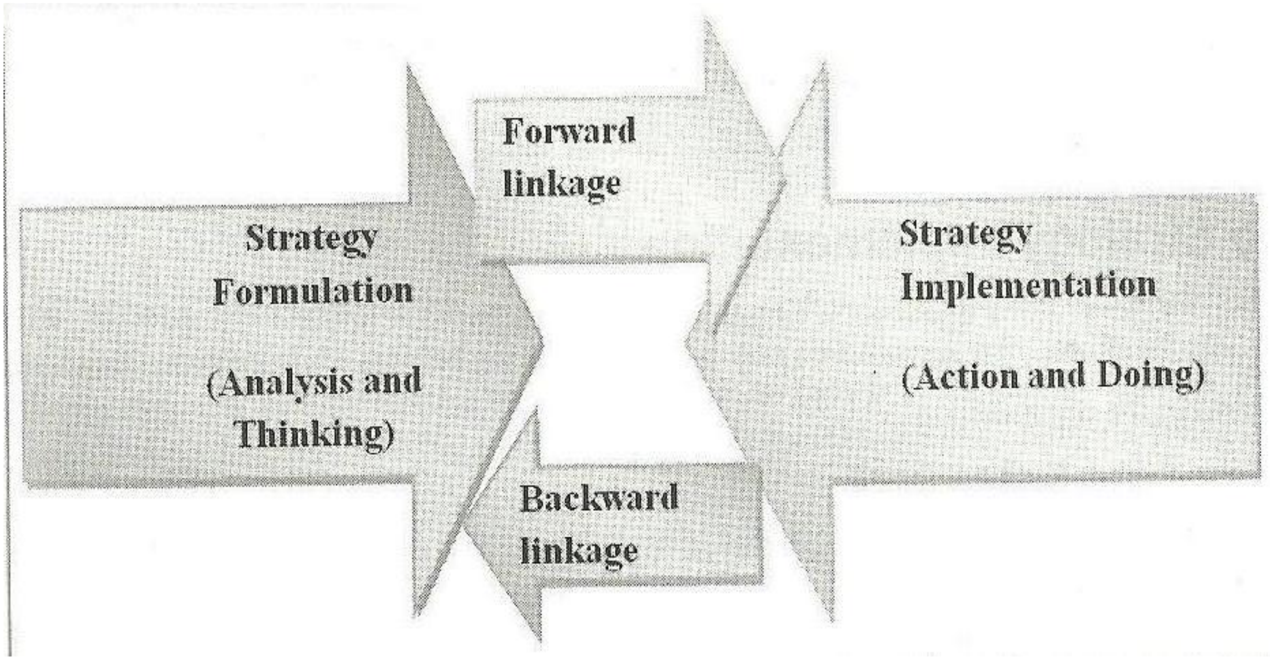
Concept of Strategy Implementation
Strategy implementation involves actions and tasks that needed to be performed after the formulation of the strategies. Strategy implementation should have the undernoted features:

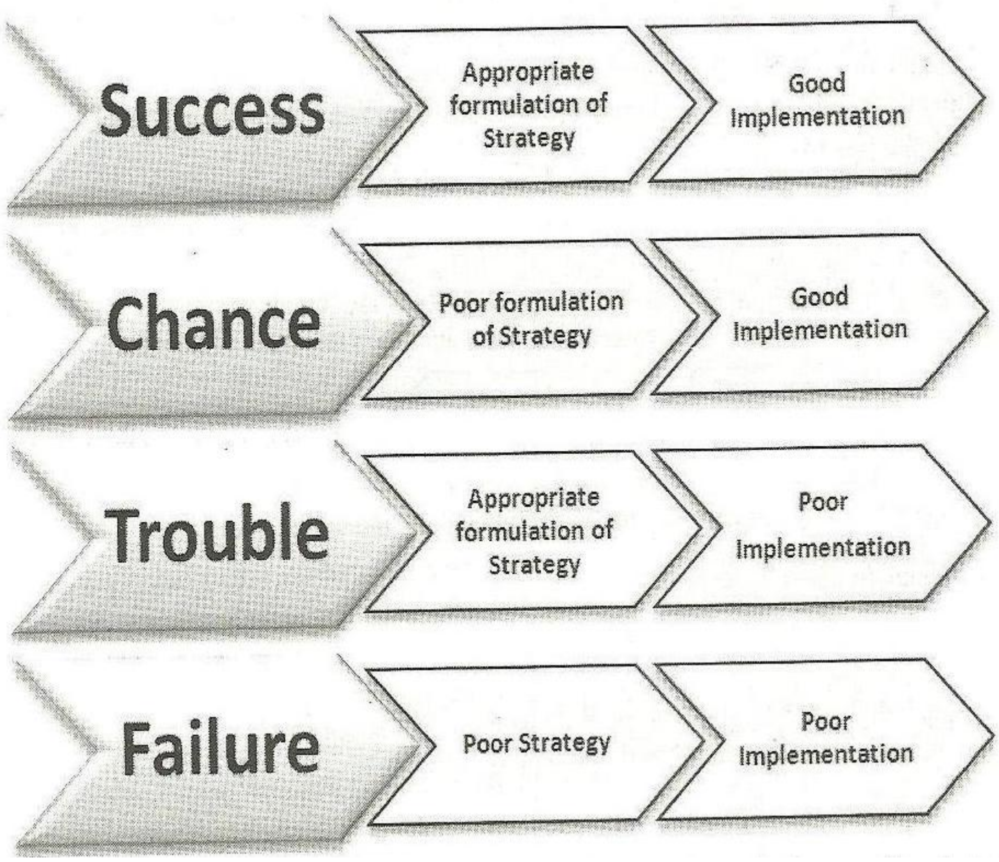
- **Action Oriented**: Implies that a strategy should be actionable. A strategy is made actionable with the help of different management processes, such as planning and organizing. The role of management is not just restricted to formulating the plans, but also extends to converting these plans into actions.

