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Models of Strategic Management: Mintzberg, Ansoff, Porter, Prahalad and Gary Hammel, McKinsey’s 7’S Framework: A Tool to Evaluate and Control an Organisation


Competitive Analysis: Competitor Analysis Framework, Rivalry Analysis, Competitive Dynamics, Competitive Rivalry


Analyzing Resources and Capabilities: Factors affecting the Internal Environment, Resources and Capabilities as Sources of Profit, Resources of the Firm, Organizational Capabilities, Appraising Resources and Capabilities, Putting Resource and Capability Analysis to Work, Developing Resources and Capabilities
**Formulating Functional Level Strategy:** Putting Strategy into Action, Structural Design, Information and Control System, Human Resources

**Corporate Goals and Strategic Gap:** Corporate Goals, Strategic Gap, Porter’s Generic Strategies

CHAPTER

INTRODUCTION TO STRATEGIC MANAGEMENT

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RISE AND DOWNSWALL OF KODAK

Eastman Kodak revolutionised the photography industry by recording images on a film (as against the traditional glass plates) through a novel product called portable camera, in early 1901. The camera was a major hit with millions of customers. The name – Kodak – became the most respected brand of photographic films almost instantaneously. Continuous innovations (especially the colour film – those yellow little boxes of film) and the absence of competition took Eastman Kodak Company to dizzying heights over the years. It became a giant corporation registering sales of over $20 billion by 1990 – powered by contributions from a vast army of over 1 lakh employees. The ad campaign: “You press the button; we do the rest” – made Kodak a household name all over the globe. Meanwhile, Fuji Photo Film Company of Japan entered the fray with a little green box of film that challenged Kodak’s dominance for over a century. Using latest manufacturing technologies, Fuji cut the price down aggressively without, of course, sacrificing quality. For the customers, both were equally good. But the big price differential between product prices brought Kodak down and the company lost the title of “official film of the 1984 Summer Olympics to Fuji. From then onwards, Fuji gained market share steadily as customers came to realise that Fuji is a legitimate alternative to Kodak and is not just a low price brand.

The introduction of digital imaging technologies at around the same time from the likes of Sony, Canon, Motorola, Casio and Hewlett-Packard changed the rules of the game, more or less, permanently. In the interim, a bad acquisition (a pharma company) and some failed innovations (entering office copier business, introducing a 35mm camera; a disposable camera – in a belated manner — and some heavy investments in Kodak Advantix system running to over $200 million) have had a telling effect on the brand image. When the mobile phone technology took off and the home computer market exploded in a big way, it was all over for Kodak (2008 reported revenues just $442 million). The lethargic response to tumultuous changes in the industry environment, according to experts, brought the company down. As Trout commented, ‘if you are known for one thing, the market will not give you another thing’. Kodak is a film in the minds of the marketplace and not camera (Nikon fits such a description). As it turned out, Kodak could not find a rewarding space in the marketplace beyond the realm of conventional photography. When you fail to make intelligent moves – proactively and in sync with market expectations and remain stuck with a well-entrenched position and fail miserably in exploiting emerging opportunities, you get punished and pushed aside. Before hiding its head in the sand, Kodak did try a trick or two to cover the lost ground by embracing the digital imaging technology. However, it was too late for it to make any difference.
Adding salt to its injuries, due to fierce competition, the digital camera business got commoditised and the Kodak brand did not offer any value for money. In 2006, the company had to close the business and show the door to over 27,000 people. The most respected brand for over 100 years in photographic films had been decimated beyond belief within a span of just 10 years!
After studying this chapter, you should be able to:

- Appreciate the meaning and definition of strategic management
- Identify the nature and dimensions of strategic management
- Evaluate the need and significance of strategic management
- Describe the process of strategic management
- Discuss the vision in strategic management
- Explain the mission in strategic management
- Know about the business definitions of strategic management

1.1 INTRODUCTION

The firm’s strategy process is how its managers envision a possible future and guide the firm toward it. This ‘possible future’ is a moving target. The firm and the environment change in unpredictable ways. So, ‘guiding the firm’ does not mean formulating a strategy for others to implement. The firm must be structured and its processes shaped so that it follows the right strategic path in an ever-changing world.

Strategic management is a dynamic process of aligning strategies, performance and business results; it is all about people, leadership, technology and processes. Effective combination of these elements will help with strategic direction and successful service delivery. It is a continuous activity of setting and maintaining the strategic direction of the organisation and its business, and making decisions on a day-to-day basis to deal with changing circumstances and the challenges of the business environment. As part of your strategic thinking about advancing the business, you (and your partners) will have set a course for a particular direction, but subsequent policy drivers (such as new performance targets) or business drivers (such as increased demand for services) could take the organisation in a different direction. There could be implications for accountability when you decide whether to take corrective action to get back on course or to go with the new direction. Similarly, there could be implications for governance if relationships with partners change.

Strategic management is exciting and challenging. It makes fundamental decisions about the future direction of a firm – its purpose, its resources and how it interacts with the environment in which it operates. Every aspect of the organisation plays a role in strategy – its people, its finances, its production methods, its customers and so on.

Strategic management can be described as the identification of the purpose of the organisation and the plans and actions to achieve that purpose. It is that set of managerial decisions and actions that determine the long-term performance of a business enterprise.
It involves formulating and implementing strategies that will help in aligning the organisation and its environment to achieve organisational goals. Strategic management does not replace the traditional management activities such as planning, organising, leading or controlling. Rather, it integrates them into a broader context taking into account the external environment and internal capabilities and the organisation’s overall purpose and direction. Thus, strategic management involves those management processes in organisations through which future impact of change is determined and current decisions are taken to reach a desired future. In short, strategic management is about envisioning the future and realising it.

### 1.2 Definitions of Strategic Management

To get an understanding of what goes on in strategic management, it is useful to begin with definitions of strategic management. In this chapter, we introduce the elements and the process of strategic management and the importance, benefits and limitations of strategic management.

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

“Strategic management is concerned with the determination of the basic long-term goals and the objectives of an enterprise and the adoption of courses of action and allocation of resources necessary for carrying out these goals”.

– Alfred Chandler, 1962

“Strategic management is a stream of decisions and actions which lead to the development of an effective strategy or strategies to help achieve corporate objectives”.

– Glueck and Jauch, 1984

“Strategic management is a process of formulating, implementing and evaluating cross-functional decisions that enable an organisation to achieve its objective”.

– Fed R David, 1997

“Strategic management is the set of decisions and actions resulting in the formulation and implementation of plans designed to achieve a company’s objectives.”

– Pearce and Robinson, 1988

“Strategic management includes understanding the strategic position of an organisation, making strategic choices for the future and turning strategy into action.”

– Johnson and Sholes, 2002
“Strategic management consists of the analysis, decisions, and actions organisation undertakes in order to create and sustain competitive advantages.”

– Dess, Lumpkin & Taylor, 2005

We observe from the above definitions that different authors have defined strategic management in different ways. Note that the definition of Chandler that we have quoted above is from the early 1960s, the period when strategic management was being recognised as a separate discipline. This definition consists of three basic elements:

- Determination of long-term goals
- Adoption of courses of action
- Allocation of resources to achieve those goals

Though, this definition is simple, it does not consist of all the elements and does not capture the essence of strategic management.

The definitions of Fred R. David, Pearce and Robinson, Johnson and Sholes and Dell, Lumpkin and Taylor are some of the definitions of recent origin. Taken together, these definitions capture three main elements that go to the heart of strategic management. The three on-going processes are strategic analysis, strategic formulation and strategic implementation. These three components parallel the processes of analysis, decisions and actions. That is, strategic management is basically concerned with:

- **Analysis** of strategic goals (vision, mission and objectives) along with the analysis of the external and internal environment of the organisation.

- **Decisions** about two basic questions:
  - What businesses should we compete in?
  - How should we compete in those businesses to implement strategies?

- **Actions to implement strategies.** This requires leaders to allocate the necessary resources and to design the organisation to bring the intended strategies to reality. This also involves evaluation and control to ensure that strategies are effectively implemented.

The real strategic challenge to managers is to decide on strategies that provide competitive advantage that can be sustained over time. This is the essence of strategic management, and Dess, Lumpkin and Taylor have rightly captured this element in their definition.
Fill in the blanks:
1. Strategic management provides overall ....................... to the enterprise.
2. Strategic management is a question of interpreting, and continuously ....................... the possibilities presented by ....................... circumstances for advancing an organisation’s objectives.
3. The foundation of strategy is a definition of organisational .......................  

Select an FMCG company of your choice. Collect data on new brands introduced in different product categories in the last one year. Can you identify the similarity in strategies adopted by the company in successive product launches?

**1.3 NATURE OF STRATEGIC MANAGEMENT**

Strategic management can be defined as the art and science of formulating, implementing, and evaluating, cross-functional decisions that enable an organisation to achieve its objectives. Strategic management is different in nature from other aspects of management. An individual manager is most often required to deal with problems of operational nature. He generally focuses on day-to-day problems such as the efficient production of goods, the management of a sales force, the monitoring of financial performance or the design of some new system that will improve the level of customer service.

These are all very important tasks. But they are essentially concerned with effectively managing resources already deployed, within the context of an existing strategy. In other words, operational control is what managers are involved in most of their time. It is vital to the effective implementation of strategy, but it is not the same as strategic management.

**DEFINITION**

Strategic management involves elements geared toward a firm’s long-term survival and achievement of management goals.

The components of the content of a strategy making process include a desirable future, resource allocation, management of the firm-environment and a competitive business ethics.
Fill in the blank:
4. An individual is most often required to deal with problems of
..........................
Multi-functional or multi-business consequences: Strategic management has complex implications for most areas of the firm. They impact various strategic business units especially in areas relating to customer-mix, competitive focus, organisational structure etc. All these areas will be affected by allocations or reallocations of responsibilities and resources that result from these decisions.

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

Self Assessment Questions

Fill in the blank:
5. Organisations set up appropriate monitoring and control systems, develop standards and targets to judge ..................

Activity

Cyrus Mistry is the new Chairman of the Tata Group. Identify three decisions of Cyrus Mistry which have long-term implications and are futuristic.

1.5 NEED FOR STRATEGIC MANAGEMENT

No business firm can afford to travel in a haphazard manner. It has to travel with the support of some route map. Strategic management provides the route map for the firm. It makes it possible for the firm to take decisions concerning the future with a greater awareness of their implications. It provides direction to the company; it indicates how growth could be achieved.

The external environment influences the management practices within any organisation. Strategy links the organisation to this external world. Changes in these external forces create both opportunities and threats to an organisation's position – but above all, they create uncertainty. Strategic planning offers a systematic means of coping with uncertainty and adapting to change. It enables managers to consider how to grasp opportunities and avoid problems, to establish and coordinate appropriate courses of action and to set targets for achievement.

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

- It helps the firm to be more proactive than reactive in shaping its own future.
- It provides the roadmap for the firm. It helps the firm utilise its resources in the best possible manner.
- It allows the firm to anticipate change and be prepared to manage it.
- It helps the firm to respond to environmental changes in a better way.
- It minimises the chances of mistakes and unpleasant surprises.
- It provides clear objectives and direction for employees.

**SELF ASSESSMENT QUESTIONS**

Fill in the blank:

6. .................................. and .................................. of strategy rarely proceed according to plan.

**ACTIVITY**

You had a definite plan in mind about new product launches for the new financial year. Three months after the plan was made, you find that you have to make frequent changes to the original plan because of business environmental factors. Should you discard planning altogether? If no, give reasons.

### 1.6 STRATEGIC MANAGEMENT PROCESS

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

**Strategic Analysis:** The foundation of strategy is a definition of organisational purpose. This defines the business of an organisation and what type of organisation it wants to be. Many organisations develop broad statements of purpose, in the form of vision and mission statements. These form the springboards for the development of more specific objectives and the choice of strategies to achieve them.

**Environmental Analysis:** Assessing both the external and internal environments is the next step in the strategy process. Managers need to assess the opportunities and threats of the external environment in the light of the organisation’s strengths and weaknesses keeping in view the expectations of the stakeholders. This analysis allows the organisation to set more specific goals or objectives which might specify
where people are expected to focus their efforts. With a more specific set of objectives in hand, managers can then plan how to achieve them.

**Strategic Choice:** The analysis stage provides the basis for strategic choice. It allows managers to consider what the organisation could do given the mission, environment and capabilities – a choice which also reflects the values of managers and other stakeholders. These choices are about the overall scope and direction of the business. Since managers usually face several strategic options, they often need to analyse these in terms of their feasibility, suitability and acceptability before finally deciding on their direction.

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

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

Table 1.1 summarises the steps involved in each of the above elements of strategic management.

### TABLE 1.1: STEPS INVOLVED IN THE STRATEGIC MANAGEMENT PROCESS

<table>
<thead>
<tr>
<th>Elements in strategy process</th>
<th>Questions</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRATEGY FORMULATION</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategic Analysis</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defining organisational purpose</td>
<td>What is our purpose?</td>
<td>Organisational purpose is generally articulated in vision and mission statements. The first task is, therefore, to identify vision and mission of the organisation.</td>
</tr>
<tr>
<td></td>
<td>What kind of organisation do we want to be?</td>
<td>Environmental analysis involves the gathering and analysis of intelligence on the business environment. This encompasses the external environment (general and competitive forces), the internal environment (resources, competences, performance relative to competitors), and stakeholder expectations.</td>
</tr>
</tbody>
</table>

Contd...
Strategic Choice

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Where do we want to be?</th>
<th>Objectives provide a more detailed articulation of purpose and a basis for monitoring performance.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Options analysis</td>
<td>Are there alternative routes?</td>
<td>Alternative strategic options may be identified; options require to be appraised in order that the best can be selected.</td>
</tr>
<tr>
<td>Strategies</td>
<td>How are we going to get there?</td>
<td>Strategies are the means or courses of action to achieve the purpose of the organisation.</td>
</tr>
</tbody>
</table>

Strategy Implementation

| Actions | How do we turn plans into reality? | A specification of the operational activities and tasks required to enable strategies to be implemented. |

Strategy Evaluation and Control

| Monitoring and control | How will we know if we are getting there? | Monitoring performance and progress in meeting objectives, taking corrective action as necessary and reviewing strategy. |

The above steps can also be depicted as a series of processes involved in strategic management.

It can also be shown through a general framework as given in Figure 1.1.

Figure 1.1: General Framework of Strategic Management Process
The seven steps in the above model of strategy process fall into three broad phases – formulation, implementation and evaluation – though in practice the three phases interact closely.

Good strategists know that formulation and implementation of strategy rarely proceed according to plan, partly because the constantly changing external environment brings new opportunities or threats, and partly because there may also be inadequate internal competence. Since these may lead the management to change the plan, there will be frequent interaction between the activities of formulating and implementing strategy, and management may need to return and reformulate the plan.

1.6.1 STRATEGY LEVELS

Many organisations develop strategies at four different levels: corporate, business, functional and production level.

**Figure 1.2: Structure of the Strategy Level**

**Corporate Level Strategy:** It is the process of defining the overall character and purpose of the organisation, the business it will enter and leave and how resources will be distributed among those businesses. Strategy at this level is typically developed by top management (The Board of Directors, CEO etc.). The decisions are broad-based, carry greater risk and affect most parts of the organisation (e.g. the type of business that the organisation should enter, changes required in growth strategy, acquisition and Diversification decisions etc.).

**Business Level Strategy:** It is the planning process concerned primarily with how to manage the interests and operations of a particular unit within the organisation, commonly known as a Strategic Business Unit (SBU). A strategic business unit is a distinct business with its own set of competitors that can be managed reasonably independently of other businesses within the organisation. Generally, the heads of the respective business units develop business strategies, with the approval of top management. Strategies at this level are aimed at deciding the competitive advantage to build, determining responses to changing market situations, allocating resources
within the business unit and coordinating functional-level strategies developed by functional managers.

**Functional Level Strategy:** It is the process of determining policies and procedures for (relatively narrow levels of activity) different functions of an enterprise like marketing, finance, personnel, IT, R&D, HR and Manufacturing etc. These are developed by functional managers and are typically reviewed by business unit heads.

**Product Level Strategy:** It is the process of determining the cost, quality, quantity, raw material, supplies, categories, brands, range etc. of the product the organisation manufacture. Sometimes this level of strategy is undertaken in functional level strategy itself in many organisations.

Coordinating strategies across the four levels is crucial in maximising strategic impact.

### 1.6.2 TYPOLOGIES AND METHODS OF STRATEGY

The different typologies and methods of strategy are shown in Table 1.2.

<table>
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<th>Strategy</th>
<th>Typologies/ Methods</th>
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<td>Dominance strategies</td>
<td>Leader, Challenger, Follower, Nicher</td>
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<td>Innovation strategies</td>
<td>Pioneers, Close followers, Late followers</td>
</tr>
<tr>
<td>Growth strategies</td>
<td>Integration, Diversification, Intensification</td>
</tr>
<tr>
<td>Co-operative strategies</td>
<td>JV, licensing, strategic alliance, technology tie-up</td>
</tr>
<tr>
<td>Miles &amp; Snow strategy of firms typology</td>
<td>Prospector, Analyser, Defender, Reactor</td>
</tr>
</tbody>
</table>

Now we will discuss all the typologies and methods of strategy in the following paragraphs.

**Dominance Strategies**

Dominance strategies are a type of marketing strategy that classifies firms based on their market share or dominance of an industry.

Dominance is a measure of the strength of a brand, product, service, or firm, relative to competitive offerings. There is often a geographic element to the competitive landscape. In defining market dominance, you must see to what extent a product, brand, or firm controls a product category in a given geographic area. Typically there are four types of dominance strategies that a manager will consider. There are leader, challenger, follower and nichers.
Leader

The market leader is dominant in its industry. It has substantial market share and often extensive distribution arrangements with retailers. It typically is the industry leader in developing innovative new business models and new products (although not always). It tends to be on the cutting edge of new technologies and new production processes. It sometimes has some market power in determining either price or output. Of the four dominance strategies, it has the most flexibility in crafting strategy. There are few options not open to it. However it is in a very visible position and can be the target of competitive threats and government anti-merger actions.

Research in experience curve effects and the PIMs study during the 1970s concluded that market leadership was the most profitable strategy in most industries. It was claimed that if you cannot get enough market share to be a major player, you should get out of that business and concentrate your resources where you can take advantage of experience curve effects and economies of scale, and thereby gain dominant market share. Today we recognise that other less dominant strategies can also be effective.

The main options available to market leaders are:

- Expand the total market by finding:
  - new users of the product
  - new uses of the product
  - more usage on each use occasion
- Protect your existing market share by:
  - developing new product ideas
  - improve customer service
  - improve distribution effectiveness
  - reduce costs
- Expand your market share:
  - by targeting one or more competitor
  - without being noticed by government regulators.

Challenger

A challenger is a firm in a strong, but not dominant position that is following an aggressive strategy of trying to gain market share. It typically targets the industry leader (for example, Pepsi targets Coke), but it could also target smaller, more vulnerable competitors. The fundamental principles involved are:

- Assess the strength of the target competitor. Consider the amount of support that the target might muster from allies.
Choose only one target at a time.

Find a weakness in the target’s position. Attack at this point. Consider how long it will take for the target to realign their resources so as to reinforce this weak spot.

Launch the attack on as narrow a front as possible. Whereas a defender must defend all their borders, an attacker has the advantage of being able to concentrate their forces at one place.

Launch the attack quickly, then consolidate.

Some of the options open to a market challenger are:

- Price discounts or price cutting
- Line extensions
- Introduce new products
- Reduce product quality
- Increase product quality
- Improve service
- Change distribution
- Cost reductions
- Intensify promotional activity.

**Follower**

A market follower is a firm in a strong, but not dominant position that is content to stay at that position. The rationale is that by developing strategies that are parallel to those of the market leader, they will gain much of the market from the leader while being exposed to very little risk. This “play it safe” strategy is how Burger King retains its position behind McDonalds. The advantages of this strategy are:

- no expensive R&D failures
- no risk of bad business model
- “best practices” are already established
- able to capitalise on the promotional activities of the market leader
- no risk of government anti-combines actions
- minimal risk of competitive attacks
- don’t waste money in a head-on battle with the market leader.