- **Varied Skills:** Imply that strategy implementation involves wide-ranging skills. In an organization, vast knowledge, attitude, and abilities are required to implement a strategy. These skills help in allocating resources, designing structures, and formulating policies.
- **Wide Involvement:** Means that strategy implementation requires the participation of the top, middle, and lower level management. The top management must clearly communicate the strategy, which needs to be implemented, to the middle management. You should note that the middle management plays an active role in strategy implementation.

- **<u>Integrated Process:</u>** Refers to covering a wide range of activities for strategy implementation. These activities include allocating budgets, designing training programs, launching advertising campaigns, and controlling costs.

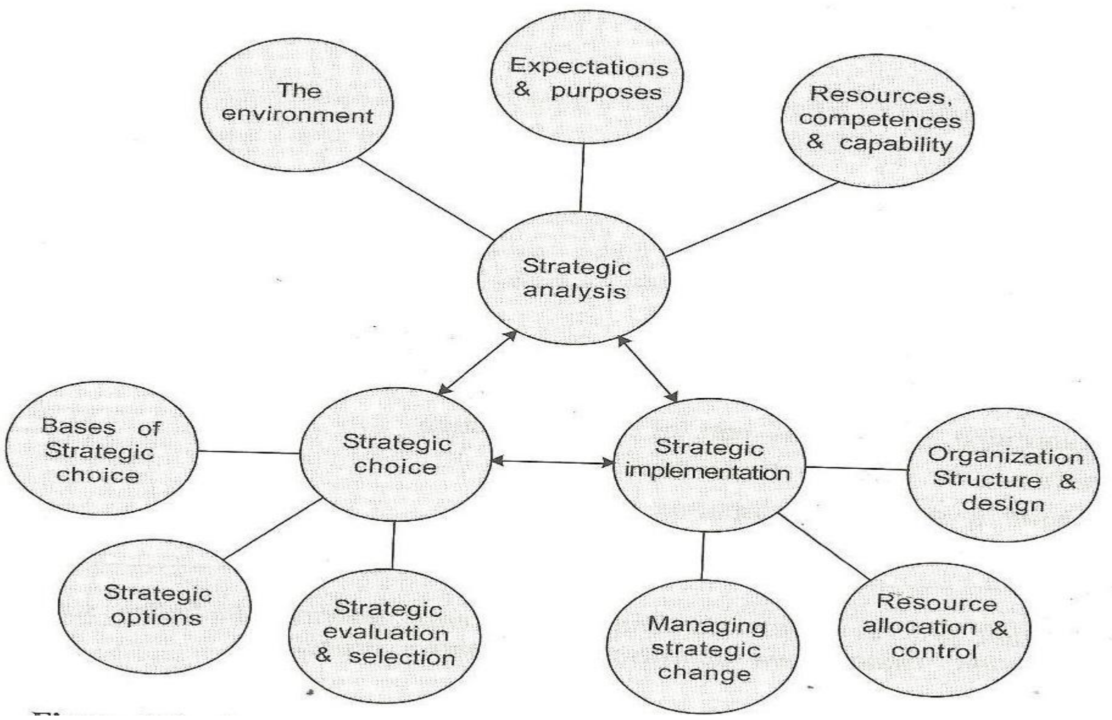
CONNECTION BETWEEN STRATEGY FORMULATION AND STRATEGY IMPLEMENTATION





Differences between SF and SI

Strategy Formulation	**Strategy Implementation**
1. Involves Strategic planning about organizational goals	1. Involves the execution of s/planning
2.Refers to an Intellectual Process	2. Refers to an operational process
3.Requres analytical and Intuitive skills	3. Requires Motivation and leadership skills
4.Coordination among top management	4. Coordination by all cadres of staff
5. Focuses on effectiveness	5. Focuses on efficiency



Process of Strategy Implementation

The implementation of strategy involves the application of strategies designed by the top management.

According to Steiner ‘the implementation process covers the entire managerial activities including such matters as motivation, compensation, managerial appraisal and control process’.

According to Higgins 'Almost all management functions: Planning, controlling, organizing, motivating, leading, directing, integrating, communicating and innovation are in some degree applied in the implementation process.'

Successful strategy implementation can be initiated by following a three – stage process:

a) Activating strategies

b) Managing change

c) Achieving effectiveness.

Activating Strategies

After Formulating a strategy, it is activated by dividing the strategy into Plans, Programs, Projects, Policies, Procedures, and rules and regulations.

Managing Change

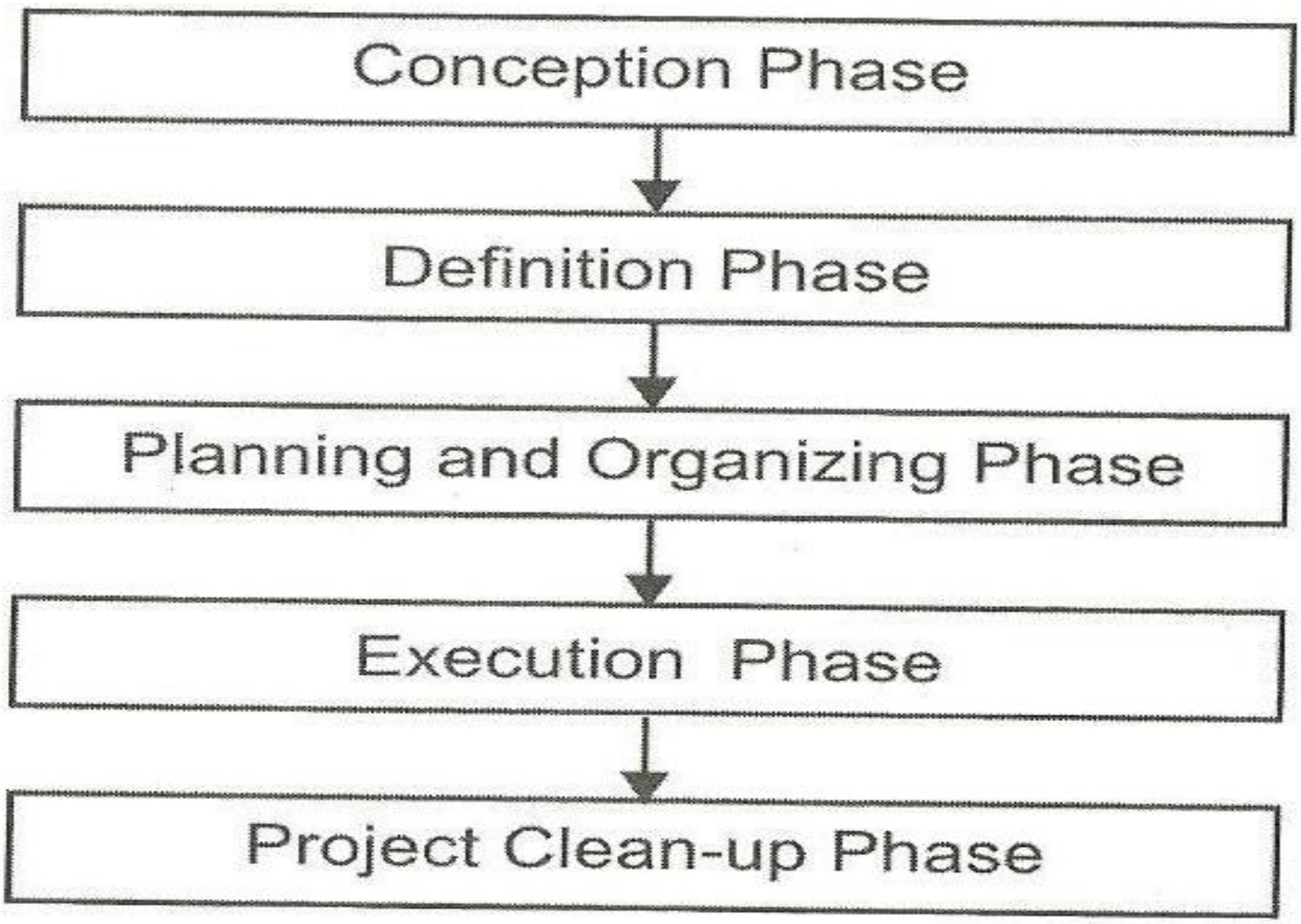
Change is an essential element, since every organization has to deal with the dynamic forces present in the business environment. The procedure of change management involves identifying a required change and preparing the organization to manage that change. There are two issues that need to be handled by a firm in regard to change namely: Degree of change and Timing of Change Degree of change Implies extent of change within the organization. A change can be radical or incremental. A radical change is a major change that transforms the org such as change of top management. Incremental change is a routine small change that take place over a period of time e.g. small training programmes on monthly basis may end up changing the attitude of employees. Timing of change focuses on the question of when to change. They are can be Anticipatory change or Reactive change. In the strategy implementation the org faces both types of change.