**Nicher**

In this niche strategy, the firm concentrates on a select few target markets. It is also called a focus strategy. It is hoped that by focusing ones marketing efforts on one or two narrow market segments and tailoring your marketing mix to these specialised markets, you can better meet the needs of that target market. The niche should be large
enough to be profitable, but small enough to be ignored by the major industry players. Profit margins are emphasised rather than revenue or market share. The firm typically looks to gain a competitive advantage through effectiveness rather than efficiency. It is most suitable for relatively small firms and has much in common with guerrilla marketing warfare strategies. The most successful nichers tend to have the following characteristics:

- They tend to be in high value added industries and are able to obtain high margins.
- They tend to be highly focused on a specific market segment.
- They tend to market high end products or services, and are able to use a premium pricing strategy.
- They tend to keep their operating expenses down by spending less on R&D, advertising and personal selling.

Innovation Strategies

Innovation strategies is all about who is on the cutting edge, who churns out the new products and technologies before anyone else. The company is a pioneer, close follower or late follower.

- **Pioneer**: The firm or the organisation concentrates on being the one with the newest, hottest products around. The company promise that its customers will get the new technology before anyone else does.

- **Close follower**: The company waits for other to pioneer in different direction, and when they are on to something, the company quickly adopts it, improve it and make it the company’s own innovation.

- **Late follower**: The company adopts only the most stable of technology, the company stress to its customers that the products of the company will be stable, tried and tested, with no bugs or last minute recalls.

Growth Strategies

When operating under growth strategies, the company focus should be on how to make its business grow. The company use:

- **Horizontal integration**: The company tries to expand by acquiring or starting new business in the same field as its main business, this way the company control a bigger market share, and sideline the competition.

- **Vertical integration**: The company tries to acquire or start businesses that supply your current business or sell its products. This way the company can have a stable production and delivery structure.
Co-operative Strategies

Cooperative strategies are becoming increasingly important for large corporations because technology continues to drive many important markets. The rapid advance of knowledge in many fields and the growing technical sophistication of the present day consumers are driving the companies to cooperate with specialist firms. Strategic alliances represent one of the more innovative methods of cooperation, and they are being actively exploited.

Joint ventures: Joint ventures, alliances, and other corporate partnering are fuelling the growth of the world’s most unsuccessful companies. The demand to deliver more new products, quicker, and at lower prices has never been greater. Joint ventures and other collaborative business arrangements are revolutionising how winning companies compete. They permit companies to enter new markets and field new products that they otherwise couldn’t do on their own. They are the quickest way to grow a company, particularly in times of change.

Licensing: A contractual agreement whereby one company (the licensor) makes an asset available to another company (the licensee) in exchange for royalties, license fees, or some other form of compensation

- Patent
- Trade secret
- Brand name
- Product formulations

Advantages of Licensing

- Provides additional profitability with little initial investment
- Provides method of circumventing tariffs, quotas and other export barriers
- Attractive ROI
- Low costs to implement

Disadvantages of Licensing

- Limited participation
- Returns may be lost
Lack of control
Licensee may become competitor
Licensee may exploit company resources

**Special Licensing Arrangements**

- **Contract manufacturing:**
  - Company provides technical specifications to a subcontractor or local manufacturer.
  - Allows company to specialise in product design while contractors accept responsibility for manufacturing facilities.

- **Franchising:** Contract between a parent company-franchisor and a franchisee that allows the franchisee to operate a business developed by the franchisor in return for a fee and adherence to franchise-wide policies.

- **Technology Tie-up:** Technology tie-ups give the companies double advantage of adopting – the new and advanced technology resulting in improved and better productivity and the next thing is that the company increases its size and people.

**BOX 1.1: BHEL AND ALSTOM IN TECHNOLOGY TIE-UP**

**Tuesday, 16 Jan., 2007**

Bharat Heavy Electricals and Alstom of France, on 15th January 2007, entered into a technology transfer agreement for Alstom technology for supercritical power equipment of rating 800 MW and higher.

The ministry of heavy industries has opined that BHEL and Alstom would be major players in India's effort to add 1,50,000 MW of power capacity over the next ten years.

In a related development, the ministry also stated that India offers huge opportunity for investment and collaboration in a number of sectors including energy, automobiles, capital goods, chemicals, services, urban development and infrastructure. Besides, with the isolation of India in the nuclear sector coming to an end, the collaboration areas in nuclear energy also offer a big possibility.

*Source: www.projectstoday.com/News/NewsDetails*

**Miles & Snow Strategy of Firms Typology**

Since its publication in 1978, Miles and Snow's Organisational Strategy, Structure, and Process (Miles & Snow, 1978) has had considerable influence on the fields of strategic management and organisation theory (Hambrick, 1983). Up to 2003, over 1100 scholarly works have cited the book, paying attention especially to the Miles and Snow strategy typology highlighted in the book (Ketchen, 2003). Based on field studies in four industries, Miles and Snow classify firms...
within a given industry into four groups, i.e. defenders, prospectors, analysers and reactors, depending on how a firm responds to the three major problems facing the firm (entrepreneurial, engineering and administrative problems).

- **Defenders:** Defenders have a limited range of products and focus on efficiency and process improvement.

- **Prospectors:** Prospectors have a broad market/product domain and tend to lead change in the industry.

- **Analysers:** Analysers fall between the above two groups and are likely to follow a second-but-better strategy.

- **Reactors:** Reactors have no consistent strategy and they merely respond passively to environment pressure.

Miles and Snow argued that companies develop their adaptive strategies based on their perception of their environments. Hence, as seen above, the different organisation types view their environments in different ways, causing them to adopt different strategies. These adaptive strategies allow some organisations to be more adaptive or more sensitive to their environments than others, and the different organisation types represent a range of adaptive companies. Because of their adaptive strategies, prospector organisations are the most adaptive type of company. In contrast, reactor organisations are the least adaptive type. The other two types fall in between these extremes: analysers are the second most adaptive organisations, followed by defenders.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

7. Once a firm has committed itself to a particular strategy, its ....................... and ....................... are tied to it.

8. ....................... basic characteristics distinguish functional strategies from corporate level and business level strategies.

**ACTIVITY**

Classify the following companies as pioneers, close followers and late followers and state reasons behind your choice:

- Apple
- Nokia
- Samsung
- Panasonic
The strength of the business-level strategy is enhanced when functional level strategies support its basic thrust. Similarly, the corporate level is likely to have greater impact when business level strategies support one another in bolstering the corporate level strategy.

1.7 VISION

The first task in the process of strategic management is to formulate the organisation’s vision and mission statements. These statements define the organisational purpose of a firm. Together with objectives, they form a “hierarchy of goals” as shown in Figure 1.3.

![Figure 1.3: Hierarchy of Goals](image)

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

Vision can be defined as “a mental image of a possible and desirable future state of the organisation” (Bennis and Nanus). It is “a vividly descriptive image of what a company wants to become in future”. Vision represents top management’s aspirations about the company’s direction and focus. Every organisation needs to develop a vision of the future. A clearly articulated vision moulds organisational identity, stimulates managers in a positive way and prepares the company for the future.

“The critical point is that a vision articulates a view of a realistic, credible, attractive future for the organisation, a condition that is better in some important ways than what now exists.”
According to Collins and Porras, a well-conceived vision consists of two major components:

- Core ideology
- Envisioned future

Core ideology is based on the enduring values of the organisation (“what we stand for and why we exist”), which remain unaffected by environmental changes. Envisioned future consists of a long-term goal (what we aspire to become, to achieve, to create) which demands significant change and progress.

### 1.7.1 DEFINING VISION

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

A number of authors have given their definitions of organisational vision as per their findings and experiences, some of them are as follows:

- **Johnson**
  Vision is “clear mental picture of a future goal created jointly by a group for the benefit of other people, which is capable of inspiring and motivating those whose support is necessary for its achievement”.

- **Kirkpatrick et. al.**
  Vision is “an ideal that represents or reflects the shared values to which the organisation should aspire”.

- **Thornberry**
  Vision is “a picture or view of the future. Something not yet real, but imagined. What the organisation could and should look like. Part analytical and part emotional”.

- **Shoemaker**
  Vision is “the shared understanding of what the firm should be and how it must change”.

- **Kanter et. al.**
  Vision is “a picture of a destination aspired to, an end state to be achieved via the change. It reflects the larger goal needed to keep in mind while concentrating on concrete daily activities”.

- **Stace and Dunphy**
  Vision is “an ambition about the future, articulated today, it is a process of managing the present from a stretching view of the future”.

Most refer to a future or ideal to which organisational efforts should be directed. The vision itself is presented as a picture or image that serves as a guide or goal. Depending on the definition, it is referred to as inspiring, motivating, emotional and analytical. For Boal and Hooijberg, effective visions have two components:

- A cognitive component (which focuses on outcomes and how to achieve them)
- An affective component (which helps to motivate people and gain their commitment to it).

### 1.7.2 NATURE OF VISION

A vision represents an animating dream about the future of the firm. By its nature, it is hazy and vague. That is why Collins describes it as a Big Hairy Audacious Goal (BHAG). Yet it is a powerful motivator to action. It captures both the minds and hearts of people. It articulates a view of a realistic, credible, attractive future for the organisation, which is better than what now exists. Developing and implementing a vision is one of the leader’s central roles. He should not only have a “strong sense of vision”, but also a “plan” to implement it.

**Example:**

- Henry Ford’s vision of a “car in every garage” had power. It captured the imagination of others and aided internal efforts to mobilise resources and make it a reality. A good vision always needs to be a bit beyond a company’s reach, but progress towards the vision is what unifies the efforts of company personnel.

- One of the most famous examples of a vision is that of Disneyland “To be the happiest place on earth”. Other examples are:
  - **Hindustan Lever:** Our vision is to meet the everyday needs of people everywhere.
  - **Microsoft:** Empower people through great software any time, any place and on any device.
  - **Britannia Industries:** Every third Indian must be a Britannia consumer.

Although such vision statements cannot be accurately measured, they do provide a fundamental statement of an organisation’s values, aspirations and goals.

Some more examples of vision statements are given below:

- “A Coke within arm’s reaches of everyone on the planet” (Coca Cola)
- “Encircle Caterpillar” (Komatsu)
- “Become the Premier Company in the World” (Motorola)
- “Put a man on the moon by the end of the decade” (John F. Kennedy, April 1961)
Eliminate what annoys our bankers and customers” (Texas Commerce Bank)

“The one others copy” (Mobil).

1.7.3 CHARACTERISTICS OF VISION STATEMENTS

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

- **Possibility** means the vision should entail innovative possibilities for dramatic organisational improvements.
- **Desirability** means the extent to which it draws upon shared organisational norms and values about the way things should be done.
- **Actionability** means the ability of people to see in the vision, actions that they can take that are relevant to them.
- **Articulation** means that the vision has imagery that is powerful enough to communicate clearly a picture of where the organisation is headed.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

9. A .................. can be defined as the overall goal of an organisation that all business activities and processes should contribute toward achieving.

10. Formulation and implementation of strategy must occur side-by-side rather than ..................

11. When a strategy becomes internalised into a corporate culture, it can lead to ..................

12. Corporate vision is a short, succinct, and inspiring statement of what the organisation intends to ................. and to .................

**ACTIVITY**

Choose the vision statements of any five companies that you like. Prepare a presentation on how these vision statements inspire you and how these companies went about fulfilling their vision.

**NOTE**

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

“A mission statement is an enduring statement of purpose”. A clear mission statement is essential for effectively establishing objectives and formulating strategies.

A mission statement is the purpose or reason for the organisation’s existence. A well-conceived mission statement defines the fundamental, unique purpose that sets it apart from other companies of its type and identifies the scope of its operations in terms of products offered and markets served. It also includes the firm’s philosophy about how it does business and treats its employees. In short, the mission describes the company’s product, market and technological areas of emphasis in a way that reflects the values and priorities of the strategic decision makers.

As Fred R. David observes, mission statement is also called a creed statement, a statement of purpose, a statement of philosophy etc. It reveals what an organisation wants to be and whom it wants to serve. It describes an organisation’s purpose, customers, products, markets, philosophy and basic technology. In combination, these components of a mission statement answer a key question about the enterprise: “What is our business?”

1.8.1 DEFINING MISSION

Thompson defines mission as “The essential purpose of the organisation, concerning particularly why it is in existence, the nature of the business it is in, and the customers it seeks to serve and satisfy”. Hunger and Wheelen simply call the mission as the “purpose or reason for the organisation’s existence”.

A mission can be defined as a sentence describing a company’s function, markets and competitive advantages. It is a short written statement of your business goals and philosophies. It defines what an organisation is, why it exists and its reason for being. At a minimum, a mission statement should define who are the primary customers of the company, identify the products and services it produces, and describe the geographical location in which it operates.

Example:

- **Ranbaxy Pharmaceuticals**: “To become a research based global company”.
- **Reliance Industries**: “To become a major player in the global chemicals business and simultaneously grow in other growth industries like infrastructure”.
- **ONGC**: “To stimulate, continue and accelerate efforts to develop and maximize the contribution of the energy sector to the economy of the country”.
NOTES

- Cadbury India: “To attain leadership position in the confectionary market and achieve a strong national presence in the food drinks sector”.
- Hindustan Lever: “Our purpose is to meet everyday needs of people everywhere – to anticipate the aspirations of our consumers and customers, and to respond creatively and competitively with branded products and services which raise the quality of life”.
- McDonald: “To offer the customer fast food prepared in the same high quality worldwide, tasty and reasonably priced, delivered in a consistent low key décor and friendly manner”.

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

1.8.2 IMPORTANCE OF MISSION STATEMENT

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

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

Developing a comprehensive mission statement is also important because divergent views among managers can be revealed and resolved through the process.

According to Pearce (1982), vision and mission statements have the following value:

- They provide managers with a unity of direction that transcends individual, parochial and transitory needs.
- They promote a sense of shared expectations among all levels and generations of employees.
- They consolidate values over time and across individuals and interest groups.
- They project a sense of worth and intent that can be identified and assimilated by company outsiders.
Finally, they affirm the company’s commitment to responsible action, in order to preserve and protect the essential claims of insiders for sustained survival, growth and profitability of the firm.

According to Fred R. David, a mission statement is more than a statement of purpose. It is:
- a declaration of attitude and outlook;
- a declaration of customer orientation;
- a declaration of social policy and responsibility.

### 1.8.3 Characteristics of a Mission Statement

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

- **Not lengthy**: A mission statement should be brief.
- **Clearly articulated**: It should be easy to understand so that the values, purposes, and goals of the organisation are clear to everybody in the organisation and will be a guide to them.
- **Broad, but not too general**: A mission statement should achieve a fine balance between specificity and generality.
- **Inspiring**: A mission statement should motivate readers to action. Employees should find it worthwhile working for such an organisation.
- **Feeling and emotions**: It should arouse positive feelings and emotions of both employees and outsiders about the organisation.
- **Reflect the firm’s worth**: A mission statement should generate the impression that the firm is successful, has direction and is worthy of support and investment.
- **Relevant**: A mission statement should be appropriate to the organisation in terms of its history, culture and shared values.
- **Current**: A mission statement may become obsolete after some time. As Peter Drucker points out, “Very few mission statements have anything like a life expectancy of thirty, let alone, fifty years. To be good enough for ten years is probably all one can normally expect”. Changes in environmental factors and organisational factors may necessitate modification of the mission statement.
- **Unique**: An organisation’s mission statement should establish the individuality and uniqueness of the company.
- **Enduring**: A mission statement should continually guide and inspire the pursuit of organisational goals. It may not be fully achieved, but it should be challenging for managers and employees of the organisation.
Dynamic: A mission statement should be dynamic in orientation allowing judgments about the most promising growth directions and the less promising ones.

Basis for guidance: Mission statement should provide useful criteria for selecting a basis for generating and screening strategic options.

Customer orientation: A good mission statement identifies the utility of a firm’s products or services to its customers, and attracts customers to the firm.

A declaration of social policy: A mission statement should contain its philosophy about social responsibility including its obligations to the stakeholders and the society at large.

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

1.8.4 COMPONENTS OF A MISSION STATEMENT

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

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

1.8.5 FORMULATION OF MISSION STATEMENT

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

Mission statements are generally formulated as follows:

- In many cases, the mission is inherited i.e. the founder establishes the mission which may remain unchanged down the years or may be modified as the conditions change.

- In some cases, the mission statement is drawn up by the CEO and board of directors or a committee of strategists constituted for the purpose.

- Engaging consultants for drawing up the mission statement is also common.

- Many companies hold brainstorming sessions of senior executives to develop a mission statement. Soliciting employees’ views is also common.

- According to Fred R. David, an ideal approach for developing a mission statement would be to select several articles about mission statements and ask all managers to read these as background information. Then ask managers to prepare a draft mission statement for the organisation. A facilitator or a committee of top managers, merge these statements into a single document and distribute this draft mission statement to all managers. Then the mission statement is finalised after taking inputs from all the managers in a meeting. Thus, the process of developing a mission statement represents a great opportunity for strategists to obtain needed support from all managers in the firm.

- Decision on how best to communicate the mission to all managers, employees and external constituencies of an organisation are needed when the document is in its final form. Some organisations even develop a videotape to explain the mission statement and how it was developed.

- The practice in Indian companies appears to be a consultative-participative route. For example, at Mahindra and Mahindra, workshops were conducted at two levels within the organisation with corporate planning group acting as facilitators. The State Bank of India went one step ahead by inviting labour unions to partake in the exercise. Satyam Computers went one more step ahead by involving their joint venture companies and overseas clients in the process.

Although many organisations have mission statements, their value has sometimes been questioned. Kay (1996) asserts that visions or missions are indicative of a ‘wish-driven strategy’ that fails to recognise the limits to what might be possible, given finite organisational resources. He cites the case of Groupe Bull, a French computer
company, which for many years sought to challenge the supremacy of IBM, particularly in the large US market. After several attempts, Bull finally conceded that its mission was faulty. Kay’s analysis was that for 30 years Groupe Bull was: Driven not by an assessment of what it was, but by a vision of what it would like to be. Throughout, it lacked the distinctive capabilities that would enable it to realise that vision. Bull epitomises wish-driven strategy, based on aspiration, not capability (Kay, 1996).

In a study of some organisations, Leach (1996) found that mission statements and strategic vision had become fashionable. While in some organisations, mission statements had made a real impact in clarifying organisational values and culture, others regarded them only as symbolic public relations documents that had little effect as a management tool.

The dangers are not just that missions are unrealistic and fail to recognise an organisation’s capabilities (as in the case of Groupe Bull), but also that management fails to develop a belief in the mission statement throughout the organisation. People come to believe in and act upon the mission statement only when they see others doing so, especially senior management and other influential players. The ideas of the mission statement need to be cascaded through the structure to ensure a link between mission and day-to-day actions.

**BOX 1.2: MISSION OF TWO GLOBAL COMPANIES**

**Mission Statement of IBM**

At IBM, we strive to lead in the invention, development and manufacture of the industry’s most advanced information technologies, including computer systems, software, storage systems and microelectronics.

We translate these advanced technologies into value for our customers through our professional solutions, services and consulting businesses worldwide.

**Mission Statement of FedEx**

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

*Source:* ibm.com and fedex.com

### 1.8.6 EVALUATING MISSION STATEMENT

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

- The mission statement is clear and understandable to all parties involved. The organisation can articulate and relate to it.
- The mission statement is brief enough for most people to remember.
The mission statement clearly specifies the purpose of the organisation. This includes a clear statement about:
- what needs the organisation is attempting to fill (not what products or services are offered)?
- who the organisation’s target populations are?
- how the organisation plans to go about its business; that is, what its primary technologies are?

The mission statement should have a primary focus on a single strategic thrust.

The mission statement should reflect the distinctive competence of the organisation (e.g., what can it do best? What is its unique advantage?)

The mission statement should be broad enough to allow flexibility in implementation, but not so broad as to permit lack of focus.

The mission statement should serve as a template and be the same means by which the organisation can make decisions.

The mission statement must reflect the values, beliefs and philosophy of operations of the organisation.

The mission statement should reflect attainable goals.

The mission statement should be worked so as to serve as an energy source and rallying point for the organisation (i.e., it should reflect commitment to the vision).

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

13. The mission statement should have a primary focus on a ................. strategic thrust.

14. The mission statement should reflect ................. goals.

15. A mission can be defined as a sentence describing a company’s ................., ................. and .................

16. It is more important to communicate the mission statement to ................. than to .................

**ACTIVITY**

Select a company of your choice. Prepare a presentation on its mission statement assessing it in terms of focus, competence, values and strategic thrust.

**1.9 BUSINESS DEFINITION**

In its broadest sense, strategic management is about taking “strategic decisions.” A number of definitions given by various eminent authors
are already being given at the beginning of the chapter. In practice, a thorough strategic management process has three main components, shown in the Figure 1.4.