Achieving Effectiveness

Achieving effectiveness refers to achieving the org effectiveness, which specifies an organization is able to fulfill its objectives

Project Implementation

Project Management is defined as the discipline of planning, organizing, and managing resources to bring about the successful completion of specific project goals and objectives. The process of project management consists of the following phases as shown in the chart



Procedural Implementation

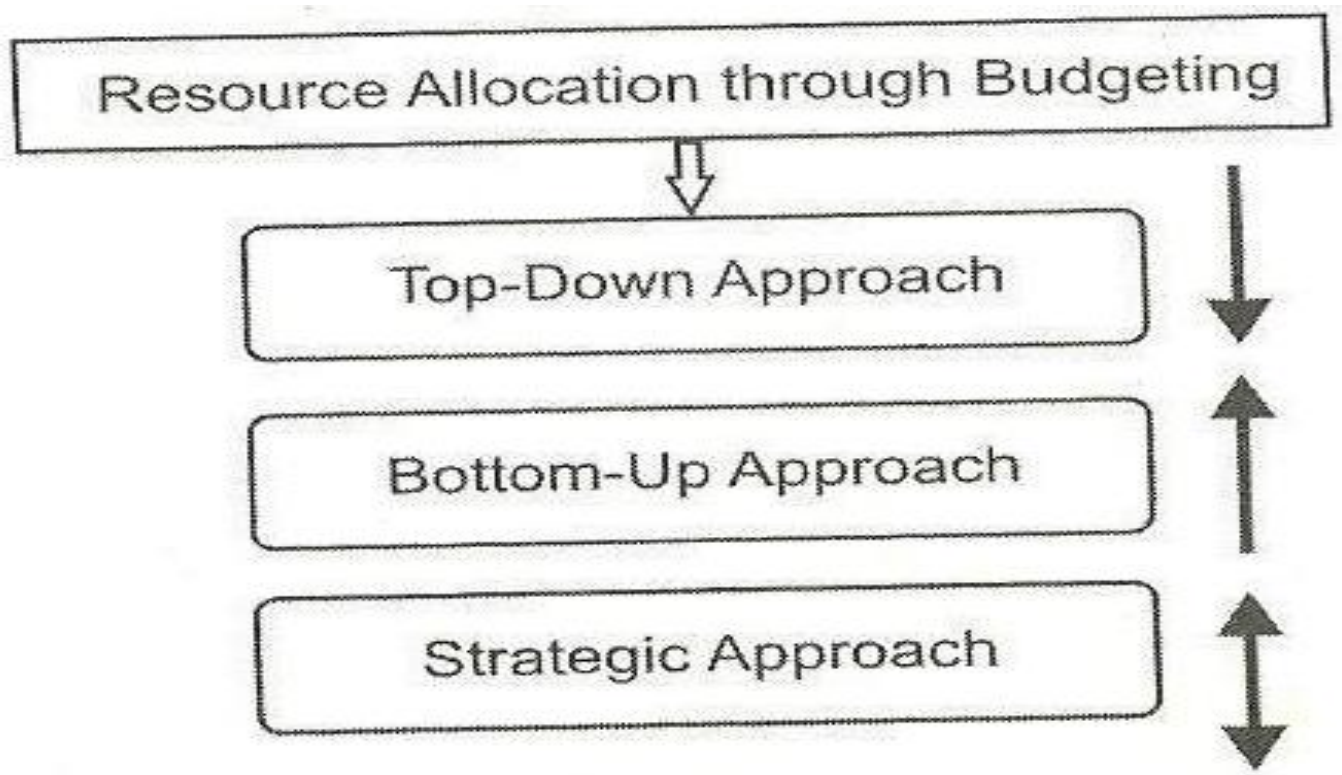
Procedures provide the proper framework to an organization to implement strategies. The plans, projects, and progress of the organization come under the procedural framework, which consists of various legislative enactments and administrative orders laid down by the government. Some of the procedures are formation of the organization, licensing procedure, foreign collaboration procedures, import/export requirements, patents/copyrights /trademarks requirement, labour regulation, environmental protection, consumer protection and incentive/ benefits.

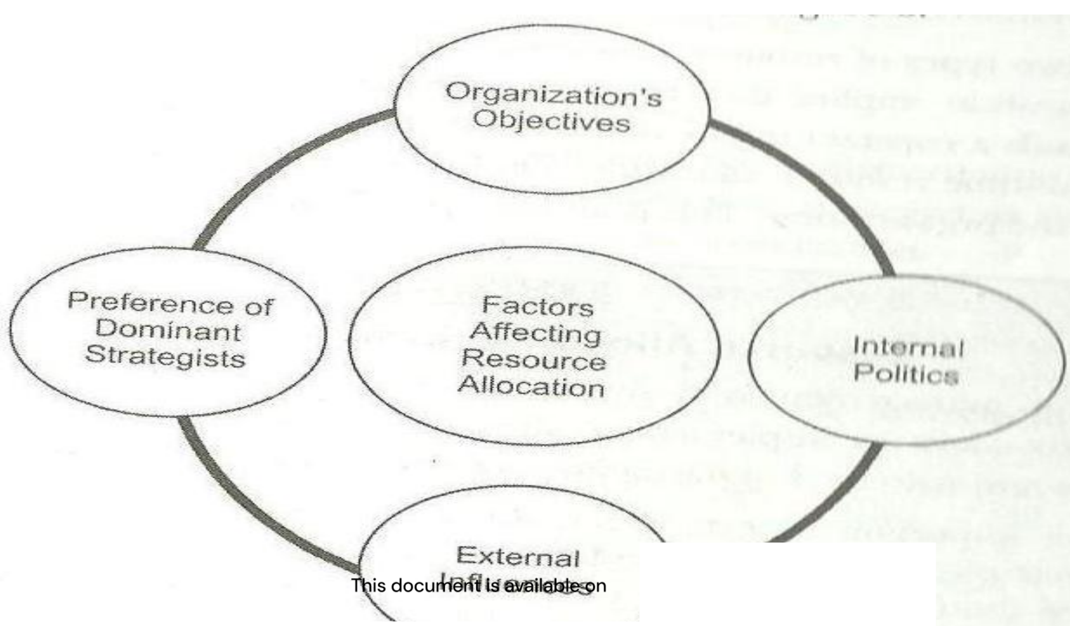
Resource Allocation

Efficient allocation Resource, such as financial, human and technical, is imperative for strategy implementation. Resources are required to take action but not to ensure success of implementation. Strategy implementation deals with two types of resource allocation, namely one–time resource allocation and continuous resource allocation.

Resource allocation process

The process is done though budgeting





Resource allocation are affected by

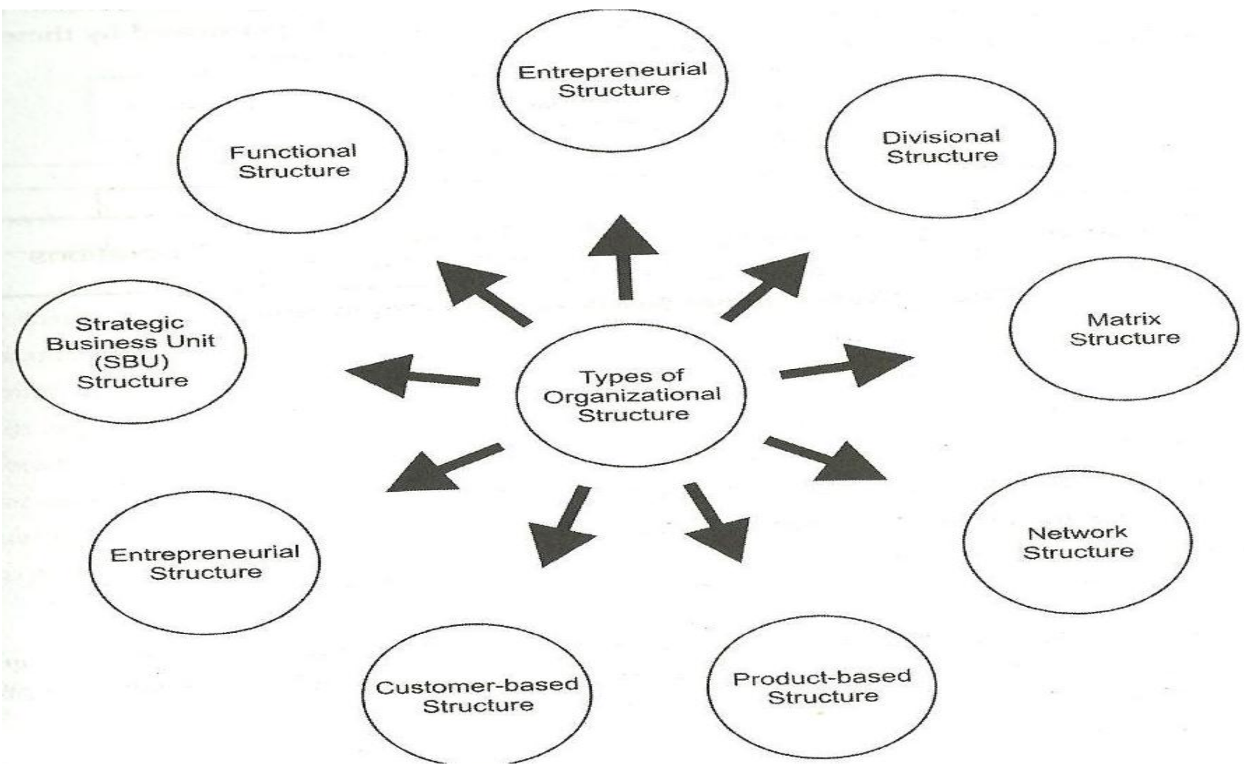
Structural Implementation

- Structural implementation of strategy involves designing the structure of the organization and interlinking its various departments.
- Structural implementation consists of the following key features:

1. Defining the tasks required to implement the strategy.
2. Grouping and subdividing the tasks on the basis of common links.
3. Identifying the formal reporting relationship.
4. Designing and administering the control systems.
5. Ensuring effective communication, coordination, and integration across departments

Types of Organization Structure

The structure of an organization influences the design or framework of the organization structure



Organizational design and Change

Organizational design aims at creating right organizational structure s that fit the requirements of an organization. Organizational change modifies the existing organizational structure s that appear to be wrong and do not fit the requirements of an organization.