**Figure 1.4: Components of Strategic Management**

**Strategic Analysis**
This is all about the analysing the strength of businesses’ position and understanding the important external factors that may influence that position. The process of strategic analysis can be assisted by a number of tools, including:

- **PEST Analysis**: A technique for understanding the “environment” in which a business operates.
- **Scenario Planning**: A technique that builds various plausible views of possible futures for a business.
- **Five Forces Analysis**: A technique for identifying the forces which affect the level of competition in an industry.
- **Market Segmentation**: A technique which seeks to identify similarities and differences between groups of customers or users.
- **Directional Policy Matrix**: A technique which summarises the competitive strength of businesses operations in specific markets.
- **Competitor Analysis**: A wide range of techniques and analysis that seeks to summarise a businesses’ overall competitive position.
- **Critical Success Factor Analysis**: A technique to identify those areas in which a business must outperform the competition in order to succeed.
- **SWOT Analysis**: A useful summary technique for summarising the key issues arising from an assessment of a businesses “internal” position and “external” environmental influences.

**Strategic Choice**
This process involves understanding the nature of stakeholder expectations (the “ground rules”), identifying strategic options, and then evaluating and selecting strategic options.
Strategy Implementation

Often the hardest part, when a strategy has been analysed and selected, the task is then to translate it into organisational action.

**SELF ASSESSMENT QUESTIONS**

Fill in the blank:

17. Strategy formulation includes defining the ..................., specifying achievable ..................., developing .................... and setting policy guidelines.

**ACTIVITY**

Consider the three components of strategic management. Which of these three components is the toughest part? State reasons.

1.10 SUMMARY

- Strategic or institutional management is the conduct of drafting, implementing and evaluating cross-functional decisions that will enable an organisation to achieve its long-term objectives. It is a level of managerial activity under setting goals and over tactics.

- Strategic management is the process of specifying the organisation’s mission, vision and objectives; developing policies and plans, often in terms of projects and programs, which are designed to achieve these objectives, and then allocating resources to implement the policies and plans, projects and programs.

- Strategic management provides overall direction to the enterprise and is closely related to the field of Organisation Studies.

- Although a sense of direction is important, it can also stifle creativity, especially if it is rigidly enforced. In an uncertain and ambiguous world, fluidity can be more important than a finely tuned strategic compass.

- When a strategy becomes internalised into a corporate culture, it can lead to group think. It can also cause an organisation to define itself too narrowly.

- Even the most talented manager would no doubt agree that “comprehensive analysis is impossible” for complex problems.

- Formulation and implementation of strategy must thus occur side-by-side rather than sequentially, because strategies are built on assumptions which, in the absence of perfect knowledge, will never be perfectly correct.

- The essence of being “strategic” thus lies in a capacity for “intelligent trial-and-error” rather than linear adherence to finally honed and detailed strategic plans.
Strategic management is a question of interpreting, and continuously reinterpreting, the possibilities presented by shifting circumstances for advancing an organisation’s objectives.

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

It includes environmental scanning, strategy formulation, strategy implementation, evaluation and control.

Strategy formulation is the development of long range plans for the effective management of environmental opportunities and threats in light of corporate strengths and weaknesses.

Strategy formulation includes defining the corporate mission, specifying achievable objectives, developing strategies and setting policy guidelines.

Corporate strategy is one, which decides what business the organisation should be in, and how the overall group of activities should be structured and managed.

**KEY WORDS**

- **Mission**: A statement that declares what business a company is in and who its customers are.
- **Plan**: A set of intended actions, through which one expects to achieve a goal.
- **Strategic Choice**: Choice of course of action given the environment, mission and capabilities.
- **Strategic Management**: Stream of decisions and actions that lead to development of effective strategy.
- **Strategy**: A plan of action designed to achieve a particular goal.
- **Vision**: The overall goal of an organisation that all business activities and processes should contribute toward achieving.

### 1.11 DESCRIPTIVE QUESTIONS

1. What are the dimensions of strategic management? What explains the need for strategic management?
2. Examine the significance of strategic management.
3. “Strategic management process is the way in which strategists determine objectives and strategic decisions”. Discuss.
4. Bring out the distinguishing features of strategic management.
5. Can the process of strategic management really be depicted in a given model or it is a prompt and dynamic process? Give reasons.
6. Given the vision, as the new Director, what ideas would you want to implement to achieve the vision?

7. Has there ever been a time in your life when your vision of the future was so inspiring that you converted initial nay-sayers into followers later on? If yes discuss. If no, analyse a situation when it could have happened. Why do you think you failed?

8. Discuss a time when you established a vision for your team. What process was used? Were others involved in setting the vision? How did the vision contribute to the functioning of the unit?


10. What do you mean by business definition? Explain the tools of strategic analysis process.

1.12 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 1.4 & 1.5

The dimensions for Strategic Management comprises top management involvement, requirement of large amounts of resources, affecting the firm’s long-term prosperity, future-oriented, multi-functional or multi-business consequences and non-self generative decisions. The need for strategic management arises as it provides the route map for the firm and makes it possible for the firm to take decisions concerning the future with a greater awareness of their implications. It provides direction to the company; it indicates how growth could be achieved.

2. Refer to 1.3

The significance of strategic management deals with the art and science of formulating, implementing, and evaluating, cross-functional decisions that enable an organisation to achieve its objectives. Strategic management is different in nature from other aspects of management. An individual manager is most often required to deal with problems of operational nature. He generally focuses on day-to-day problems such as the efficient production of goods, the management of a sales force, the monitoring of financial performance or the design of some new system that will improve the level of customer service.

3. Refer to 1.6

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

4. Refer to 1.4 &1.5

The features of strategic management is concerned with effectively managing resources already deployed, within the context of an existing strategy. In other words, operational control is what managers are involved in most of their time. It is vital to the effective implementation of strategy, but it is not the same as strategic management. Strategic management involves elements geared toward a firm’s long-term survival and achievement of management goals. The components of the content of a strategy making process include a desirable future, resource allocation, management of the firm-environment and a competitive business ethics. Other distinguishing features include top management involvement, requirement of large amounts of resources, affecting the firm’s long-term prosperity, future-oriented, multi-functional or multi-business consequences and non-self generative decisions.
5. Refer to 1.4 & 1.6

Yes, the process of strategic management really be depicted in a given model and a prompt and dynamic process. It involves the seven steps of strategy process which fall into three broad phases – formulation, implementation and evaluation – though in practice the three phases interact closely. The reasons for a dynamic process are – top management involvement, requirement of large amounts of resources, affecting the firm’s long-term prosperity, future-oriented, multi-functional or multi-business consequences and non-self generative decisions.

6. Refer to 1.7 & 1.7.3

Vision can be defined as “a mental image of a possible and desirable future state of the organisation” (Bennis and Nanus). It is “a vividly descriptive image of what a company wants to become in future”. For achieving vision, it should have possibility, desirability, actionability and articulation.

7. Refer to 1.7.3

Yes. Vision statements deal with possibility, desirability, actionability and articulation.

8. Refer to 1.7.1, 1.7.2 & 1.7.3

Vision represents top management’s aspirations about the company’s direction and focus. Every organisation needs to develop a vision of the future. A clearly articulated vision moulds organisational identity, stimulates managers in a positive way and prepares the company for the future.

“The critical point is that a vision articulates a view of a realistic, credible, attractive future for the organisation, a condition that is better in some important ways than what now exists.” The process of vision include core ideology and envisioned future. Core ideology is based on the enduring values of the organisation (“what we stand for and why we exist”), which remain unaffected by environmental changes. Envisioned future consists of a long-term goal (what we aspire to become, to achieve, to create) which demands significant change and progress.

9. Refer to 1.8.6

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

10. Refer to 1.9

A business definition is a clear statement of the business the firm is engaged in or is planning to enter. The process of strategic analysis can be assisted by a number of tools, including PEST Analysis, Scenario Planning, Five Forces Analysis, Market Segmentation, Directional Policy Matrix and Competitor Analysis.
1.13 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS


E-REFERENCES

- http://www.differ.com/difference/Mission_Statement_vs_Vision_Statement
## MODELS OF STRATEGIC MANAGEMENT

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DELL'S GENERIC STRATEGIES

Over the years, DELL COMPUTERS is constantly changing, adapting and finding innovative ways to master its environment and push rivals to the wall. One thing, of course, has not changed: its focus on speed and low cost. It has retained its image of what it does best. A custom order placed with Dell at 9 am on Monday can be on a delivery truck by 9 pm on Tuesday. The company spent years developing a core competence in low cost and speedy delivery by squeezing time lags and inefficiencies out of the manufacturing and assembly process and then extending the same brutal standards to the supply chain. Just peep into the Tapfer Manufacturing Centre at the Dell’s headquarters and you will understand how Dell does things with meticulous care, passion and love. The parts storage does not occupy too much space (occupying the space of just an average bedroom!). Dell can receive parts in fifteen minutes that could take two days to reach IBM or Gateway. Boxes of microchips and electronic components skitter by on double decker conveyer belts. Assembly workers get the right part — whether you talk of microprocessors or combination of software being delivered at the right time with clock work precision. The system takes care of everything so as to reduce the number of worker touches per machine. Over 25,000 finished computers head off towards happy customer every day. Dell does everything in a very transparent manner providing complete information to employees, suppliers and customers. Precise coordination aided by sophisticated supply chain software means Dell can keep just two hours’ worth of parts inventory and replenish only when it needs throughout the day. The just-in-time system works so efficiently that nearly 8.5 percent of orders are built, customised and shipped within eight hours. Speed has enabled Dell to slash inventories and parts costs so low that it can under-price rivals by 10 to 15 per cent. Competitors having watched as more and more customers turned to Dell are trying to imitate the company’s way of doing business.
After studying this chapter, you should be able to:

- Evaluate the meaning, definition and significance of strategic management model
- Explain the strategic planning model of Mintzberg
- Analyse the strategic decision model of Ansoff
- Know about the generic strategies model of Porter
- Identify the core competency model of Prahalad and Hammel

2.1 INTRODUCTION

The term ‘strategy’ proliferates in discussions of business. Scholars and consultants have provided myriad models and frameworks for analysing strategic choice. Today there are a variety of firms and organisations having different nature and environment of work but every one has same objective that is to raise the sale of the firm. For doing so it needs to tailor its strategy of working in such a way that it can get its target or objective in the specified time with minimum possible wastage of resources. In this chapter, we will discuss a few such strategic models designed by various eminent management professionals in their long course of experience and expertise.

2.2 MINTZBERG

2.2.1 MINTZBERG’S FIVE P’S FOR STRATEGY

The word “strategy” has been used implicitly in different ways even if it has traditionally been defined in only one. Explicit recognition of multiple definitions can help people to manoeuvre through this difficult field. Mintzberg provides five definitions of strategy:

- Plan
- Ploy
- Pattern
- Position
- Perspective.

Plan

Strategy is a plan – some sort of consciously intended course of action, a guideline (or set of guidelines) to deal with a situation.

DEFINITION

Strategies have two essential characteristics: they are made in advance of the actions to which they apply, and they are developed consciously and purposefully.
Ploy

As plan, a strategy can be a ploy too, really just a specific manoeuvre intended to outwit an opponent or competitor.

Pattern

If strategies can be intended (whether as general plans or specific ploys), they can also be realised. In other words, defining strategy as plan is not sufficient; we also need a definition that encompasses the resulting behaviour: Strategy is a pattern – specifically, a pattern in a stream of actions. Strategy is consistency in behaviour, whether or not intended. The definitions of strategy as plan and pattern can be quite independent of one another: plans may go unrealised, while patterns may appear without preconception.

Plans are intended strategy, whereas patterns are realised strategy; from this we can distinguish deliberate strategies, where intentions that existed previously were realised, and emergent strategies where patterns developed in the absence of intentions, or despite them.

Position

Strategy is a position – specifically a means of locating an organisation in an “environment”. By this definition strategy becomes the mediating force, or “match”, between organisation and environment, that is, between the internal and the external context.

Perspective

Strategy is a perspective – its content consisting not just of a chosen position, but of an ingrained way of perceiving the world. Strategy in this respect is to the organisation what personality is to the individual. What is of key importance is that strategy is a perspective shared by members of an organisation, through their intentions and/or by their actions. In effect, when we talk of strategy in this context, we are entering the realm of the collective mind – individuals united by common thinking and/or behaviour.

2.2.2 MINTZBERG VIEWS ON STRATEGIC PLANNING

Mintzberg says “Strategic planning is not strategic thinking. Strategic planning often spoils strategic thinking, causing managers to confuse real vision with the manipulation of numbers. This confusion lies at the heart of the issue: the most successful strategies are visions, not plans.”

Strategic planning, as it has been practiced, has really been strategic programming, the articulation and elaboration of strategies or visions that already exist. When companies understand the difference between planning and strategic thinking, they can get back to what the strategy-making process should be: capturing what the manager learns from all sources and then synthesising that learning into a vision of the direction that the business should pursue.
Planners should make efforts around the strategy-making process rather than inside it. They should supply the formal analyses or hard data that is needed in strategic thinking, broadening the consideration of issues rather than trying to discover the one right answer. They should act as catalysts who support strategy-making by encouraging managers to think strategically.

Planning is about analysis, breaking down a goal or set of intentions into steps, formalising those steps so that they can be implemented almost automatically and articulating the anticipated consequences or results of each step. Strategic thinking, on the other hand, is about synthesis. It comprises – intuition and creativity. The result of strategic thinking is an integrated perspective of the enterprise, a not-too-precisely articulated vision of direction. Such strategies often cannot be developed on schedule and immaculately conceived. They must be free to appear at any time and at any place in the organisation, typically through messy processes of informal learning that must necessarily be carried out by people at various levels who are deeply involved with the specific issues at hand. Formal planning has always been dependent on the preservation and rearrangement of established categories. But real strategic change requires not merely rearranging the established categories, but inventing new ones. Strategy needs to function beyond the boxes, to encourage the informal learning that produces new perspectives and new combinations.

There are two types of planner, the analytical thinker and the creative thinker. Many organisations need both types and it is top management’s job to ensure it has them in appropriate proportions.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

1. Strategy is a plan – some sort of consciously ...................... course of action, a guideline to deal with a situation.

2. Strategy is a position – specifically a means of locating an ................. in an “environment”.

3. According to Mintzberg strategic ......................... is not strategic thinking.

**ACTIVITY**

Strategic planning often spoils strategic thinking, causing managers to confuse real vision with the manipulation of numbers. Yet, business leaders like N R Narayana Murthy suggest: “In God we trust, everybody else must bring data to the table.” Strategy planning then is more than mere number crunching. Discuss.
2.3 ANSOFF

Until the publication of corporate strategy, companies had little guidance on how to plan for, or make decisions about, the future. Traditional methods of planning were based on an extended budgeting system which used the annual budget, projecting it a few years into the future. By its nature, this system paid little or no attention to strategic issues.

With the advent of greater competition, higher interest in acquisitions, mergers and diversification, and greater turbulence in the business environment, however, strategic issues could no longer be ignored. Ansoff felt that, in developing strategy, it was essential to systematically anticipate future environmental challenges to an organisation, and draw up appropriate strategic plans for responding to these challenges. In corporate strategy, Igor Ansoff explored these issues, and built up a systematic approach to strategy formulation and strategic decision-making through a framework of theories, techniques and models.

2.3.1 STRATEGY DECISIONS

Ansoff identified four standard types of organisational decisions as related to strategy, policy, programmes, and standard operating procedures. The last three of these, he argued, are designed to resolve recurring problems or issues and, once formulated, do not require an original decision each time. This means that the decision process can easily be delegated. Strategy decisions are different, however, because they always apply to new situations and so need to be made anew every time.

Ansoff developed a new classification of decision-making, partially based on Alfred Chandler's work, Strategy and Structure (Cambridge, Mass, MIT Press, 1962). This distinguished decisions as either: strategic (focused on the areas of products and markets); administrative (organisational and resource allocating), or operating (budgeting and directly managing). Ansoff’s decision classification became known as Strategy-Structure-Systems, or the 3S model.

2.3.2 COMPONENTS OF STRATEGY

Ansoff argued that within a company’s activities there should be an element of core capability, an idea later adopted and expanded by Hamel and Prahalad. To establish a link between past and future
Ansoff identified four key strategy components:

- **Product-market scope**: A clear idea of what business or products a company was responsible for (predating the exhortations of Peters and Waterman to “stick to the knitting”).

- **Growth vector**: As explained in the section below on the Ansoff matrix, this offers a way of exploring how growth may be attempted.

- **Competitive advantage**: Those advantages an organisation possesses that will enable it to compete effectively. A concept later championed by Michael Porter.

- **Synergy**: Ansoff explained synergy as “2 + 2 = 5”, or how the whole is greater than the mere sum of the parts, and it requires an examination of how opportunities fit the core capabilities of the organisation.

### 2.3.3 ANSOFF MATRIX

Variously known as the “product-mission matrix” or the “2 × 2 growth vector component matrix”, the Ansoff Matrix remains a popular tool for organisations that wish to understand the risk component of various growth strategies, including product versus market development and diversification.

The matrix was first published in a 1957 article called ‘Strategies for diversification’ and the example below illustrates what such a matrix may look like the matrix shown in Figure 2.1.

![Figure 2.1: Ansoff’s Matrix Model](image)

**Figure 2.1: Ansoff’s Matrix Model**

**DEFINITION**

The Ansoff Growth matrix is a tool that helps businesses decide their product and market growth strategy.
Ansoff’s product/market growth matrix suggests that a business’ attempts to grow depend on whether it markets new or existing products in new or existing markets.

The output from the Ansoff product/market matrix is a series of suggested growth strategies that set the direction for the business strategy. These are described below:

**Market penetration:** Market penetration is the name given to a growth strategy where the business focuses on selling existing products into existing markets. Market penetration seeks to achieve four main objectives:

- Maintain or increase the market share of current products – this can be achieved by a combination of competitive pricing strategies, advertising, sales promotion and perhaps more resources dedicated to personal selling.
- Secure dominance of growth markets.
- Restructure a mature market by driving out competitors; this would require a much more aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors.
- Increase usage by existing customers – for example by introducing loyalty schemes.

A market penetration marketing strategy is very much about “business as usual”. The business is focusing on markets and products it knows well. It is likely to have good information on competitors and on customer needs. It is unlikely, therefore, that this strategy will require much investment in new market research.

**Market development:** Market development is the name given to a growth strategy where the business seeks to sell its existing products into new markets. There are many possible ways of approaching this strategy, including:

- New geographical markets, for example, exporting the product to a new country.
- New product dimensions or packaging, for example, New distribution channels.
- Different pricing policies to attract different customers or create new market segments.

**Product development:** Product development is the name given to a growth strategy where a business aims to introduce new products into existing markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets.

**Diversification:** Diversification is the name given to the growth strategy where a business markets new products in new markets. This
is an inherently more risk strategy because the business is moving into markets in which it has little or no experience. For a business to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of the risks.

Of the four strategies given in the matrix, market penetration requires increasing existing product market share in existing markets.

2.3.4 PARALYSIS BY ANALYSIS

It has sometimes been suggested that the application of the ideas in corporate strategy can lead to an over heavy emphasis on analysis. Ansoff himself recognised this possibility, however, and coined the now famous phrase “paralysis by analysis” to describe the type of procrastination caused by excessive planning.

2.3.5 TURBULENCE

The issue of turbulence underlies all of Ansoff’s work on strategy. One of his key aims in establishing a better framework for strategy formulation was to improve the existing planning processes of the stable, postwar economy of the USA, since he realised these would not be sufficient to cope with pressures that rapid and discontinuous change would place on them. By the 1980s change, and the pace of change, had become a key issue for management in most organisations.

Ansoff recognised, however, that if some organisations were faced with conditions of great turbulence, others still operated in relatively stable conditions. Consequently, although strategy formulation had to take environmental turbulence into account, one strategy could certainly not be made to fit every industry. These ideas are discussed in Implanting Strategic Management, where five levels of environmental turbulence are outlined as:

- **Repetitive**: Change is at a slow pace, and is predictable.
- **Expanding**: A stable marketplace, growing gradually.
- **Changing**: Incremental growth, with customer requirements altering fairly quickly.
- **Discontinuous**: Characterised by some predictable change and some more complex change.
- **Surprising**: Change which cannot be predicted and which both develops, and develops from, new products or services.