Concept of organizational design

Organizational design is defined as a process that helps in matching the structure of an organization to its objectives. There are two dimensions namely:

1. Structural Dimensions
2. Contextual Dimensions

Structural Dimensions

Includes the internal characteristics of an organization which are follows:

- **Formalization**: Involves the policies, regulations, job descriptions, procedures and processes.
- **Specialization**: Specifies the degree to which organizational tasks are subdivided into different jobs.
- **Centralization**: Implies the extent of decision – making within an organization.
- **Professionalism**: Involves learning and knowledge within an organization Includes various influences, such as environment, goals strategy, culture, and technology, which shape the structural dimensions an organization.

Organizational Change

Organizational change is carried out through various external and internal forces:

- External forces are forces beyond the control of the organization i.e. Government policies, changes in the economy, competition, cost of raw materials, pressure groups, Technology push, Scarcity of labor, Social pressures and legal requirements.
- Internal Forces refer to the forces that exit within an organization and affects its working i.e. Change in leadership, implementation of new technology, Decline in profitability, changes in employee profile, Union actions and low morale of employees.

Level of Change

Change can occur in varying degrees at various levels of an organization: Individual level change refers to changes in the behavior of employee, Group level change refers to changes in the behavior of a group, and Organizational level change refers to changes involving major programmes that affect both individuals and groups

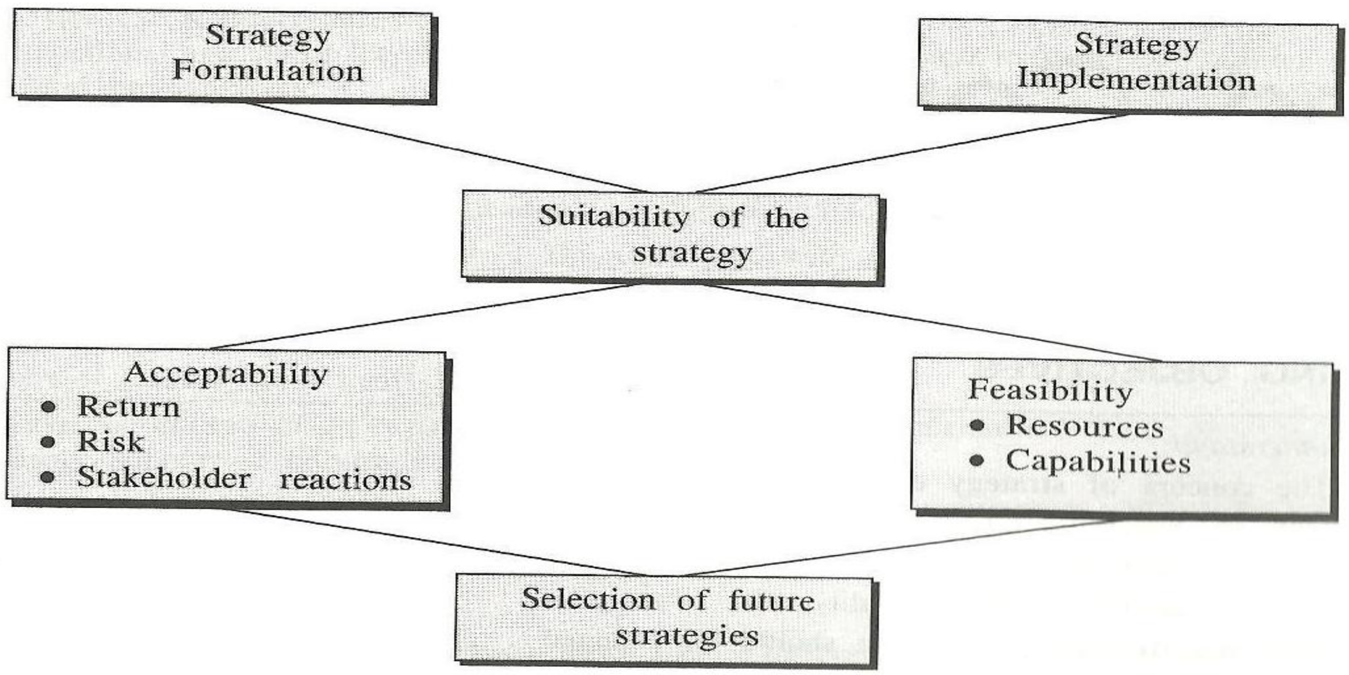
Types of Organizational Change

- **Planned change**- Conscious change, in the hands of change implementers.