2.3.6 ANSOFF’S WORK IN PERSPECTIVE

Although Ansoff’s work is frequently referred to by other strategists, it has not become more generally recognised in comparison with that of other theorists. The complexity of his work, and its reliance on the disciplines of analysis and planning, are perhaps among the reasons why Ansoff is not popularly viewed as belonging within the
top echelons of management thinkers. Other theorists were working on similar themes to Ansoff at similar times.

In the 1960s Ansoff’s notion of competence (which was later developed by Hamel and Prahalad) was not unique, and although Ansoff seems to have been the originator of his $2 \times 2$ growth vector component matrix, a similar matrix had been published earlier. During the 1980s and 1990s, it is likely that much work by other theorists about strategy formation under conditions of uncertainty or chaos owed something to Ansoff’s theory of turbulence, though it is difficult to evaluate the extent of the debt.

A debate between Ansoff and Henry Mintzberg over their differing views of strategy was reflected in print over many years, particularly in the Harvard Business Review. Ansoff has often been criticised by Mintzberg, who disliked the idea of strategy being built from planning which is supported by analytical techniques.

This criticism was based on the belief that Ansoff’s reliance on planning suffered from three fallacies: that events can be predicted, that strategic thinking can be separated from operational management, and that hard data, analysis and techniques can produce novel strategies.

**Self Assessment Questions**

Fill in the blanks:

4. Ansoff identified four standard types of organisational decisions as related to strategy, policy, ................................., and standard operating procedures.

5. Ansoff argued that within a company’s activities there should be an element of ................................. .

**Activity**

Excessive analysis and planning may turn out to be counter productive for corporate strategy. Discuss.

**Note**

Market expansion requires the identification of new customers for existing products; product expansion requires developing new products for existing customers; and diversification requires new products to be produced for new markets.

### 2.4 Porter

#### 2.4.1 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 Table 2.1 illustrates Porter’s generic strategies.

<table>
<thead>
<tr>
<th>Target Scope</th>
<th>Advantage</th>
<th>Product Uniqueness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad (Industry Wide)</td>
<td>Low Cost</td>
<td>Differentiation Strategy</td>
</tr>
<tr>
<td>Narrow (Market Segment)</td>
<td>Focus Strategy (low cost)</td>
<td>Focus Strategy (differentiation)</td>
</tr>
</tbody>
</table>

**Cost Leadership Strategy**

This generic strategy calls for being the low cost producer in an industry for a given level of quality. The firm sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain market share. In the event of a price war, the firm can maintain some profitability while the competition suffers losses. Even without a price war, as the industry matures and prices decline, the firms that can produce more cheaply will remain profitable for a longer period of time. The cost leadership strategy usually targets a broad market.

Some of the ways that firms acquire cost advantages are by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and vertical integration decisions, or avoiding some costs altogether. If competing firms are unable to lower their costs by a similar amount, the firm may be able to sustain a competitive advantage based on cost leadership.

Firms that succeed in cost leadership often have the following internal strengths:

- Access to the capital required to make a significant investment in production assets; this investment represents a barrier to entry that many firms may not overcome.
- Skill in designing products for efficient manufacturing, for example, having a small component count to shorten the assembly process.
- High level of expertise in manufacturing process engineering.
- Efficient distribution channels.
Each generic strategy has its risks, including the low-cost strategy. For example, other firms may be able to lower their costs as well. As technology improves, the competition may be able to leapfrog the production capabilities, thus eliminating the competitive advantage. Additionally, several firms following a focus strategy and targeting various narrow markets may be able to achieve an even lower cost within their segments and as a group gain significant market share.

**Differentiation Strategy**

A differentiation strategy calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better than or different from the products of the competition. The value added by the uniqueness of the product may allow the firm to charge a premium price for it. The firm hopes that the higher price will more than cover the extra costs incurred in offering the unique product. Because of the product's unique attributes, if suppliers increase their prices the firm may be able to pass along the costs to its customers who cannot find substitute products easily.

Firms that succeed in a differentiation strategy often have the following internal strengths:

- Access to leading scientific research.
- Highly skilled and creative product development team.
- Strong sales team with the ability to successfully communicate the perceived strengths of the product.
- Corporate reputation for quality and innovation.

The risks associated with a differentiation strategy include imitation by competitors and changes in customer tastes. Additionally, various firms pursuing focus strategies may be able to achieve even greater differentiation in their market segments.

**Focus Strategy**

The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation. The premise is that the needs of the group can be better serviced by focusing entirely on it. A firm using a focus strategy often enjoys a high degree of customer loyalty, and this entrenched loyalty discourages other firms from competing directly.

Because of their narrow market focus, firms pursuing a focus strategy have lower volumes and therefore less bargaining power with their suppliers. However, firms pursuing a differentiation-focused strategy may be able to pass higher costs on to customers since close substitute products do not exist.

Firms that succeed in a focus strategy are able to tailor a broad range of product development strengths to a relatively narrow market.
segment that they know very well. Some risks of focus strategies include imitation and changes in the target segments. Furthermore, it may be fairly easy for a broad-market cost leader to adapt its product in order to compete directly. Finally, other focusers may be able to carve out sub-segments that they can serve even better.

2.4.2 A COMBINATION OF GENERIC STRATEGIES – STUCK IN THE MIDDLE

These generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt it may achieve no advantage at all. For example, if a firm differentiates itself by supplying very high quality products, it risks undermining that quality if it seeks to become a cost leader. Even if the quality did not suffer, the firm would risk projecting a confusing image. For this reason, Michael Porter argued that to be successful over the long-term, a firm must select only one of these three generic strategies. Otherwise, with more than one single generic strategy the firm will be “stuck in the middle” and will not achieve a competitive advantage.

However, there exists a viewpoint that a single generic strategy is not always best because within the same product customers often seek multi-dimensional satisfactions such as a combination of quality, style, convenience and price. There have been cases in which high quality producers faithfully followed a single strategy and then suffered greatly when another firm entered the market with a lower-quality product that better met the overall needs of the customers.

2.4.3 GENERIC STRATEGIES AND INDUSTRY FORCES

These generic strategies each have attributes that can serve to defend against competitive forces. The Table 2.2 compares some characteristics of the generic strategies in the context of the Porter’s five forces.

<table>
<thead>
<tr>
<th>Industry Force</th>
<th>Generic Strategies</th>
<th>Cost Leadership</th>
<th>Differentiation</th>
<th>Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry Barriers</td>
<td>Ability to cut price in retaliation</td>
<td>Customer loyalty can discourage potential entrants.</td>
<td>Focusing develops core competencies that can act as an entry barrier.</td>
<td></td>
</tr>
</tbody>
</table>

Contd...
### Notes

<table>
<thead>
<tr>
<th><strong>Buyer Power</strong></th>
<th><strong>Supplier Power</strong></th>
<th><strong>Threat of Substitutes</strong></th>
<th><strong>Rivalry</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to offer lower price to powerful buyers.</td>
<td>Better insulated from powerful suppliers.</td>
<td>Can use low price to defend against substitutes.</td>
<td>Better able to compete on price.</td>
</tr>
<tr>
<td>Large buyers have less power to negotiate because of few close alternatives.</td>
<td>Better able to pass on supplier price increases to customers.</td>
<td>Customer’s become attached to differentiating attributes, reducing threat of substitutes.</td>
<td>Brand loyalty to keep customers from rivals.</td>
</tr>
<tr>
<td>Large buyers have less power to negotiate because of few alternatives.</td>
<td>Suppliers have power because of low volumes, but a differentiation-focused firm is better able to pass on supplier price increases.</td>
<td>Specialised products &amp; core competency protect against substitutes.</td>
<td>Rivals cannot meet differentiation-focused customer needs.</td>
</tr>
</tbody>
</table>

### Self Assessment Questions

Fill in the blanks:

6. **Market penetration** is the name given to a ____________ where the business focuses on selling existing products into existing markets.

7. **Market development** is the name given to a growth strategy where the business seeks to sell its existing products into ________________.

8. **Cost leadership strategy** calls for being the ____________ in an industry for a given level of quality.

9. **The focus strategy** concentrates on a narrow segment and within that segment attempts to achieve either a ________________ or differentiation.

### Activity

Rajiv Bajaj opines that strategy is specialisation. Analyse the brand led growth strategy behind the launch and marketing of Pulsar, KTM and Boxer in this context.
Porter argued that firms that are able to succeed at multiple strategies often do so by creating separate business units for each strategy. By separating the strategies into different units having different policies and even different cultures, a corporation is less likely to become “stuck in the middle.”

### 2.5 PRAHALAD AND GARY HAMMEL

The core competencies are the source of competitive advantage and enable the firm to introduce an array of new products and services.

According to Prahalad and Hammel, core competencies lead to the development of core products. Core products are not directly sold to end users; rather, they are used to build a larger number of end-user products. For example, motors are a core product that can be used in a wide array of end products. The business units of the corporation each tap into the relatively few core products to develop a larger number of end user products based on the core product technology. This flow from core competencies to end products is shown in Figure 2.2.

![Figure 2.2: Core Competencies to End Products](image)

The intersection of market opportunities with core competencies forms the basis for launching new businesses. By combining a set of core competencies in different ways and matching them to market opportunities, a corporation can launch a vast array of businesses.

Without core competencies, a large corporation is just a collection of discrete businesses. Core competencies serve as the glue that bonds the business units together into a coherent portfolio.
2.5.1 DEVELOPING CORE COMPETENCIES

According to Prahalad and Hammel, core competencies arise from the integration of multiple technologies and the coordination of diverse production skills. There are three tests useful for identifying a core competence. A core competence should:

- provide access to a wide variety of markets,
- contribute significantly to the end-product benefits,
- be difficult for competitors to imitate.

Core competencies tend to be rooted in the ability to integrate and coordinate various groups in the organisation. While a company may be able to hire a team of brilliant scientists in a particular technology, in doing so it does not automatically gain a core competence in that technology. It is the effective coordination among all the groups involved in bringing a product to market that results in a core competence.

It is not necessarily an expensive undertaking to develop core competencies. The missing pieces of a core competency often can be acquired at a low cost through alliances and licensing agreements. In many cases an organisational design that facilitates sharing of competencies can result in much more effective utilisation of those competencies for little or no additional cost.

To better understand how to develop core competencies, it is worthwhile to understand what they do not entail. According to Prahalad and Hammel, core competencies are not necessarily about:

- Outspending rivals on R&D
- Sharing costs among business units
- Integrating vertically

While the building of core competencies may be facilitated by some of these actions, by themselves they are insufficient.

2.5.2 LOSS OF CORE COMPETENCIES

Cost-cutting moves sometimes destroy the ability to build core competencies. For example, decentralisation makes it more difficult to build core competencies because autonomous groups rely on outsourcing of critical tasks, and this outsourcing prevents the firm from developing core competencies in those tasks since it no longer consolidates the know-how that is spread throughout the company.

Failure to recognise core competencies may lead to decisions that result in their loss. For example, in the 1970’s many U.S. manufacturers divested themselves of their television manufacturing businesses, reasoning that the industry was mature and that high quality, low cost models were available from Far East manufacturers. In the process, they lost their core competence in video, and this loss resulted in a handicap in the newer digital television industry.
Similarly, Motorola divested itself of its semiconductor DRAM business at 256Kb level, and then was unable to enter the 1Mb market on its own. By recognising its core competencies and understanding the time required to build them or regain them, a company can make better divestment decisions.

**Activity**

In about 100 words discuss the flow from core competencies to end products.

2.5.3 CORE PRODUCTS

Core competencies manifest themselves in core products that serve as a link between the competencies and end products. Core products enable value creation in the end products. Examples of firms and some of their core products include:

- 3M – substrates, coatings, and adhesives
- Black & Decker – small electric motors
- Canon – laser printer sub-systems
- Matsushita – VCR sub-systems, compressors
- NEC – semi-conductors
- Honda – gasoline powered engines

The core products are used to launch a variety of end products. For example, Honda uses its engines in automobiles, motorcycles, lawn mowers, and portable generators.

Because firms may sell their core products to other firms that use them as the basis for end user products, traditional measures of brand market share are insufficient for evaluating the success of core competencies. Prahalad and Hamel suggest that core product share is the appropriate metric. While a company may have a low brand share, it may have high core product share and it is this share that is important from a core competency standpoint. Once a firm has successful core products, it can expand the number of uses in order to gain a cost advantage via economies of scale and economies of scope.

2.5.4 IMPLICATIONS FOR CORPORATE MANAGEMENT

Prahalad and Hamel suggest that a corporation should be organised into a portfolio of core competencies rather than a portfolio of independent business units. Business unit managers tend to focus on getting immediate end-products to market rapidly and usually do not feel responsible for developing company-wide core competencies. Consequently, without the incentive and direction from corporate management to do otherwise, strategic business units are inclined to under invest in the building of core competencies.
If a business unit does manage to develop its own core competencies over time, due to its autonomy it may not share them with other business units. As a solution to this problem, Prahalad and Hammel suggest that corporate managers should have the ability to allocate not only cash but also core competencies among business units. Business units that lose key employees for the sake of a corporate core competency should be recognised for their contribution.

### 2.5.5 COMPETING FOR THE FUTURE

Hamel and Prahalad start their most popular work, Competing for the Future, with some questions. “Does the senior management have a clear and broadly shared understanding of how the industry may be different ten years future?” “Is the task of regenerating core strategies receiving as much top management attention as the task of reengineering core process?” They indicate, by those questions, how largely senior managements of corporations devote their efforts to maintain and improve only present business, such as restructuring and reengineering. The book, then, shows the limits of those actions for the future success.

![Figure 2.3: Core Competencies for Future](image)

Hammel and Prahalad accomplished their theories in this masterpiece. The pair says management executives should act differently from others, so that they could make their new future, which represents new industry, new value, and new market; rather than maintaining or improving present market or present product. It can be, they say, first of all, having a good ‘Foresight,’ secondly, designing a ‘Strategic architecture’; and finally creating ‘Strategic intent’ and rebuilding ‘Core competencies’, which will pull a corporation to the future, is shown diagrammatically in Figure 2.3.

**Foresight**

For competing for tomorrow, Hammel and Prahalad insist that the first thing should be done is to develop foresight. Foresight is prescience about the size and shape of tomorrow’s opportunities, such as, new types of customer benefits or new ways of delivering the benefits. They explain forgetting the present market, the present product, or the present business units, or the organisation. For instance,
“Motorola dreams of a world in which telephone numbers will be assigned to people, rather than places; where small hand-held devices will allow people to stay in touch no matter where they are; and where the new communicators can deliver video images and data as well as voice signals.”

**Strategic Architecture**

To bring a corporation to real future from foresight, the two theorists say it is the next action should be done to craft a ‘Strategic Architecture’ instead of strategic planning. Strategic architecture should describes “which new benefits, or ‘functionalities’ (not present product) will be offered” for the future, and “on what new competencies will needed to create those benefit,” and “how the customer interface will need to change to allow customers to access those benefits most effectively”. They also indicate it is impossible to create a detailed plan for a ten-or fifteen-year competitive, which is traditionally considered in a strategic planning. They cite NEC, a Japanese electronic company, as an example of a strategic architecture. NEC, initially a supplier of telecommunications equipment, dreamed being a leader in ‘C&C,’ computers and communication in 1980s. The company identified three streams of technological and market evolution.

- Computing would evolve from large mainframes to distributed processing (now called “client-server”)  
- Components would evolve from simple Integrated Circuits (ICs) to ultra large-scale ICs  
- Communications would evolve from mechanical cross-bar switching to complex digital systems.

**Strategic Intent and Core Competence**

The two gurus describe how to achieve the future in creating ‘strategic intent’ and rebuilding ‘core competencies’, which had been developed in their works before the book.

Strategic intent is something “ambitious and compelling” that “provides the emotional and intellectual energy” for the future. They explain “Strategic architecture is the brain; strategic intent is the heart.” They insist the most actually providing gateway to the future is “core competence.” Competencies are integration of skills and technology, they defined. Competencies of a corporation can be ‘core,’ which provide a value to customer, are different from competitor, and are extendable in new products or services. To get to the future, core competencies should be founded, rebuilt, and developed. Motorola found, rebuilt, and developed their competencies in digital compression, flat screen displays, and battery technology, and the company made their foresight to the real future.
Fill in the blank:
10. Real strategic change requires not merely ........................................
    the established categories, but inventing new ones.

Consider the case of Canon, which is into the production and sales of photocopier machines, cameras and the likes. What is the underlying core competence?

2.6 SUMMARY

- There is no one perfect strategic management model for any organisation. Each organisation ends up developing its own nature and model of strategic planning, often by selecting a model and modifying it as they go along in developing their own planning process.

- The models discussed in this chapter provide a range of alternatives from which organisations might select an approach and begin to develop their own strategic planning process.

- It should be noted that an organisation might choose to integrate the models, e.g., using a scenario model to creatively identify strategic issues and goals, and then an issues-based model to carefully strategise to address the issues and reach the goals.

- 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.

- Generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt it may achieve no advantage at all.

- The core competencies are the source of competitive advantage and enable the firm to introduce an array of new products and services. According to Prahalad and Hammel, core competencies lead to the development of core products. Core products are not directly sold to end users; rather, they are used to build a larger number of end-user products.

KEY WORDS

- **Core Competencies**: Cluster of extraordinary abilities or related ‘excellences’ that a firm acquires from its founders, after consistent striving over the years, and which cannot be easily imitated.
Planning: Basic management function involving formulation of one or more detailed plans to achieve optimum balance of needs or demands with the available resources.

Strategic Management: Systematic analysis of the factors associated with customers and competitors (the external environment) and the organisation itself (the internal environment) to provide the basis for rethinking the current management practices. Its objective is to achieve better alignment of corporate policies and strategic priorities.

Market Development: Market development is the name given to a growth strategy where the business seeks to sell its existing products into new markets.

Strategic Intent: Strategic intent is something “ambitious and compelling” that “provides the emotional and intellectual energy” for the future.

Foresight: Foresight is prescience about the size and shape of tomorrow’s opportunities, such as, new types of customer benefits or new ways of delivering the benefits.

2.7 DESCRIPTIVE QUESTIONS

1. What is the significance of five P’s in the strategic planning model of Mintzberg?

2. Do you think the strategy decision model of Ansoff is relevant in present day organisations? Give appropriate reasons in support of your answer.

3. What is significance of generic strategy model of Porter?

4. What is future of the Prahalad and Hammel’s core competencies model of strategic management?

5. Describe the Ansoff Growth matrix in detail.

6. Describe four key strategy components identified by Ansoff.


8. How core competencies get developed? Give the reasons for the loss of core competency.

9. How core competencies manifest themselves in core products that serve as a link between the competencies and end products? Explain. What are its implications for Corporate Management?

10. Discuss the views of Mintzberg on Strategic Planning.
2.8 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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<tr>
<th>Topic</th>
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HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 2.2.1

The word “strategy” has been used implicitly in different ways even if it has traditionally been defined in only one. Explicit recognition of multiple definitions can help people to manoeuvre through this difficult field. Mintzberg provides five definitions of strategy: Plan, Ploy, Pattern, Position and Perspective.

2. Refer to 2.3.6

Although Ansoff’s work is frequently referred to by other strategists, it has not become more generally recognised in comparison with that of other theorists. The complexity of his work, and its reliance on the disciplines of analysis and planning, are perhaps among the reasons why Ansoff is not popularly viewed as belonging within the top echelons of management thinkers. Other theorists were working on similar themes to Ansoff at similar times.

3. Refer to 2.4.1

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.

4. Refer to 2.5

For competing for tomorrow, Hammel and Prahalad insist that the first thing should be done is to develop foresight. Foresight is prescience about the size and shape of tomorrow’s opportunities, such as, new types of customer benefits or new ways of delivering the benefits. They explain forgetting the present market, the present product, or the present business units, or the organisation.

5. Refer to 2.3.3

The Ansoff Growth matrix is a tool that helps businesses decide their product and market growth strategy. Ansoff’s product/market growth matrix suggests that a business’ attempts to grow depend on whether it markets new or existing products in new or existing markets.

The output from the Ansoff product/market matrix is a series of suggested growth strategies that set the direction for the business strategy.

6. Refer to 2.3.2

Product market scope, Growth vector, Competitive advantage and synergy are the four key strategy components identified by Ansoff.

7. Refer to 2.4.2

These generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt it may achieve no advantage at all. For example, if a firm differentiates itself by supplying very high quality products, it risks undermining that quality if it seeks to become a cost leader. Even if the quality did not suffer, the firm would risk projecting a confusing image. For this reason, Michael Porter argued that to be successful over the long-term, a firm must select only one of these three generic strategies. Otherwise, with more than one single generic strategy the firm will be “stuck in the middle” and will not achieve a competitive advantage.

8. Refer to 2.5.1 & 2.5.2

According to Prahalad and Hammel, core competencies arise from the integration of multiple technologies and the coordination of diverse production skills. The loss of core competencies depend
9. Refer to 2.5.3 & 2.5.4

Core competencies manifest themselves in core products that serve as a link between the competencies and end products. Core products enable value creation in the end products. The core products are used to launch a variety of end products. Because firms may sell their core products to other firms that use them as the basis for end user products, traditional measures of brand market share are insufficient for evaluating the success of core competencies. Prahalad and Hammel suggest that core product share is the appropriate metric. The implications of core competencies depends upon business unit managers who tend to focus on getting immediate end-products to market rapidly and usually do not feel responsible for developing company-wide core competencies. Consequently, without the incentive and direction from corporate management to do otherwise, strategic business units are inclined to under invest in the building of core competencies.

10. Refer to 2.2.2

Mintzberg says “Strategic planning is not strategic thinking. Strategic planning often spoils strategic thinking, causing managers to confuse real vision with the manipulation of numbers. This confusion lies at the heart of the issue: the most successful strategies are visions, not plans.”

### 2.9 Suggested Readings for Reference

#### Suggested Readings

E-REFERENCES

- http://www.ansoffmatrix.com/
- http://faculty.bcitbusiness.ca/kevinw/4800/Bobs_porter_notes.pdf
- http://www.quickmba.com/strategy/core-competencies/
CHAPTER

STRATEGIC MANAGEMENT IN GLOBAL ENVIRONMENT

CONTENTS

3.1 Introduction
3.2 Need for Globalisation
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AN ARENA OF GLOBALIZED WORLD

The world is shrinking in all major respects. People, goods, capital and information are moving around the globe like never before with faster communication, transportation and financial flow, the barriers between nations have disappeared and the world is becoming a borderless market. In the new millennium, global companies seem to virtually dance all over the place. They are not constrained by national borders. For instance, people drive Fords in Germany, use Dell computers in India, eat McDonald’s hamburgers in France, and snack on Mars candy bars in England. They drink Coke and wear Levi Strauss jeans in China and South Africa. The Japanese buy Kodak film and use American Express credit cards. People around the world fly on American Airlines in planes made by Boeing. Their buildings are constructed with Caterpillar machinery, their factories are powered by General Electric engines and they buy Chevron oil. Coca Cola has over 80 percent of its sales outside of its home market (Nestle has 50 percent, Procter and Gamble 65 percent and Avon 60 percent). BMW builds cars in South Carolina. McDonald’s sells hamburgers in China. Wal-Mart, the global retailing giant employs over 500,000 employees across the globe. It serves 50 million customers in international markets via 3,000 stores and enjoys sales of over $70 billion in international markets. These giant corporations source and coordinate resources and activities in the most suitable areas, to offer sophisticated, cost-effective products and services to customers all over the globe. For example, the Boeing Company’s commercial jet aircraft, the 777, uses 1,32,500 engineered parts that are produced around the world by 545 suppliers. Eight Japanese suppliers make parts of the fuselage, doors and wings; a supplier in Singapore makes the doors for the nose landing gear; three suppliers in Italy manufacture wing flaps and so on. More and more companies are using the lowering of barriers to international trade and investment that has taken place during the past half century quite successfully.

True, boundaries between nations have collapsed with the dismantling of restrictions on trade and investment everywhere. Alongside the barriers of distance, time and culture also seem to have disappeared. It is no longer meaningful to talk about the Indian market, the Chinese market, the US market or the Japanese market—there is only one market, and that is the global market where you need a well-known brand with more or less standardised features to entice global audience. The global acceptance of Coca-Cola, Citi Group credit cards, blue jeans, Sony PlayStation, McDonald’s hamburgers, Nike shoes, the Nokia wireless phone and Microsoft’s Windows operating system are examples of this trend. As a result of this, many industries have to live with intense competition—present as well as potential—from any part of the world. Welcome to the global village where no organisation is insulated from the effects of foreign markets and competition.
After studying this chapter, you should be able to:

- Explain the need for Globalisation
- Identify the different types of international companies
- Enumerate the development of a global corporation
- Analyse the complexity of global environment
- Define industry analysis and SWOT analysis

### 3.1 INTRODUCTION

Globalisation means increasing economic interdependence among countries due to increasing cross-border flows of goods and services, capital, people and know-how. With faster communications, transportation and financial flows, the barriers between nations have disappeared and the world is becoming a borderless market. Products developed in one country – Hollywood movies, McDonald’s hamburgers, Nike shoes and Arrow shirts – are finding enthusiastic markets all over the world.

The term ‘Globalisation’ is generally used to cover three topic areas:

- **Globalisation of economies, trade activities and regulatory regimes:** World economies are slowly coming together, with barriers to trade being lowered.

- **Globalisation of industries:** Entire industries like the car industry, the aerospace industries and the paper and pulp industry are beginning to trade as one market rather than as a series of regional markets.

- **Globalisation of companies:** Companies operate in many countries and treat the whole world as one market and one source of supply. A company buys raw materials, borrows money, manufacturers and sells its products, recruits employees etc., by treating the whole world as one marketplace.

A number of forces are responsible for Globalisation. They are:

- Technological progress
- Opening up of national borders
- Strides in telecommunications
- Advancements in transportation
- Internet
- Opening up of economies such as India, China etc.

### 3.2 NEED FOR GLOBALISATION

Globalisation has become an important driver of a country’s economic growth. Countries have contributed to this and benefited from it.
Globalisation presents the best opportunities for a firm’s growth and profitability.

Globalization also poses some risks.

Opportunities: The following are the opportunities available for firms due to Globalisation:

- **Economies of scale**: Firms need a large customer base to achieve economies of scale. Global markets offer exciting opportunities to exploit the latest demand in world markets, and expand their production volumes.

- **Performance enhancement**: Globalisation helps in improving the performance of the firm. For example, Microsoft’s decision to establish a corporate research laboratory in Cambridge, England, helped it to build and sustain world-class excellence in selected value-creating activities. This strategic decision helped Microsoft gain access to outstanding technical and professional talent, which in turn helped in improved performance.

- **Reduced costs**: Firms all over the world are under pressure to reduce costs by locating their production facilities in countries where they can be produced more economically.

- **Homogeneity of demand**: Homogeneity of demand means that irrespective of where customers are physically located, they are likely to prefer the same kind of product or service world-wide.

- **Spreading of R&D costs**: In some industries such as pharmaceuticals and aircraft manufacturing, Research and Development (R&D) costs are so high that unless there are world-wide sales, the cost of development cannot be covered.

- **New customers**: Globalisation helps in increasing the customer base of the firm. Many multinationals view the Indian and Chinese markets with their huge population base as very attractive for expansion.

- **Exploit local advantages**: The most important reasons for international expansion are low-cost labour and availability of natural resources in various parts of the world. Countries such as India, China, Taiwan and Israel are becoming important engineering, manufacturing and development centres for key skills in software and computer design. Availability of cheap labour, cheap land prices, low energy costs etc., in countries such as China, India, Indonesia and other South-East Asian countries has encouraged many Japanese, Korean and American companies to build production units there.

- **Government incentives**: Government incentives in the form of subsidies, tax concessions, export incentives have motivated many domestic firms to expand their operations globally. Generous
loans, subsidies etc., given by the South Korean government have encouraged many of their firms such as Hyundai, Samsung, Daewoo, LG, etc., to invest huge sums in new technology and build global-sized plants all over the world.

**Risks:** Despite the above advantages, firms face many risks when expanding globally. They are:

- **Political and Economic Risks:** Some countries are not stable politically. Forces such as social unrest, military turmoil, demonstrations and even violent conflicts and terrorist attacks can pose serious threats. In some countries, the legal system is not reliable.

- **Currency Risks:** Currency fluctuations can pose substantial risk. A company with operations in several countries must constantly monitor the exchange rate between its own currency and that of the host country. Even a small change in the exchange rate can result in a significant difference in the cost of production or net profit when doing business overseas.

- **Management Risks:** Managers face a number of risks in foreign markets. These take a variety of forms; culture, customs, language, income levels, customer preferences, distribution systems, and so on.

### Self Assessment Questions

Fill in the blanks:

1. Upstream activities are generally ...................
2. .................... helps in increasing the customer base of the firm.
3. .................... of demand means that irrespective of where customers are physically located, they are likely to prefer the same kind of product or service world-wide.

### Activity

Choose a specific industry of your choice. Prepare a presentation on how the industry has benefited from Globalisation.

### 3.3 Different Types of International Companies

In analysing international company activity, Barlett and Ghoshal distinguished between three different types of international expansion. These types represent how Globalisation passes through three distinct stages, starting from a domestic company.

**Domestic company:** A “domestic company” acquires essentially all of its resources and sells all of its products or services within a single country. The focus of its business is its domestic operations.
International company: When the focus of a business is its domestic operations, but a portion of its activities are outside the home country, it is called an “International Company”. In other words, an international company is one that is primarily based in a single country but that acquires some meaningful share of its resources or revenues from other countries.

Multinational company: When a company operates in many countries, though it may still have a home base, it is called a “multinational company”.

Global company: When the company treats the whole world as one market and one source of supply, it is called a “global company”. There is only limited response to local demand.

The focus of the business is one world market, with each of the operating units contributing to that activity. Although a global company is stateless, boundaryless, no business has truly achieved this level of international expansion. However, Nestle comes close. Nestle is based in Switzerland, has a German CEO and gets more than 98% of its revenues and has more than 95% of its asset outside of Switzerland. The only aspect that makes Nestle a Swiss company is that its headquarters are in Switzerland and Swiss investors still own majority shares.

Fill in the blanks:

4. When the focus of a business is its domestic operations, but a portion of its activities are outside the home country, it is called an ……………………

5. When the company treats the whole world as one market and one source of supply, it is called a ……………………

Write a report of about 200 words on a company of your choice stating the bracket of international companies it falls in. State the reasons.
3.4 DEVELOPMENT OF A GLOBAL CORPORATION

The following are different ways in which a firm can compete in global markets:

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

**Merits**:
- Less expensive
- No need to set up manufacturing facilities abroad

**Demerits**:
- Not suitable for bulky, perishable or fragile goods
- Import duties make the product expensive
- High transportation costs
- Cannot avail lower production costs in host country

**Licensing**: Licensing is an arrangement whereby a firm allows another firm to use its trademark, technology, patent, copyright or other rights in return for a fee or royalty. The firm thus gains entry into another country at little risk, and the licensee, in turn, gains product expertise, brand name etc.

**Merits**:
- Firm need not incur capital costs in setting up a unit
- Firm gets a stream of revenues

**Demerits**:
- Does not allow for economies of scale
- Technological know-how may be misused
- Licensee may become a competitor
- May damage image of the firm if licensee does not adhere to quality standards.

**Franchising**: Franchising is a form of licensing in which the firm provides the foreign franchisee with complete package including equipment, product ingredients, trademark, managerial advice and standard operating practices. Franchisee agreements generally require payment of a fee upfront and then a percentage of revenues.

**Merits**:
- Firm gets a stream of revenues
- No capital costs
- No active involvement of the firm in getting local clearances etc.
NOTES

Demerits:
- Franchisee might not adhere to standards
- Lack of control over the franchisee
- Loss of firm’s image if franchisee does not adhere to standards.

Sales subsidiary: In this case, the firm retains production in its home country, and sets up a sales subsidiary in a foreign country, which performs marketing, sales and service of the product.

Merits:
- Firm remains close to customers
- Less costly than setting up production facilities
- Firm can have economies of scale

Demerits:
- High transportation costs
- Firm has to bear import duties
- Firm misses opportunity of low production costs in host country

Wholly-owned subsidiary: In this case, the firm establishes a wholly-owned subsidiary in the host country, which will look after all production, sales and service activities needed to operate in that country. There are several advantages of having a wholly-owned subsidiary.

Merits:
- The firm has complete control over its operations in that country
- Profits remain as firm’s own
- Technology or trade secrets need not be shared with outsiders
- Firm gains more experience internationally
- Allows strategic coordination worldwide
- Especially useful for technologically intensive firms

Demerits:
- High cost of capital
- Risky if the firm is unfamiliar with host country
- Misses the expertise of the local partner

Joint ventures: In a joint venture, two firms contribute equity to form a new venture, typically in the host country to develop new products or build a manufacturing facility or set up a sales and distribution network.

The commonly cited advantages are:
- Improvement of efficiency
- Access to knowledge
Dealing with political risk factors

Collusions may restrict competition

Merits:
- Two partners bring complementary expertise to the new venture
- Both parties share capital and risks
- Helps to meet host country regulations

Demerits:
- Two partners may fail to get along
- The firm has to share profits with the partner
- Host country culture may pose problems

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

**Offshoring:** When the world globalises, a firm may outsource some of its activities to firms abroad. US firms have been outsourcing many activities for years. Functions that are most often outsourced are those which a firm does not consider integral to its main business and which can be done more efficiently by an outside firm. The prime driver of outsourcing is lower costs - coming primarily as a result of lower wages.

**Choosing the pattern of expansion:** As we observe from the above discussion, there are merits and demerits to all the paths of international expansion. The path to be taken depends on such factors as experience and capabilities of the firm, the cultural and business practices, differences between the home country and host country or laws and regulations in the host country etc.

### Self Assessment Questions

Fill in the blanks:

6. .................. is a form of licensing in which the firm provides the foreign franchisee with complete package.

7. In the case of a .................., the firm remains close to customers.

8. When a firm establishes a .................. subsidiary in the host country, this subsidiary looks after all production, sales and service activities needed to operate in that country.

9. Firms such as Infosys, TCS and Wipro have been growing rapidly because of .................. of software jobs.

10. A .................. is generally formed to access a critical capability not possessed in-house.
Consider the joint venture between Tesco and Trent Ltd for FDI in multi-brand retail in India. Prepare a presentation on how both companies stand to gain from it.

The technical and marketing skill of a company in international business is also an important factor in the choice. Ultimately, strategy will also be important in determining the path of expansion.

3.5 COMPLEXITY OF GLOBAL ENVIRONMENT

Complexity is today often considered the latest business buzzword – it reflects a current common reality but not a lasting one. When introducing the complexity concept to executives in globally operating companies, complexity is multiplied to its current heightened level.

Due to Globalisation, many types of boundaries have faded. Trade liberalization allows for a substantially easier flow of goods, capital, people, and knowledge around the globe. The world has clearly moved beyond the key trade markets.

Sometimes abolishing boundaries create new homogeneity in a larger area (e.g. the Euro currency), but mostly it doesn’t. Various motives rank high on the list of possible drivers for foreign expansion, such as learning, spreading risk, gaining access to new customers, realising economies of scale and scope, or optimising one’s value proposition with partners. But the road to the promised land turns out to be more demanding than expected, and complexity is the most common and pervasive challenge that arises.

A core challenge of globalised companies, complexity cannot be made simple, and it is not going away in the near future. Managing complexity must therefore become a core competency of top executives and management. As a first step, it is crucial to understand what drives complexity. What generates complexity? In our research, we’ve identified four major sources that interact together to create today’s environment. Each of these sources of complexity was created by the erosion of boundaries, but their effects are different from each other.

Diversity: Global organisations face a complex set of challenges characterised by diversity both inside and outside the organisation – across every aspect of the business itself and its strategy drivers. Inside the organisation, executives must manage and respond to more diversity in the (internationalising) HR pool; more variety in the management systems; more variation in the means and ends ranging from simple financial goals to amore comprehensive view; and different business models for different types of business units.
Outside the organisation there is higher diversity: heterogeneous customer needs; differing cultural values; a plethora of stakeholders with different claims (investors, customers, employees, regulators etc.); various political, economic and legal environments; and finally, competitors’ differing strategies. Most firms today increasingly face each of these types of diversity. Managing the differences is not trivial, and reducing diversity often means being less responsive.

**Interdependence:** Companies must manage the effect of global interdependence to an unprecedented degree: everything is related to everything else, and the impact is felt more rapidly and pervasively. Value webs have replaced traditional value chains. Reputation, financial flows, value chain flows, top management and corporate governance issues have reached advanced levels of interdependence. The less clear-cut the boundaries of a company become, the more it is exposed to impacts on the value chain flow through mistakes, frictions, reverse trends, or even shocks. Interdependence creates opportunities for Globalisation, but taking advantage of these opportunities raises difficult challenges.

**Ambiguity:** The business world today is characterised by too much information with less and less clarity on how to interpret and apply insights. A diversity of accounting standards renders financial figures ambiguous. Studies, scenarios, survey results, and reports become less reliable due to an ever-increasing uncertainty. Many businesses find it more and more difficult to discover what their clear value drivers are. Are they image, price, related services, privileged relationships, speed, knowledge, or something else? The cause-effect relationships become blurred.

**Flux:** As if these three complexity drivers were not enough, managers have to face yet another one, flux or change. Even if you figure out temporary solutions regarding interdependence, diversity and ambiguity for your specific company, industry, and personal situation, the situation can change the next day. Today’s solutions may be outdated tomorrow. Business environments are increasingly being characterised as being VUCA (volatile, uncertain, complex and ambiguous). While there are strategies to mitigate risks associated with VUCA, it is impossible to obliterate them.

Many people have tried to simplify complexity, and contemporary management literature is misleading when trumpeting the success factor. Studies typically examine successful companies to see what managers “did”, then conclude that all managers should do the same thing. As unpredictability makes us uncomfortable, delusions are created about performance as voluntary matter of choice (companies can choose “to be great”); we like the certainty promised by these solutions. But in an interdependent world, much depends on contingencies, with no clear correction between input and output. Accountability of managers has therefore become an arbitrary element: yes, managers are responsible, but results are influenced by factors beyond their control. Navigating through this complexity requires a different way of thinking, acting, and
organising than the typical “control” mentality. A long list of advantages lures companies into globalising. Geographic expansion abroad offers the vast potential benefits of a much larger market arena, spread risks, scope/scale/location-based cost advantages, and exposure to a variety of new product and process ideas.

The practical consequence of complexity is that a managerial dilemma often shapes the decision-making process when there are two or more conflicting legitimate goals to meet demands. Both cannot be simultaneously achieved with the given resources. Companies in the financial service industry set up competing distribution channels, but expect far-reaching cooperation across the company (shared services and product platforms) to reap economics of scale. In manufacturing, one ongoing dilemma is between global standardization and response to local market needs. Any required priority decision nevertheless results in ongoing tension. As dilemmas cannot be solved, they need to be managed-continuously.

Fill in the blanks:

11. ................. from one subsidiary to another may not take place “automatically”.
12. In a ................., two firms contribute equity to form a new venture, typically in the host country.
13. Firms need not incur ................. costs in setting up a unit.
14. Global markets offer exciting opportunities to exploit the latest ................. in world markets.
15. The most important reasons for international expansion are ................. and availability of ................. in various parts of the world.
16. A company with operations in several countries must constantly monitor the ................. between its own currency and that of the host country.
17. A diversity of accounting standards renders financial figures .................

Vineet Nayar, the former CEO of HCL Technologies once remarked: “Abnormal is the new normal.” Interpret the meaning of this statement with respect to flux.

3.6 INDUSTRY ANALYSIS

Internal analysis is also referred to as “internal appraisal”, “organisational audit”, “internal corporate assessment” etc. Over the years, research has shown that the overall strengths and weaknesses
of a firm's resources and capabilities are more important for a strategy than environmental factors. Even where the industry was unattractive and generally unprofitable, firms that came out with superior products enjoyed good profits.

Managers perform internal analysis to identify the strengths and weaknesses of a firm's resources and capabilities. The basic purpose is to build on the strengths and overcome the weaknesses in order to avail of the opportunities and minimise the effects of threats. The ultimate aim is to gain and sustain competitive advantage in the marketplace.

### 3.6.1 IMPORTANCE OF INTERNAL ANALYSIS

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

Thus, systematic internal analysis helps the firm:

- To find where it stands in terms of its strengths and weaknesses
- To exploit the opportunities that are in accordance with its capabilities
- To analyze and find ways to rectify its weaknesses.
- To defend against threats
- To assess gaps in its capability and take steps to enhance its capabilities with a view to achieve its growth objectives.

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

### 3.6.2 SWOT ANALYSIS

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

We had briefly mentioned about the meaning of the terms opportunities, threats, strengths and weaknesses. We revisit the same for purposes of SWOT analysis.