- **Emergent change**- Spontaneous occurrence arising out of influencing environmental factors.
    - Episodic – Change that happen at a particular time.
- **Continuous**- Regular changes, first order changes,
- **Remedial Changes**- Changes that call for transformation, corrective measures

<u>Evaluation, Monitoring and Control</u>

In assessing strategies, there are three types of evaluation criterion which can be used:

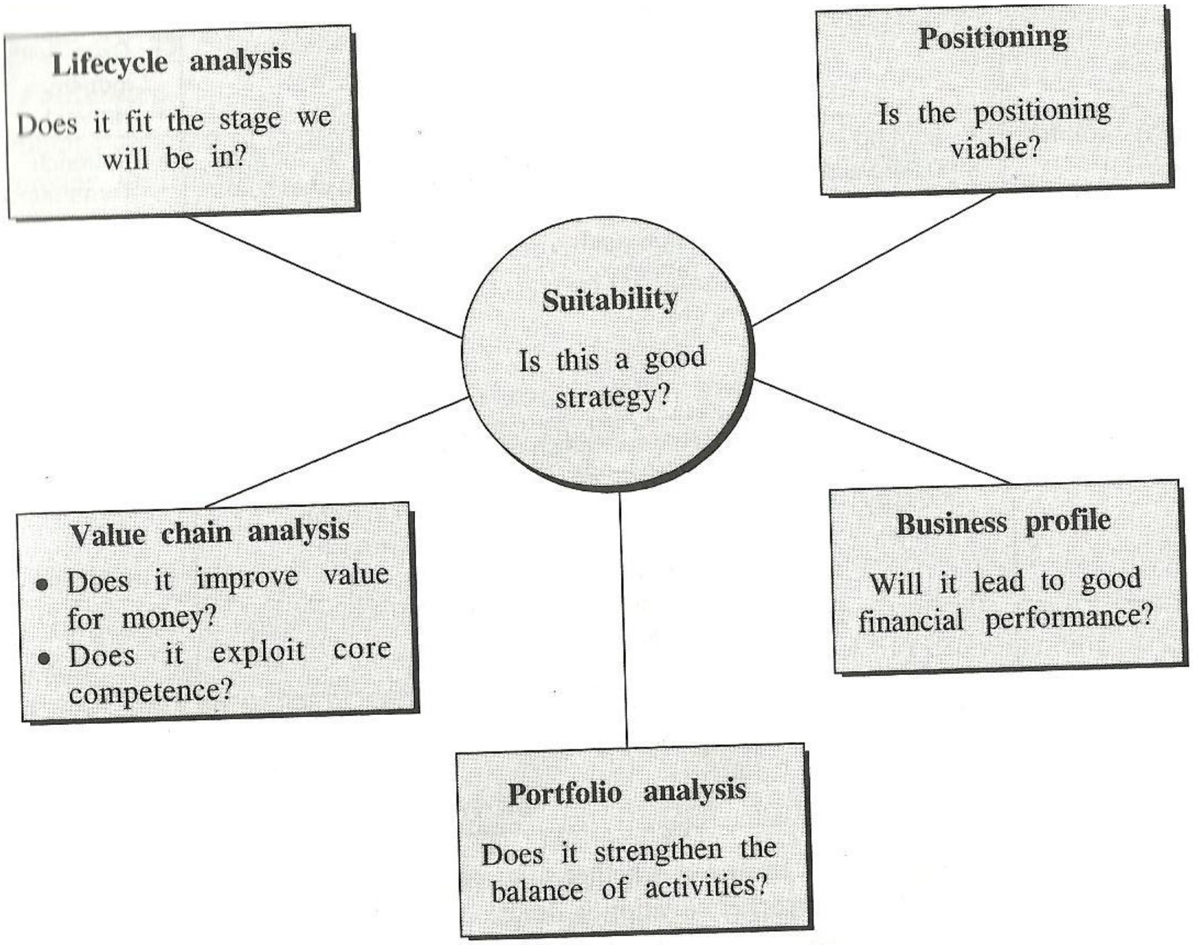


1.Suitability: The circumstance in which the organization is operating is judged. The main purpose of strategic analysis is to establish an understanding of the basis on which the suitability of strategies can be judged. It consists of assessing the extent to which a strategy:

- Exploits the opportunities in the environment and avoids the threats.

- capitalized on the organization`s strengths and core competences and avoids or remedies the weakness.

- Addresses the cultural and political context



Life Cycle

Four stage:

- Embryonic
- Growth
- Maturity
- Ageing

Competitive Position

Dominant, strong, favourable, tenable, weak

Eight extend factors which determine the position of the industry within the life cycle are:

1. Market growth rate
2. Growth potential
3. Breadth of product lines
4. No of competitors
5. Spread of market shares between these competitors
6. Customer loyalty
7. Entry barriers

8. Technology

The life cycle stage is determined by balancing these factors.

2. **Is the strategy acceptable**

Expected performance outcome is assesses.