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

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

**Opportunities:** An opportunity is a major favourable situation in a firm’s environment. Examples include market growth, favourable changes in competitive or regulatory framework, technological developments or demographic changes, increase in demand, opportunity to introduce products in new markets, turning R&D into cash by licensing or selling patents etc. The level of detail and perceived degree of realism determine the extent of opportunity analysis.

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

**Advantages and Limitations**

**Advantages**

- It is simple.
- It portrays the essence of strategy formulation: matching a firm’s internal strengths and weaknesses with its external opportunities and threats.
- Together with other techniques like Value Chain Analysis and RBV, SWOT analysis improves the quality of internal analysis.
Limitations

- It gives a static perspective, and does not reveal the dynamics of competitive environment.
- SWOT emphasises a single dimension of strategy (i.e. strength or weakness) and ignores other factors needed for competitive success.
- A firm’s strengths do not necessarily help the firm create value or competitive advantage.
- SWOT’s focus on the external environment is too narrow.
- Hill and Westbrook criticise SWOT analysis by saying that it is not a panacea. According to them, some of the criticisms against SWOT analysis are:
  - It generates lengthy lists.
  - It uses no weights to reflect priorities.
  - It uses ambiguous words and phrases.
  - The same factor can be placed in two categories (e.g. an opportunity may also be a threat).
  - There is no obligation to verify opinions with data or analysis.
  - It is only a simple level of analysis. There is no logical link to strategy implementation.
  - SWOT helps only as a starting point. By itself, SWOT analysis rarely helps a firm develop competitive advantage that it can sustain over time.

Self Assessment Questions

Fill in the blanks:
18. Strategic management is ultimately a “matching game” between .................... and ....................
19. ............. stands for strengths, weaknesses, opportunities and threats.

Activity

Do strengths and weaknesses of companies remain unchanged over a period? Discuss.

Note

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

- Everything is diverse, and nothing is stable, everything is in “fast flux”: interdependence is flowing in changing directions. The future is no longer the prolongation of the past – industry “breakpoints”, fundamentally altering the value proposition in industries, occur more rapidly.
- The variety of options could overwhelm traditional decision-making, as information often lacks clarity and is ambiguous.
- Multiple interpretations of the same facts are possible, depending on the perspective or cultural framework.
- Shared understanding cannot be assumed per se, whether inside or outside the organisation.
- Interdependence, diversity and ambiguity – all in flux – are the building blocks of managerial complexity.
- The managers have to be adept today in managing the complexities in global organisations.
- The internal environment of an organisation contains the internal resources and possesses internal capabilities and core competencies.
- SWOT Analysis is a strategic planning method used to evaluate the Strengths, Weaknesses, Opportunities, and Threats involved in a project or in a business venture.
- Culture is a powerful component of an organisation’s success, laying the tracks for strategy to roll out on.

KEY WORDS

- **Domestic Company**: It acquires essentially all of its resources and sells all of its products or services within a single country.
- **Economies of Scale**: The increase in efficiency of production as the number of goods being produced increases. Typically, a company that achieves economies of scale lowers the average cost per unit through increased production since fixed costs are shared over an increased number of goods.
- **Global Company**: When the company traits the whole world as one market and one source of supply.
- **Globalisation**: It means increasing economic interdependence among countries due to increasing cross-border flows of goods and services, capital, people and know-how.
- **International Company**: When the focus of a business is its domestic operations, but a portion of its activities are outside the home country.
- **Licensing**: An arrangement whereby a firm allows another firm to use its trademark, technology, patent, copyright or other rights in return of a fee or royalty.

Contd...
3.8 DESCRIPTIVE QUESTIONS

1. Do you believe that Globalisation has helped companies to expand their horizon? Justify your answer.

2. Discuss, in detail, various types of international strategies. Give the merits and demerits of each strategy.

3. Do you think that Globalisation improves performance of a firm? Why/why not?

4. “Complexity is today often considered the latest business buzzword – it reflects a current common reality but not a lasting one”. Explain the complexity of Global Environment.

5. Between licensing and franchising, what do you think is a better way for a firm to compete in a global market and why?

6. Explain the importance of Industry Analysis.

7. Explain the purposes of doing SWOT Analysis by companies.

8. Describe different types of international companies.

9. Explain diversity and interdependence as complexity of global environment.

10. “The term ‘Globalisation’ is generally used to cover three topic areas”. What are they? Describe the forces responsible for Globalization.

3.9 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Q. No.</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
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<td>1.</td>
<td>centralized</td>
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<td></td>
<td>2.</td>
<td>Globalisation</td>
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<td></td>
<td>3.</td>
<td>Homogeneity</td>
</tr>
<tr>
<td>Different Types of</td>
<td>4.</td>
<td>International Company</td>
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<tr>
<td>International Companies</td>
<td>5.</td>
<td>Global company</td>
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<tr>
<td>Development of a Global</td>
<td>6.</td>
<td>Franchising</td>
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<td>Corporation</td>
<td>7.</td>
<td>sales subsidiary</td>
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<th>Notes</th>
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<tr>
<td>8. wholly-owned</td>
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<td>9. offshoring</td>
</tr>
<tr>
<td>10. strategic alliance</td>
</tr>
<tr>
<td>Complexity of Global Environment</td>
</tr>
<tr>
<td>11. Knowledge transfer</td>
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<td>12. joint venture</td>
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<td>13. Capital</td>
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<td>14. Demand</td>
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<td>15. low-cost labour, natural resources</td>
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<td>16. exchange rate</td>
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<tr>
<td>17. ambiguous</td>
</tr>
<tr>
<td>Industry Analysis</td>
</tr>
<tr>
<td>18. environmental opportunities, organisational strengths</td>
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<tr>
<td>19. SWOT</td>
</tr>
</tbody>
</table>

**HINTS FOR DESCRIPTIVE QUESTIONS**

1. Refer to 3.2

   Yes, Globalization has helped companies to expand their horizon as it helps them to exploit opportunities and take risks while expanding globally.

2. Refer to 3.4

   The following are different ways in which a firm can compete in global markets. They are in the form of exporting, licensing, franchising, sales subsidiary, wholly-owned subsidiary, Joint ventures, strategic alliances, off-shoring, choosing the pattern of expansion.

3. Refer to 3.4

   Yes, Globalisation helps improve the performance of a firm as it helps the firm to export, obtain license for its products, franchising its operations, expansion through sales subsidiary, wholly-owned subsidiary, Joint ventures, strategic alliances, off-shoring, choosing the pattern of expansion.

4. Refer to 3.5

   Complexity is today often considered the latest business buzzword – it reflects a current common reality but not a lasting one. When introducing the complexity concept to executives in globally operating companies, complexity is multiplied to its current heightened level. Due to Globalisation, many types of boundaries have faded. Trade liberalization allows for a substantially easier flow of goods, capital, people, and knowledge around the globe. The world has clearly moved beyond the key trade markets. Globalising companies from developed and
developing economies try to tap the benefits of Globalisation to an unprecedented degree and therefore face – as well as contribute to – the complexity of eroding boundaries.

5. Refer to 3.4

Franchising is a better way for a firm to compete in a global market as it is a form of licensing in which the firm provides the foreign franchisee with complete package including equipment, product ingredients, trademark, managerial advice and standard operating practices. Franchisee agreements generally require payment of a fee upfront and then a percentage of revenues. Franchisers offer exclusive rights to a geographical territory to franchisees, whereas licensing companies usually offer no such protection to licensees.

6. Refer to 3.6.1

The importance of systematic internal analysis helps the firm to find where it stands in terms of its strengths and weaknesses; to exploit the opportunities that are in line with its capabilities; to correct important weaknesses; to defend against threats and to assess capability gaps and take steps to enhance its capabilities.

7. Refer to 3.6.2

SWOT stands for strengths, weaknesses, opportunities and threats. SWOT analysis is a widely used framework to summarise a company’s situation or current position. Any company undertaking strategic planning will have to carry out SWOT analysis: establishing its current position in the light of its strengths, weaknesses, opportunities and threats. Environmental and industry analyses provide information needed to identify opportunities and threats, while internal analysis provides information needed to identify strengths and weaknesses. These are the fundamental areas of focus in SWOT analysis.

8. Refer to 3.3

Different types of international companies are: Domestic company, International company, Multinational company and Global company.

9. Refer to 3.5

Diversity: Global organisations face a complex set of challenges characterised by diversity both inside and outside the organisation – across every aspect of the business itself and its strategy drivers. Inside the organisation, executives must manage and respond to more diversity in the (internationalising) HR pool; more variety in the management systems; more variation in the means and ends ranging from simple financial goals to a more comprehensive view; and different business models for different types of business units. Interdependence: Companies must manage the effect of global interdependence to an unprecedented
degree: everything is related to everything else, and the impact is felt more rapidly and pervasively. Value webs have replaced traditional value chains. Reputation, financial flows, value chain flows, top management and corporate governance issues have reached advanced levels of interdependence.

10. Refer to 3.1

The term ‘Globalisation’ is generally used to cover three topic areas. They are: Globalisation of economies, trade activities and regulatory regimes; Globalisation of industries and Globalisation of companies. A number of forces are responsible for Globalisation. They are technological progress, Opening up of national borders, strides in telecommunications, advancements in transportation, internet and opening up of economies such as India, China etc.

### 3.10 SUGGESTED READINGS FOR REFERENCE

#### SUGGESTED READINGS


#### E-REFERENCES

- [http://workforcevision.blogspot.in/2006/08/types-of-global-companies.html](http://workforcevision.blogspot.in/2006/08/types-of-global-companies.html)
- [http://www.mindtools.com/pages/article/newTMC_05.htm](http://www.mindtools.com/pages/article/newTMC_05.htm)
# Competitive Analysis

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GOOGLE UNSEATS MICROSOFT AS THE US BROWSER POWERHOUSE

The curious case of the two biggest IT powerhouses taking on each other is now a part of global corporate battle folklore. Google and Microsoft are two companies with distinct capabilities and core competencies. They have crossed swords in the past and even now are leaving no stone unturned to outsmart each other. Consider the battle for supremacy in the segment of browsers in the USA.

A recent report published by Adobe confirms that Google has unseated Microsoft as the leading web browser in the US market for the first time. According to the Adobe Digital Index (ADI), a measurement of browser usage based on tracking visits to the average U.S. website, Google’s desktop and mobile browsers – Chrome (on both platforms, the aging Android browser on the latter only), slipped past Microsoft’s Internet Explorer (IE). Google retained its premier position on the desktop but had little to show for its effort on smartphones. Google accounted for 31.8% of all browser usage in the United States. Meanwhile, Microsoft owned a 30.9% share.

Apple’s Safari was in third place with a combined desktop and mobile share of 25%, while Mozilla’s Firefox, which lacks a meaningful presence in mobile, was a distant fourth with just 8.7%. The rise of Google’s browsers, and to a lesser extent Apple’s Safari, and the corresponding declines of both IE and Firefox, can be attributed to mobile browsing, primarily that conducted on smartphones. “Today, mobile [operating systems are] more important, giving Google and Apple a leg up with default status on Android and iOS,” said ADI analyst Tyler White in a statement.

Adobe tallied visits, which in analytics parlance is synonymous with a session on a website, a period during which a user may view numerous pages before leaving, or before a time limit of inactivity expires. Adobe thus actually measures a type of “usage share,” or how active users of each browser are on the Web. Other analytic firms count differently. California-based Net Applications uses visitors, an expression of the number of unique individuals – actually their browsers, as the tracking is done with cookies – to measure “user share,” which is analogous to the number of copies of each browser in use during a specific period.

Because Adobe drew its data only from consumer-facing sites – some 10,000 of them – it was little surprise that the Chrome/Android browsers outpaced IE. Microsoft’s browser has a lock in businesses, where it’s often mandated as the only allowed desktop browser, but it has a less-dedicated – some would say less-coerced – base among consumers. On mobile, IE accounted for just 1.8% of usage.

Google’s climb to the top spot in the U.S. followed its push into that place globally by almost a year: Adobe’s data had Google’s Chrome/Android passing Microsoft’s IE in May 2013 worldwide. “Outside the U.S., Google’s browser share has grown even more rapidly,” an Adobe spokesman said.

Source: http://www.computerworld.com/s/article/9248927/Google_unseats_Microsoft_as_the_U.S._browser_powerhouse
After studying this chapter, you should be able to:

- Determine competitor analysis framework
- Understand the rivalry analysis with factors and interpretation
- Explain the competitive dynamics – slow-cycle markets, fast cycle markets and standard-cycle markets
- Understand the competitive rivalry

### 4.1 INTRODUCTION

In formulating business strategy, managers must consider the strategies of the firm's competitors. While in highly fragmented commodity industries the moves of any single competitor may be less important, in concentrated industries competitor analysis becomes a vital part of strategic planning.

Competitor analysis has two primary activities, (1) obtaining information about important competitors, and (2) using that information to predict competitor behaviour. The goal of competitor analysis is to understand:

- With which competitors to compete,
- Competitors’ strategies and planned actions,
- How competitors might react to a firm’s actions,
- How to influence competitor behaviour to the firm’s own advantage.

Casual knowledge about competitors usually is insufficient in competitor analysis. Rather, competitors should be analysed systematically, using organised competitor intelligence-gathering to compile a wide array of information so that well informed strategy decisions can be made.

### 4.2 COMPETITOR ANALYSIS FRAMEWORK

Even the simplest competitive analysis displays two critical dimensions: the competitors and the criteria, or what we’ll call the competitive framework. The purpose of the competitive framework is to present the data in a way that makes it easy to compare the various sites across the different criteria. Michael Porter presented a framework for analysing competitors. This framework is based on the following four key aspects of a competitor:

- Competitor’s objectives
- Competitor’s assumptions
- Competitor’s strategy
- Competitor’s capabilities
Objectives and assumptions are what drive the competitor, and strategy and capabilities are what the competitor is doing or is capable of doing. These components can be depicted as shown in the Figure 4.1.

![Figure 4.1: Competitor Analysis Components](image)


**DEFINITION**

A competitor analysis should include the more important existing competitors as well as potential competitors such as those firms that might enter the industry, for example, by extending their present strategy or by vertically integrating.

### 4.2.1 COMPETITOR’S CURRENT STRATEGY

The two main sources of information about a competitor’s strategy are what the competitor says and what it does. What a competitor is saying about its strategy is revealed in:

- Annual shareholder reports
- 10K reports
- Interviews with analysts
- Statements by managers
- Press releases

However, this stated strategy often differs from what the competitor actually is doing. What the competitor is doing is evident in where its cash flow is directed, such as in the following tangible actions:

- Hiring activity
- R&D projects
- Capital investments
- Promotional campaigns
- Strategic partnerships
- Mergers and acquisitions
4.2.2 COMPETITOR’S OBJECTIVES

Knowledge of a competitor’s objectives facilitates a better prediction of the competitor’s reaction to different competitive moves. For example, a competitor that is focused on reaching short-term financial goals might not be willing to spend much money responding to a competitive attack. Rather, such a competitor might favour focusing on the products that hold positions that better can be defended. On the other hand, a company that has no short term profitability objectives might be willing to participate in destructive price competition in which neither firm earns a profit.

Goals may be associated with each hierarchical level of strategy – corporate, business unit and functional level.

Competitor objectives may be financial or other types. Some examples include growth rate, market share, and technology leadership.

The competitor’s organisational structure provides clues as to which functions of the company are deemed to be the more important. For example, those functions that report directly to the chief executive officer are likely to be given priority over those that report to a senior vice president.

Other aspects of the competitor that serve as indicators of its objectives include risk tolerance, management incentives, backgrounds of the executives, composition of the board of directors, legal or contractual restrictions, and any additional corporate-level goals that may influence the competing business unit. Whether the competitor is meeting its objectives provides an indication of how likely it is to change its strategy.

4.2.3 COMPETITOR’S ASSUMPTIONS

The assumptions that a competitor’s managers hold about their firm and their industry help to define the moves that they will consider. For example, if in the past the industry introduced a new type of product that failed, the industry executives may assume that there is no market for the product. Such assumptions are not always accurate and if incorrect may present opportunities. For example, new entrants may have the opportunity to introduce a product similar to a previously unsuccessful one without retaliation because incumbent firms may not take their threat seriously. Honda was able to enter the U.S. motorcycle market with a small motorbike because U.S. manufacturers had assumed that there was no market for small bikes based on their past experience.

A competitor’s assumptions may be based on a number of factors, including any of the following:

- Beliefs about its competitive position
A thorough competitor analysis also would include assumptions that a competitor makes about its own competitors, and whether that assessment is accurate.

4.2.4 COMPETITOR'S RESOURCES AND CAPABILITIES

Knowledge of the competitor’s assumptions, objectives, and current strategy is useful in understanding how the competitor might want to respond to a competitive attack. However, its resources and capabilities determine its ability to respond effectively.

A competitor’s capabilities can be analysed according to its strengths and weaknesses in various functional areas, as is done in a SWOT analysis. The competitor’s strengths define its capabilities. The analysis can be taken further to evaluate the competitor’s ability to increase its capabilities in certain areas. A financial analysis can be performed to reveal its sustainable growth rate.

Finally, since the competitive environment is dynamic, the competitor’s ability to react swiftly to change should be evaluated. Some firms have heavy momentum and may continue for many years in the same direction before adapting. Others are able to mobilise and adapt very quickly. Factors that slow a company down include low cash reserves, large investments in fixed assets, and an organisational structure that hinders quick action.

4.2.5 COMPETITOR RESPONSE PROFILE

Information from an analysis of the competitor’s objectives, assumptions, strategy, and capabilities can be compiled into a response profile of possible moves that might be made by the competitor. This profile includes both potential offensive and defensive moves. The specific moves and their expected strength can be estimated using information gleaned from the analysis.

ACTIVITY

Consider the sports bike segment of the two-wheeler industry in India. Bajaj Pulsar waged war against Honda. Write a 200-words report on the competitor profile of Bajaj Pulsar.

NOTE

The result of the competitor analysis should be an improved ability to predict the competitor’s behaviour and even to influence that behaviour to the firm’s advantage.
Fill in the blanks:

1. Casual knowledge about competitors usually is ................ in competitor analysis.

2. The purpose of the competitive framework is to present the data in a way that makes it easy to ................. the various sites across the different criteria.

3. Knowledge of a competitor’s objectives facilitates a better prediction of the competitor’s reaction to different ................ moves.

4. The competitor’s organisational structure provides clues as to which functions of the company are deemed to be the more .................

5. The assumptions that a competitor’s managers hold about their firm and their industry help to ................. the moves that they will consider.

6. Knowledge of the competitor’s assumptions, objectives, and current strategy is useful in understanding how the competitor might want to respond to a ................. attack.

### 4.3 RIVALRY ANALYSIS

The intensity of rivalry among competitors in an industry refers to the extent to which firms within an industry put pressure on one another and limit each other’s profit potential. If rivalry is fierce, competitors are trying to steal profit and market share from one another. This reduces profit potential for all firms within the industry. According to Porter’s five forces framework, the intensity of rivalry among firms is one of the main forces that shape the competitive structure of an industry.

Porter’s intensity of rivalry in an industry affects the competitive environment and influences the ability of existing firms to achieve profitability. High intensity of rivalry means competitors are aggressively targeting each other’s markets and aggressively pricing products. This represents potential costs to all competitors within the industry.

#### 4.3.1 PORTER’S INTENSITY OF RIVALRY DETERMINING FACTORS

Several factors determine the intensity of competitive rivalry in an industry. If the industry consists of numerous competitors, Porter rivalry will be more intense. If the competitors are of equal size or market share, the intensity of rivalry will increase. If industry growth is slow, the intensity of rivalry will be high. If the industry’s fixed costs are high, competitive rivalry will be intense. If the industry’s products are undifferentiated or are commodities, rivalry will be intense.
If brand loyalty is insignificant and consumer switching costs are low, this will intensify industry rivalry. If competitors are strategically diverse – they position themselves differently from other competitors – industry rivalry will be intense. An industry with excess production capacity will have greater rivalry among competitors. And finally, high exit barriers – costs or losses incurred as a result of ceasing operations – will cause intensity of rivalry among industry firms to increase.

And of course, if the opposite is true for any of these factors, the intensity of Porter rivalry among competitors will be low. For example, a small number of firms in the industry, a clear market leader, fast industry growth, low fixed costs, highly differentiated products, prevalent brand loyalties, high consumer switching costs, no excess production capacity, lack of strategic diversity among competitors, and low exit barriers all indicate that the Porter intensity of rivalry among existing firms is low.

4.3.2 PORTER'S INTENSITY OF RIVALRY ANALYSIS

When analysing a given industry, all of the aforementioned factors regarding the intensity of competitive rivalry Porter placed among existing competitors may not apply. But some, if not many, certainly will. And of the factors that do apply, some may indicate high intensity of rivalry and some may indicate low intensity of rivalry. The results will not always be straightforward. Therefore it is necessary to consider the nuances of the analysis and the particular circumstances of the given firm and industry when using these data to evaluate the competitive structure and profit potential of a market.

Intensity of rivalry is high if:

- Competitors are numerous
- Competitors have equal size
- Competitors have equal market share
- Industry growth is slow
- Fixed costs are high
- Products are undifferentiated
- Brand loyalty is insignificant
- Consumer switching costs are low
- Competitors are strategically diverse
- There is excess production capacity
- Exit barriers are high

Intensity of rivalry is low if:

- Competitors are few
- Competitors have unequal size
- Competitors have unequal market share
Industry growth is fast
- Fixed costs are low
- Products are differentiated
- Brand loyalty is significant
- Consumer switching costs are high
- Competitors are not strategically diverse
- There is no excess production capacity
- Exit barriers are low

4.3.3 PORTER’S INTENSITY OF RIVALRY INTERPRETATION

When conducting Porter’s five forces industry analysis, low intensity of rivalry makes an industry more attractive and increases profit potential for the firms already competing within that industry, while high intensity of rivalry makes an industry less attractive and decreases profit potential for the firms already competing within that industry. The intensity of rivalry among existing firms is one of the factors to consider when analysing the structural environment of an industry using Porter’s five forces framework.

4.4 COMPETITIVE DYNAMICS

Whereas competitive rivalry concerns the ongoing actions and responses between a firm and its competitors for an advantageous
market position, competitive dynamics concerns the ongoing actions and responses taking place among all firms competing within a market for advantageous positions.

To explain competitive rivalry, we described (a) factors that determine the degree to which firms are competitors (market commonality and resource similarity), (b) the drivers of competitive behaviour for individual firms (awareness, motivation and ability), and (c) factors affecting the likelihood a competitor will act or attack (first mover incentives, organisational size, and quality) and respond (type of competitive action, reputation, and market dependence). Building and sustaining competitive advantages are at the core of competitive rivalry, in that advantages are the link to an advantageous market position.

To explain competitive dynamics, we discuss the effects of varying rates of competitive speed in different markets (called slow-cycle, fast-cycle, and standard cycle markets) on the behaviour (actions and responses) of all competitors within a given market. Competitive behaviours as well as the reasons or logic for taking them are similar within each market type, but differ across market types. Thus competitive dynamics differs in slow-cycle, fast-cycle, and standard-cycle markets. Thus sustainability of the firm’s competitive advantages is an important difference among the three market types.

As you know that the firms want to sustain their advantages for as long as possible, although no advantage is permanently sustainable.

4.4.1 SLOW-CYCLE MARKETS

Slow-cycle markets in which the firm’s competitive advantages are shielded from imitation for what are commonly long periods of time and where imitation is costly. Competitive advantages are sustainable in slow-cycle markets.

Building on of a kind competitive advantage that is proprietary leads to competitive success in a slow-cycle market. This type of advantage is difficult for competitors to understand and costly to imitate advantage results from unique historical conditions, causal ambiguity, and or social complexity. Copyrights, geography, patents, and ownership of information resources are examples of what leads to one of kind advantages. Once a proprietary advantage is developed, the firm’s competitive behaviour in a slow-cycle market is oriented to protecting, maintaining, and extending that advantage. Thus, the competitive dynamics in slow-cycle markets involve all firms concentrating on competitive actions and responses that enable them to protect, maintain, and extend their proprietary competitive advantage.

4.4.2 FAST-CYCLE MARKETS

Fast-cycle markets are markets in which the firm's capabilities that contribute to competitive advantages aren’t shielded from imitation
and where imitation is often rapid and inexpensive. Thus, competitive advantages aren't sustainable in fast-cycle markets. Firms competing in fast-cycle markets recognise the importance of speed; these companies appreciate that time is as precious a business resource as money or head count – and that the costs of hesitation and delay are just as steep as going over budget or missing a financial forecast. Such high-velocity environments place considerable pressures on top managers to make strategic decisions quickly, but they must be effective. The often substantial competition and technology-based strategic focus make the strategic decisions complex, increasing the need for a comprehensive approach integrated with decision speed, two often-conflicting characteristics of the strategic decision process.

Reverse engineering and the rate of technology diffusion in fast-cycle markets facilitate rapid imitation. A competitor uses reverse engineering to quickly gain the knowledge required to imitate or improve the firm's products, usually in only a few months. Technology is diffused rapidly in fast-cycle markets, making it available to competitors in a short period of time. The technology often used by fast-cycle competitors isn't proprietary, nor is it protected by patents, as in slow-cycle markets. Fast cycle markets are more volatile than slow cycle markets and standard cycle markets. Indeed, the pace of competition in fast-cycle markets is almost frenzied, as companies rely on ideas and the innovations resulting from them as the engines of their growth. Because prices fall quickly in these markets, companies need to profit quickly from their product innovations. Fast-cycle market characteristics make it virtually impossible for companies in this type of market to develop sustainable competitive advantages. Recognising this, firms avoid “loyalty” to any of their products, preferring to cannibalise their current product by launching a new product before competitors learn how to do so through successful imitation. This emphasis creates competitive dynamics that differ substantially from those in slow-cycle markets. Instead of concentrating on protecting, maintaining, and extending competitive advantages, as is the case for firms in slow-cycle markets, companies competing in fast-cycle markets focus on learning how to rapidly and continuously develop new competitive advantages that are superior to those they replace. In fast cycle markets, firms don’t concentrate on trying to protect a given competitive advantage because they understand that the advantage won’t exist long enough to extent it.

Competitive dynamics in this market type finds firms taking actions and responses in the course of competitive rivalry that are oriented to rapid and continuous product introductions and the use of a stream of ever-changing competitive advantages. The firm launches a product as a competitive action and then exploits the advantage associated with it for as long as possible. However, the firm also tries to move to another temporary competitive action before competitors can respond to the first one. Thus, competitive dynamics in fast cycle markets, in which all firms seek to achieve new competitive advantages before
competitors, learn how to effectively respond to current ones, often result in rapid product upgrades as well as quick product innovations. As our discussion suggests, innovation has a dominant effect on competitive dynamics in fast cycle markets. For individual firms, this means that innovation is a key source of competitive advantage. Through innovation, the firm can cannibalise its own products before competitors successfully imitate them.

4.4.3 STANDARD-CYCLE MARKETS

Standard-cycle markets are those in which the firm’s competitive advantages are moderately shielded from imitation and where imitation is moderately costly. Competitive advantages are partially sustainable in standard-cycle markets, but only when the firm is able to continuously upgrade the quality of its competitive advantages. The competitive actions and responses that form a standard-cycle market’s competitive dynamics find firms seeking large market shares, trying to gain customer loyalty through brand names, and carefully controlling their operations to consistently provide the same positive experience for customers.

Figure 4.2: Competitive Dynamics

Companies competing in standard-cycle markets serve many customers. Because the capabilities on which their competitive advantages are based are less specialised, imitation is faster and less costly for standard-cycle firms than for those competing in slow-cycle markets. However, imitation is less quick and more expensive in these markets than in fast cycle markets. Thus, the competitive dynamics in standard-cycle markets rest midway between the characteristics of dynamics in slow-cycle and fast-cycle markets. The quickness of imitation is reduced and becomes more expensive for standard-cycle competitors when a firm is able to develop economies of scale by combining coordinated and integrated design and manufacturing processes with a large sales volume.
Because of large volumes, the size of mass markets, and the need to develop scale economies, the competition for market share is intense in standard-cycle markets. This form of competition is readily evident in the battles between the Coca-Cola and PepsiCo.

**TABLE 4.1: COMPETITIVE DYNAMICS**

<table>
<thead>
<tr>
<th>Slow cycle market</th>
<th>Fast cycle market</th>
<th>Standard cycle market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive advantage</td>
<td>Shielded from imitation for long periods of time</td>
<td>Not shielded from imitation</td>
</tr>
<tr>
<td>Sustainability</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Imitation</td>
<td>Costly</td>
<td>Quick &amp; inexpensive</td>
</tr>
<tr>
<td>Strategy</td>
<td>Concentrate on competitive actions &amp; responses to protect, maintain &amp; extend proprietary advantage</td>
<td>Competitors reverse engineer to quickly imitate or improve on firm’s products Non-proprietary technology diffused rapidly</td>
</tr>
<tr>
<td>Industry</td>
<td>Pharma R&amp;D patents Disney characters</td>
<td>Reverse engineering firms- Indian pharma, PC makers</td>
</tr>
</tbody>
</table>

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

9. Competitive advantages are sustainable in ................. markets.

10. Fast-cycle markets are markets in which the firm’s capabilities that contribute to competitive advantages aren't shielded from ................. and where imitation is often rapid and inexpensive.

**ACTIVITY**

Prepare a presentation on the costs and benefits of imitation of technological competencies of rivals in the smart phone segment of the mobile handset industry.
The degree of sustainability is affected by how quickly competitive advantages can be imitated and how costly it is to do so.

### 4.5 COMPETITIVE RIVALRY

Competitive rivalry exists when companies jockey with one another in the pursuit of an advantageous market position. This means that, when one or more companies competing in an industry feels pressure to act or perceives an opportunity to improve their competitive position, competitive rivalry occurs as various companies initiate a series of actions and responses.

Competitive rivalry exists because of competitive asymmetry, which describes the fact that companies differ from one another in terms of their resources, capabilities, and core competencies, and the opportunities and threats in their competitive environments and industries.

It also is important that companies recognise that competition results in mutual interdependence among companies in the industry as each company tries to establish a sustainable competitive advantage. As companies strive to achieve strategic competitiveness and earn above-average returns, they must recognise that strategies are not implemented in isolation from competitors’ actions and responses. The strategic management process represents companies taking a series of actions, fending off counter-actions or responses and developing responses of their own.

This is important because the pattern of competitive rivalry and competitive dynamics in the market(s) in which companies compete affects strategic competitiveness and returns. Figure 4.3 below provides a model of competitive rivalry.

![Figure 4.3: A Summary Model of Competitive Rivalry](image)

We can make a number of observations from the model in Figure 4.3. Competitive rivalry or competitive dynamics begin with an assessment of competitors’ awareness and motivation to attack and/or respond to competitive moves. Market commonality and resource similarity...
are affected by a company’s awareness, and motivation affects the likelihood of attack or response. The likelihood of attack and response result in competitive outcomes, with outcomes moderated by a company’s ability to take strategic actions or responses. Feedback from competitive outcomes will affect future competitive dynamics by affecting the nature of a company’s awareness, motivation, and ability for action/response. If companies overlap in a number of markets, multipoint competition—a situation where companies compete against each other simultaneously in a number of geographic or product markets—generally results. Interestingly, a high level of commonality reduces the likelihood of competitive interaction. Since the major airlines are in so many common markets, there generally is competitive peace. However, when one company makes a competitive move, the others are compelled to respond rapidly.

The intensity of competitive rivalry in an industry often is based on the potential for response. As a result, attackers generally are not motivated to target a rival that is likely to retaliate. In other words, in most cases, dissimilar resources may increase the likelihood of an attack while companies with similar resources (overlap between their resource portfolios) will be less likely to attack because resource similarity increases the likelihood of retaliation.

As already defined, competitive rivalry is the ongoing set of competitive actions and competitive responses occurring between competing firms and an advantageous market position. Because the ongoing competitive action response sequence between a firm and a competitor affects the performance of both firms, it is important for companies to carefully study competitive rivalry to successfully use their strategies. Understanding a competitor’s awareness, motivation, and ability helps the firm to predict the likelihood of an attack by that competitor and how likely it is that a competitor will respond to the actions taken against it.

As described above, the predictions drawn from the study of competitors in terms of awareness, motivation and ability are grounded in market commonality and resource similarity. These predictions are fairly general. The value of the final set of predictions the firm develops about each of its competitor’s competitive actions and competitive responses is enhanced by studying the “Likelihood of Attack” factors (such as first mover incentives and organisational size) and the “Likelihood of Response” factors (such as the actor’s reputation).

### 4.5.1 STRATEGIC AND TACTICAL ACTIONS

Firms use both strategic and tactical actions when forming their competitive actions and competitive responses in the course of engaging in competitive rivalry. A competitive action is a strategic or tactical action the firm takes to build or defend its competitive advantages or improve its market position. A competitive response is a strategic or tactical action the firm takes to counter the effects
of a competitor’s competitive action. A strategic action or a strategic response is a market based move that involves a significant commitment of organisational resources and is difficult to implement and reverse. A tactical action or a tactical response is a market based move that is taken to fine tune a strategy; it involves fewer resources and is relatively easy to implement and reverse.

4.5.2 LIKELIHOOD OF ATTACK

In addition to market commonality, resources similarity, and the drivers of awareness, motivation, and ability, other factors also affect the likelihood a competitor will use strategic actions and tactical actions to attack its competitors. Three of these factors are first-mover incentives, organisational size and quality.

First-mover Incentives

A first mover is a firm that takes an initial competitive action to build or to defend its competitive advantages or to improve its market position. Superior Research and Development skills are often the foundation of the first mover’s competitive success. The first mover concept has been influenced by the work of the famous economist Joseph Schumpeter, who argued that firms achieve competitive advantage by taking innovative actions. In general, first movers “allocate funds for product innovation and development, aggressive advertising, and advanced research and development.”

The benefits of being a successful first mover can be substantial. Especially in fast-cycle markets where changes occur rapidly and where it is virtually impossible to sustain a competitive advantage for any period of time, “a first mover may experience five to ten times the valuation and revenue of a second mover.” This evidence suggests that although first-mover benefits are never absolute they are often critical to firm’s success in industries experiencing rapid technological developments and relatively short product life cycles.

In addition to earning above average returns until its competitors respond to its successful competitive action, the first mover can gain (a) the loyalty of customers who may become committed to the goods or services of the firm that first made them available and (b) market share that can be difficult for competitors to take during future competitive rivalry.

First movers tend to be aggressive and willing to experiment with innovation and take higher, yet reasonable, levels of risk. To be a first mover, the firm must have readily available the amount of resources required to significantly invest in Research & Development as well as to rapidly and successfully produce and market a stream of innovative products. Organisational slack makes it possible for firms to have the ability (as measured by available resources) to be first movers. Slack is the buffer or cushion provided by actual or obtainable resources that aren’t currently in use and are in excess of the minimum resources needed to produce a given level of organisational output. Thus, slack
is liquid resources that the firm can quickly allocate to support the actions such as Research & Development investments and aggressive marketing campaigns that lead to first mover benefits. Slack allows a competitor to take aggressive competitive actions to continuously introduce innovative products. Furthermore, a first mover will try to rapidly gain market share and customer loyalty in order to earn above average returns until its competitors are able to effectively respond to its first move.

Being a first mover also carries risk. For example, it is difficult to accurately estimate the returns that will be earned from introducing product innovations. Additionally, the first mover’s cost to develop a product innovation can be substantial, reducing the slack available to support further innovation. Also, research has shown that in some cases, a first mover is less likely to make the conversion to the product design that eventually becomes the dominant in the industry. In such cases, a first mover enjoys most of the benefits from its new product in the period before adoption of a dominant design. These risks mean that a firm should carefully study the results a competitor achieves as a first mover. Continuous success by the competitor suggests additional product innovations, while lack of product acceptance over the course of the competitor’s innovations may indicate less willingness in the future to accept the risks of being a first mover.

**Second Mover Incentives**

A second mover is a firm that responds to the first mover’s competitive action, typically through imitation. More cautious than the first mover, the second mover studies customers’ reactions to product innovations. In the course of doing so, the second mover also tries to find any mistakes the first mover made so that it can avoid the problems resulting from them. Often, successful imitation of the first mover’s innovations allows the second mover “to avoid both the mistakes and the huge spending of the pioneers (first movers).” Second movers also have the time to develop processes and technologies that are more efficient than those the first mover used. Greater efficiencies could result in lower costs for the second mover. Overall, the outcomes of the first mover’s competitive actions may provide an effective blueprint for second and even late movers as they determine the nature and timing of their competitive responses.

Determining that a competitor thinks of itself as an effective second mover allows the firm to predict that the competitor will tend to respond quickly to first movers’ successful, innovation based market entries. If the firm itself is a first mover, then it can expect a successful second mover competitor to study its market entries and to respond to them quickly. As a second mover, the competitor will try to respond with a product that creates customer value exceeding the value provided by the product that the firm introduced initially as a first mover. The most successful second movers are able to rapidly and meaningfully interpret market feedback to respond quickly, yet productively, to the first mover’s innovations.
Late Mover Incentives

A late mover is a firm that responds to a competitive action, but only after considerable time has elapsed after the first mover’s action and the second mover’s response. Typically, a late response is better than no response at all, although any success achieved from the late competitive response tends to be slow in coming and considerably less than that achieved by first and second movers. Thus, the firm competing against a late mover can predict that the competitor will likely enter a particular market only after both the first and second movers have achieved success. Moreover, on a relative basis, the firm can predict that the late mover’s competitive action will allow it to earn even average returns only when enough time has elapsed for it to understand how to create value that is more attractive to customers than is the value offered by the first and second mover’s products. Although exceptions do exist, the firm can predict that the late mover’s competitive actions will be relatively ineffective, certainly as compared with those initiated by first movers and second movers.

| Table 4.2: Factors affecting likelihood of attack |
|----------------|---------------------------------|
| **First mover** | Allocate funds for product innovation, aggressive advertising, R&D Can gain loyalty of customers committed to the firm’s goods or services Difficult for competitors to take market share |
| **Second mover** | Responds typically through imitation Studies customer reactions to innovation, avoids mistakes & huge spends May develop more efficient processes and technologies |
| **Late mover** | Responds to competitive action after considerable time has elapsed Slow to succeed, lesser share & average returns than first & second movers |
| **Small firms** | More likely to launch quicker competitive actions, rely on speed and surprise to defend competitive advantages or develop new ones |
| **Large firms** | Likely to initiate more competitive and strategic actions over a period |

4.5.3 Organisational Size

An organisation’s size affects the likelihood that it will take competitive actions as well as the types of actions it will take and their timing. In general, compared with large companies, small firms are nimble and flexible competitors who rely on speed and surprise to defend their competitive advantages or develop new ones while engaged in competitive rivalry, especially with large companies, to gain an advantageous market position. Small firms’ flexibility and nimbleness allow them to develop greater variety in their competitive actions relative to larger firms. Nevertheless, because they tend to have more slack resources, large firms are likely to initiate more competitive
and strategic actions during a given time. Thus, the competitive actions a firm likely will encounter from competitors larger than itself are different from the competitive actions it will encounter from competitors who are smaller.

Relying on a limited variety of competitive actions (which is the large firm's tendency) can lead to reduced competitive success across time, partly because competitors learn how to effectively respond to a predictable set of competitive actions taken by a firm. In contrast, remaining flexible and nimble (which is the small firm's tendency) in order to develop and use a wide variety of competitive actions contributes to success against rivals.

4.5.4 LIKELIHOOD OF RESPONSE

So far in this chapter we have examined how market commonality, resource similarity, awareness of mutual interdependence, motivation to act based on perceived gains and losses, and the ability of a firm to take action can influence competitive behaviour. We have also described how first mover incentives, organisational size, and a firm's emphasis on quality can help a firm predict whether a competitor will pursue a competitive action. These same factors should also be evaluated to help a firm predict whether a competitor will respond to an action it is considering. In addition, this section describes other factors that a firm should consider when predicting competitive responses from one or more competitors.

The success of a firm's competitive action is affected both by the likelihood that a competitor will respond to it and by the type (strategic or tactical) and effectiveness of that response. As noted earlier, a competitive response is a strategic or tactical action the firm takes to counter the effects of a competitor's competitive action. In general, a firm is likely to respond to a competitor's action if the action either significantly strengthens the position of the competitor or significantly weakens the competitive position of the firm. For instance, the actions of a competitor may lead to better use of its capabilities to create competitive advantages or an improved market position. Alternatively, the actions of a competitor could damage the firm's own ability to use its capabilities to create or maintain an advantage or could make its market position less defensible.

Three factors can help a firm predict how a competitor is likely to respond to competitive actions: the type of competitive action, reputation and market dependence.