A judgment is also made on the extent to which these would be in line with the expectations of stakeholders
The acceptability of the strategies can be assessed in three broad ways: return, risk and stakeholder reactions.

Analysis return through profitability analysis, cost-benefit analysis and shareholder value analysis e.g. ROCE, payback period, Discounted Cash Flow (DCF).

Analysis risk through financial ratio projections, sensitivity analysis and stimulation modelling.

3. **Is the strategy feasible?**
   This is to determine whether the strategy is workable or could be put in practice. Assessing the feasibility of a strategy required a more detailed assessment of organizational resources and capabilities. The analytical approaches that can be used are funds flow analysis, break-even analysis and resource deployment analysis.

<u>Strategy Evaluation</u>

<u>Criteria</u>

The major factors are:
1. Value of key implementers
2. Market opportunities
3. Organization competence
4. Timing and risk

<u>Changing the Strategy Formulation</u>

Peter Drucker stated "in turbulent times, managers cannot assume that tomorrow will be an extension of today. On the contrary, they must manage for change; change alike as an opportunity and threat."
Strategy formulation is a continuous process, on ongoing system. The strategy formulation may be changed due to reasons such as results are less impressive than might have been expected; internal changes or dramatic external changes. Factors such as increased competition, changing consumer behavior and change in the market structure necessitate new company strategies

<u>Establishing Strategic Control</u>

There is a considerable gap between the time a strategy is formulated and when it is implemented. As time elapses between the initial implementation of a strategy and achievement of its intended results, numerous actions and resource allocation has taken place. As changes are taking place in both the external and internal environment of the firm, there is a possibility that the assumptions made while formulating strategy do not remain valid or, at least, are no longer valid

Strategic controls are necessary to steer the firm through these events.

The four basis types of strategic controls are:

a. Premise control

b. Implementation control

c. Strategic surveillance

d. Special alert control

a) Premise Control

- Every strategy is based on certain planning premises i.e. assumption about environmental and organizational factors.
  Premise control is designed to systematically and continuously check whether the premises on which the strategy is based are still valid. Premise control serves the purpose of continually testing the assumptions to determine whether they are still valid or not.
  Enables strategists to take corrective action at the right time rather than continuing with a strategy based on valid assumptions.

b) Implementation control

Strategy implementation takes place as a series of steps, program and investments. Implementation control is aimed at evaluating whether these programs and investments are actually guiding the organization towards its predetermined objectives or not.

Implementation control is designed to assess whether the overall strategy needs to be changed in light of the current available results, due to implementation carried out so far.

Implementation control may be put into practice through identification and monitoring of strategic thrusts such as an assessment of the marketing success of a new product after pre-testing or checking the feasibility of a diversification program after initial attempts at seeking technological collaboration.

Another method of Implementation control is milestone reviews, through which critical points in strategy implementation are identified in terms of events, major resource allocation, or time. After identification milestones, a comprehensive review of implementation is made to reassess its continued relevance to achievement of objectives.

c) Strategic surveillance

The premise and implementation types of strategic controls are focused in nature. Strategic surveillance, on the other hand, is aimed at a more generalized control designed to monitor a broad range of events inside and outside the company that are likely to threaten the course of a firm`s strategy. Strategic surveillance can be carried out through a broad-based, general monitoring based on selected information sources to uncover events that are likely to affect the strategy of an organization

d) Special alert control

Special alert control is the thorough and quick analysis and reconsideration of a firm`s strategy due to an unexpected situation. This is a trigger mechanism for rapid response and immediate reassessment of strategy in the light of sudden and unexpected events

Operational Control

The basic theme of strategic control is to continually assess the changing environment to uncover events that may significantly affect the course of an organization`s strategy. Strategy controls by which top management monitors and steers the basic direction of the company should be supplemented by a control system at the operational level of strategy implementation. An operational control system comprises all the operational groups and promotes operation efficiency. While strategic controls attempt to steer the company over an extended time period, operational controls provide post-action evaluation and control over short time periods – usually from one month to one year.
Operational controls involve measurement of the enterprise and its degree of success. Such controls extend to every level of business activity. The operational control system involves the following steps:

1. Establishing criteria and standards
2. Measuring and comparing performance
3. Performance gap analysis
4. Taking corrective measures

Types of operational control

- Budgeting
- Scheduling
- Key success factors

Importance of strategic management

- Taking an organization-wide, proactive approach to a changing global world.
- Building an executive team that serves as a model of cross-functional or horizontal teamwork.
- Having an intense executive development and strategic orientation process.
- Defining focused, quantifiable outcomes and measures of success.
- Making intelligent budgeting decisions.
- Clarifying the firm`s competitive advantage.
- Reducing conflict; empowering the organization.
- Providing clear guidelines for day-to-day decision making.
- Creating a critical mass for change.
- Singing from the same hymnal" throughout the organization.
- Clarifying and simplifying the barrage of management techniques.
- Empowering middle managers.
- Focusing everyone in the organization in the same overall framework.
- Speeding up implementation of the core strategies.
  Providing tangible tools for dealing with the stress of change