Type of Competitive Action

Competitive responses to strategic actions differ from responses to tactical actions. These differences allow the firm to predict a competitor's likely response to a competitive action that has been launched against it. Of course, a general prediction is that strategic actions receive strategic responses while tactical responses are taken to counter the effects of tactical actions.
In general, strategic actions elicit fewer total competitive responses. The reason in this case is that as with strategic responses, such as market based moves, involve a significant commitment of resources and are difficult to implement and reverse. Moreover, the time needed for a strategic action to be implemented and its effectiveness assessed delays the competitor’s response to that action. In contrast to the time often required to respond to a strategic action, a competitor likely will respond quickly to a tactical action, such as when an airline company almost immediately matches a competitor’s tactical action of reducing prices in certain markets. Either strategic actions or tactical actions that target a large number of a rival’s customers are likely to be targeted with strong responses. In fact, if the effects of a competitor’s action on the local firms are significant (e.g., loss of market share, loss of major resources such as critical employees), a response is likely to be swift and strong.

Actor’s Reputation

In the context of competitive rivalry, an actor is the firm taking an action or response; reputation is “the positive or negative attribute ascribed by one rival to another based on past competitive behaviour.” A positive reputation may be a source of competitive advantage and high returns, especially for producers of consumer goods. To predict the likelihood of a competitor’s response to a current or planned action, the firm studies the responses that the competitor has taken previously when attacked – past behaviour is assumed to be a reasonable predictor of future behaviour.

Competitors are more likely to respond to either strategic or tactical actions that are taken by a market leader. In particular, successful actions will be quickly imitated.

Dependence on the Market

Market dependence denotes the extent to which a firm’s revenues or profits are derived from a particular market. In general, firms can predict that competitors with high market dependence are likely to respond strongly to attacks threatening their market position. Interestingly, the threatened firm in these instances may not respond quickly, but rather take more of a calculated approach so that its response is more effective.

**ACTIVITY**

- Consider an island where people are not accustomed to wearing shoes and thus, stay bare footed. In such circumstances, would the first mover’s advantage accrue to a company that sets shop in the market at the earliest?
- What is blitzkrieg strategy? Write a 200-words report on a company that may have used this to attack its more established industry peers.
SELF ASSESSMENT QUESTIONS

Fill in the blanks:

11. ……………….. or ………………. begin with an assessment of competitors’ awareness and motivation to attack and/or respond to competitive moves.

12. The value of the final set of predictions the firm develops about each of its competitor’s competitive actions and competitive responses is enhanced by studying the ………………… factors and the ………………… factors.

13. Competitive responses to strategic actions differ from responses to …………………

14. Three factors can help a firm predict how a competitor is likely to respond to competitive actions: the type of …………………, ………………. and …………………

4.6 SUMMARY

- Competitor analysis is an important part of a firm’s development of its strategy. Its importance lies in the understanding of competitors, their strategy, and resources and capabilities.

- Competitor analysis also allows a firm to assess its own firm versus competitors and plan for what competitors’ actions may be as a reaction to actions the firm may take.

- A competitor analysis provides a firm with the knowledge to leverage its strengths and address its weaknesses and conversely, take advantage of weaknesses of competitors and counter their strengths.

- Competitor analysis also gives a firm a better understanding not only of the competitors but also their overall sector and where the emerging opportunities may be.

- Competitive rivalry exists because of competitive asymmetry, which describes the fact that companies differ from one another in terms of their resources, capabilities, and core competencies, and the opportunities and threats in their competitive environments and industries.

KEY WORDS

- **Competitive Advantage**: Condition which enables a company to operate in a more efficient or otherwise higher-quality manner than the companies it competes with, and which results in benefits accruing to that company.
Notes

- **Competitor**: Any person or entity which is a rival against another. In business, a company in the same industry or a similar industry which offers a similar product or service. The presence of one or more competitors can reduce the prices of goods and services as the companies attempt to gain a larger market share. Competition also requires companies to become more efficient in order to reduce costs.

- **Intensity of Rivalry**: The intensity of rivalry among competitors in an industry refers to the extent to which firms within an industry put pressure on one another and limit each other’s profit potential.

- **Competitive Dynamics**: Competitive dynamics concerns the ongoing actions and responses taking place among all firms competing within a market for advantageous positions.

- **Strategic Action**: A strategic action or a strategic response is a market based move that involves a significant commitment of organisational resources and is difficult to implement and reverse.

- **Tactical Action**: A tactical action or a tactical response is a market based move that is taken to fine tune a strategy; it involves fewer resources and is relatively easy to implement and reverse.

### 4.7 DESCRIPTIVE QUESTIONS

1. When competing against one another, firms jockey for a market position that is advantageous, relative to competitors. In this jockeying, what are the ethical considerations associated with the way competitor intelligence is gathered?

2. Second movers often respond to a first mover’s competitive actions through imitation. Is there anything unethical about a company imitating a competitor’s good or service as a means of engaging in competition?

3. Discuss the implications of competitive advantage on slow-cycle markets. Explain how the firms in fast-cycle markets facilitate rapid imitation.

4. Explain the competitor analysis framework with a suitable diagram.

5. How does Porter’s intensity of rivalry in an industry affects the competitive environment and influences the ability of existing firms to achieve profitability? Explain with factors of intensive rivalry.


7. Explain the difference between strategic and tactical actions which the firms use it for forming their competitive actions.
and competitive responses in the course of engaging in the competitive rivalry.

8. Explain the factors affecting the likelihood of attack which competitors use it for defending competition.

9. How does the assumptions help the competitor's managers for defining the competitive moves? Explain with an example. State the competitor response profile.

10. “An organisation’s size affects the likelihood that it will take competitive actions as well as the types of actions it will take and their timing”. Discuss in context to large size and small size firms.

### 4.8 ANSWERS AND HINTS

#### ANSWERS FOR SELF-ASSESSMENT QUESTIONS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Q. No.</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
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<td>Competitor Analysis</td>
<td></td>
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<tr>
<td>Framework</td>
<td>1.</td>
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#### HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 4.5

   Competitive rivalry or competitive dynamics begin with an assessment of competitors’ awareness and motivation to attack and/or respond to competitive moves. Market commonality and resource similarity are affected by a company’s awareness, and motivation affects the likelihood of attack or response. The likelihood of attack and response result in competitive outcomes,
with outcomes moderated by a company’s ability to take strategic actions or responses. Feedback from competitive outcomes will affect future competitive dynamics by affecting the nature of a company’s awareness, motivation, and ability for action/response.

2. Refer to 4.5.2

There is not anything unethical about a company imitating a competitor’s good or service as a means of engaging in competition. Often, successful imitation of the first mover’s innovations allows the second mover “to avoid both the mistakes and the huge spending of the pioneers (first movers).” Second movers also have the time to develop processes and technologies that are more efficient than those the first mover used. Greater efficiencies could result in lower costs for the second mover. Overall, the outcomes of the first mover’s competitive actions may provide an effective blueprint for second and even late movers as they determine the nature and timing of their competitive responses. As a second mover, the competitor will try to respond with a product that creates customer value exceeding the value provided by the product that the firm introduced initially as a first mover. The most successful second movers are able to rapidly and meaningfully interpret market feedback to respond quickly, yet productively, to the first mover’s innovations.

3. Refer to 4.4.1 & 4.4.2

Building on of a kind competitive advantage that is proprietary leads to competitive success in a slow-cycle market. This type of advantage is difficult for competitors to understand and costly to imitate advantage results from unique historical conditions, causal ambiguity, and or social complexity. Copyrights, geography, patents, and ownership of information resources are examples of what leads to one of kind advantages. Once a proprietary advantage is developed, the firm’s competitive behaviour in a slow-cycle market is oriented to protecting, maintaining, and extending that advantage. Thus, the competitive dynamics in slow-cycle markets involve all firms concentrating on competitive actions and responses that enable them to protect, maintain, and extend their proprietary competitive advantage. Reverse engineering and the rate of technology diffusion in fast-cycle markets facilitate rapid imitation. A competitor uses reverse engineering to quickly gain the knowledge required to imitate or improve the firm’s products, usually in only a few months. Indeed, the pace of competition in fast-cycle markets is almost frenzied, as companies rely on ideas and the innovations resulting from them as the engines of their growth. Because prices fall quickly in these markets, companies need to profit quickly from their product innovations. Fast-cycle market characteristics make it virtually impossible for companies in this type of market to develop sustainable competitive advantages. Recognising this, firms avoid “loyalty” to any of their products, preferring to
cannibalise their current product by launching a new product before competitors learn how to do so through successful imitation. This emphasis creates competitive dynamics that differ substantially from those in slow-cycle markets.

4. Refer to 4.2

Even the simplest competitive analysis displays two critical dimensions: the competitors and the criteria, or what we’ll call the competitive framework. The purpose of the competitive framework is to present the data in a way that makes it easy to compare the various sites across the different criteria. Michael Porter presented a framework for analysing competitors. This framework is based on the following four key aspects of a competitor: Competitor’s objectives; Competitor’s assumptions; Competitor’s strategy and Competitor’s capabilities.

5. Refer to 4.3.1 & 4.3.2

Several factors determine the intensity of competitive rivalry in an industry. If the industry consists of numerous competitors, Porter rivalry will be more intense. If the competitors are of equal size or market share, the intensity of rivalry will increase. If industry growth is slow, the intensity of rivalry will be high. If the industry’s fixed costs are high, competitive rivalry will be intense. If the industry’s products are undifferentiated or are commodities, rivalry will be intense.

6. Refer to 4.4.3

Standard-cycle markets are those in which the firm’s competitive advantages are moderately shielded from imitation and where imitation is moderately costly. Competitive advantages are partially sustainable in standard-cycle markets, but only when the firm is able to continuously upgrade the quality of its competitive advantages. The competitive actions and responses that form a standard-cycle market’s competitive dynamics find firms seeking large market shares, trying to gain customer loyalty through brand names, and carefully controlling their operations to consistently provide the same positive experience for customers.

7. Refer to 4.5.1

A competitive response is a strategic or tactical action the firm takes to counter the effects of a competitor’s competitive action. A strategic action or a strategic response is a market based move that involves a significant commitment of organisational resources and is difficult to implement and reverse. A tactical action or a tactical response is a market based move that is taken to fine tune a strategy; it involves fewer resources and is relatively easy to implement and reverse.

8. Refer to 4.5.2

In addition to market commonality, resources similarity, and the drivers of awareness, motivation, and ability, other factors also
affect the likelihood a competitor will use strategic actions and tactical actions to attack its competitors. Three of these factors are first-mover incentives, organisational size and quality.

9. Refer to 4.2.3 & 4.2.5

The assumptions that a competitor’s managers hold about their firm and their industry help to define the moves that they will consider. For example, if in the past the industry introduced a new type of product that failed, the industry executives may assume that there is no market for the product. Such assumptions are not always accurate and if incorrect may present opportunities. Information from an analysis of the competitor’s objectives, assumptions, strategy, and capabilities can be compiled into a response profile of possible moves that might be made by the competitor. This profile includes both potential offensive and defensive moves.

10. Refer to 4.5.3

An organisation’s size affects the likelihood that it will take competitive actions as well as the types of actions it will take and their timing. In general, compared with large companies, small firms are nimble and flexible competitors who rely on speed and surprise to defend their competitive advantages or develop new ones while engaged in competitive rivalry, especially with large companies, to gain an advantageous market position. Small firms’ flexibility and nimbleness allow them to develop greater variety in their competitive actions relative to larger firms.

4.9 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS


E-REFERENCES

- http://www.netmba.com/strategy/competitor-analysis/
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PESTLE ANALYSIS OF RUSSIAN GAS INDUSTRY

The latest episode of US-Russia belligerence over the annexation of Crimea can potentially trigger tectonic shifts in the global natural gas industry. As allegations fly thick and fast on Russian expansionism, an intense and interesting sub-plot of rivalry promises to unfold.

Russia is the largest producer and exporter of natural gas in the world. Gazprom the state run natural gas monopoly is perhaps Vladimir Putin’s license to kill. Since the collapse of the Soviet Union, Russia under the leadership of Putin has identified energy as a sunrise sector. Russia is also likely to possess the world’s largest volume of still-undiscovered natural gas: a mean probable volume of 6.7 trillion cubic meters. A growing economy implies that domestic demand for natural gas is on the rise.

In the aftermath of Russia sending troops to safeguard the interests of Russian speaking people and then following it up with a referendum, deep cracks have appeared in bilateral relations between USA-EU and Russia. Over the last three months USA has retaliated to Russian aggression with economic sanctions and freezing of business operations of both Russian multi-national companies and individuals who are close to Putin. Many Russian banks have been selectively out casted from the banking system of the European Union.

Ukraine, the tug of war between EU and Russia is at a receiving end. Germany the largest economy in Europe also stands to face challenges. Germany has a robust industrial base and German demand for natural gas is on the rise. Sources claim that almost forty percent of the German demand for natural gas is supplied by Russia. Germany’s domestic energy resources are by far too insignificant relative to demand to be taken seriously. Ukraine, the cause of disagreement between Russia and US used to enjoy the benefits of highly subsidised Russian natural gas. Now that the bonhomie between Ukraine and Russia has gone for a toss, Gazprom the state run Russian company has decided to levy a debt with retrospective effect for its earlier gas supplies. The European Commission has requested Bulgaria, the poorest EU member nation to suspend the construction of a gas pipeline beneath the Black Sea that would have enabled Russia to supply gas to southern Europe. However, Bulgaria depends entirely on Russian gas supplies.

Gazprom, the Russian natural gas company is about to witness some excitement in the near future courtesy the interplay of competitive forces.
LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Explain the meaning of economic features of strategic management
- Describe the competitive forces shaping the strategy
- Define competition and value

5.1 INTRODUCTION

Industry analysis is a market strategy tool used by businesses to determine if they want to enter a product or service market. Company management must carefully analyze several aspects of the industry to determine if they can make a profit selling goods and services in the market. Analysing economic factors, supply and demand, competitors, future conditions and government regulations will help management decide whether to enter an industry or invest money elsewhere.

Economic Factors: Economic factors of industry analysis include raw materials, expected profit margins and the interference of substitute goods. The cost of raw materials is an important factor in industry analysis because over-priced goods will not sell in an established market. Profit margins are closely linked to materials costs because offering discounts or sales prices will shrink company profits and lessen cash inflows for future production activity.

Supply and Demand: A supply and demand analysis helps management understand if enough consumers are willing to purchase more goods in an industry. If demand is high and supply is low, a company may be willing to enter the market and offer goods near the market price to gain a competitive advantage in the industry. A trend of declining demand indicates an industry that is oversold, and any new competitors will likely lose money because consumers are not interested in current goods or services.

Competitors: The number of competitors is an important factor for proper industry analysis. If few competitors exist in a market, they may be charging consumers higher prices because of limited availability of products or services. As new competitors enter the market, existing companies can lower prices to maintain their current market share; newer competitors may not be able to match these price cuts if their products costs are too high. As industries contract, inefficient producers are forced out.

Future Conditions: While no company managers can predict the future of an industry, they can try to determine where the industry is
in the business cycle. If the industry is in an emerging market stage, companies can enter an industry and expect to earn a profit from rising consumer demand. If the industry is in a plateau stage, then only the most efficient producers with the lowest costs can continue to earn profits. At the end of a business cycle, demand is declining and producers leave the industry for more profitable markets.

**Government Regulations:** Some industries have heavier regulations or taxes than others, which must be considered by companies looking to enter new markets. Taxes and other government fees add to the cost of doing business, which eats into profits earned by companies. Properly understanding the amount of government regulation in an industry helps management to determine if expected profit margins will earn a high enough return to cover these costs.

In the terms of industry analysis and to make an industry grow in the competitive world it is quite essential to be strategic in its planning and future expectations. In the following paragraphs we will focus on all the aspects of industry analysis and strategic management in relation to that.

### 5.2 FORMULATION OF STRATEGY

The real meaning of strategy formulation is coping with competition. Yet it is easy to view competition too narrowly and too pessimistically. While one sometimes hears executives complaining to the contrary, intense competition in an industry is neither coincidence nor bad luck. In addition, in the fight for market share, competition is not manifested only in the other players. Rather, competition in an industry is rooted in its underlying economics, and competitive forces exists that go well beyond the established combatants in a particular industry. Customers, suppliers, potential entrants, and substitute products are all competitors that may be more or less prominent or active depending on the industry.

**DEFINITION**

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

The collective strength of the forces may be painfully apparent to all the antagonists; but to cope with them, the strategist must delve below the surface and analyse the sources of each. Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic agenda of action. They highlight the critical strengths and weaknesses of the company, animate the positioning of the company in its industry, clarify the areas where strategic changes may yield the greatest payoff, and highlight the places where industry trends promise to hold the greatest significance as wither opportunities or threats. Understanding these sources also proves to be of help in considering areas for diversification.
5.3 FIVE COMPETITIVE FORCES THAT SHAPE STRATEGY

In essence, the job of the strategist is to understand and cope with competition. Often, however, managers define competition too narrowly, as if it occurred only among today’s direct competitors. Yet competition for profits goes beyond established industry rivals to include four other competitive forces as well: customers, suppliers, potential entrants and substitute products. The extended rivalry that results from all five forces defines an industry’s structure and shapes the nature of competitive interaction within an industry.

As different from one another as industries might appear on the surface, the underlying drivers of profitability are the same. The global auto industry, for instance, appears to have nothing in common with the worldwide market for art masterpieces or the heavily regulated health-care delivery industry in Europe. But to understand industry competition and profitability in each of those three cases, one must analyze the industry’s underlying structure in terms of the five forces.

If the forces are intense, as they are in such industries as airlines, textiles, and hotels, almost no company earns attractive returns on investment. If the forces are benign, as they are in industries such as software, soft drinks, and toiletries, many companies are profitable. Industry structure drives competition and profitability, not whether an industry produces a product or service, is emerging or mature, high tech or low tech, regulated or unregulated. While a myriad of factors can affect industry profitability in the short run – including the weather and the business cycle – industry structure, manifested in the competitive forces, sets industry profitability in the medium and long run.
5.3.1 Differences in Industry Profitability

Understanding the competitive forces, and their underlying causes, reveals the roots of an industry’s current profitability while providing a framework for anticipating and influencing competition (and profitability) over time. A healthy industry structure should be as much a competitive concern to strategists as their company’s own position. Understanding industry structure is also essential to effective strategic positioning. As we will see, defending against the competitive forces and shaping them in a company’s favour are crucial to strategy.

![Diagram: Five Forces that Shape the Industry Competition](image)

Figure 5.1: Five Forces that Shape the Industry Competition

The configuration of the five forces differs by industry. In the market for commercial aircraft, fierce rivalry between dominant producers Airbus and Boeing and the bargaining power of the airlines that place huge orders for aircraft are strong, while the threat of entry, the threat of substitutes, and the power of suppliers are more benign. In the movie theatre industry, the proliferation of substitute forms of entertainment and the power of the movie producers and distributors who supply movies, the critical input, are important.

The strongest competitive force or forces determine the profitability of an industry and become the most important to strategy formulation. The most salient force, however, is not always obvious.

Example: Even though rivalry is often fierce in commodity industries, it may not be the factor limiting profitability. Low returns in the photographic film industry, for instance, are the result of a superior substitute product – as Kodak and Fuji, the world’s leading producers of photographic film, learned with the advent of digital photography. In such a situation, coping with the substitute product becomes the number one strategic priority.
Industry structure grows out of a set of economic and technical characteristics that determine the strength of each competitive force. We will examine these drivers in the pages that follow, taking the perspective of an incumbent, or a company already present in the industry. The analysis can be readily extended to understand the challenges facing a potential entrant.

5.3.2 THREAT OF ENTRY

New entrants to an industry bring new capacity and a desire to gain market share that puts pressure on prices, costs, and the rate of investment necessary to compete. Particularly when new entrants are diversifying from other markets, they can leverage existing capabilities and cash flows to shake up competition, as Pepsi did when it entered the bottled water industry, Microsoft did when it began to offer internet browsers, and Apple did when it entered the music distribution business. The threat of entry, therefore, puts a cap on the profit potential of an industry. When the threat is high, incumbents must hold down their prices or boost investment to deter new competitors. In specialty coffee retailing, for example, relatively low entry barriers mean that Starbucks must invest aggressively in modernising stores and menus.

The threat of entry in an industry depends on the height of entry barriers that are present and on the reaction entrants can expect from incumbents. If entry barriers are low and newcomers expect little retaliation from the entrenched competitors, the threat of entry is high and industry profitability is moderated. It is the threat of entry, not whether entry actually occurs, that holds down profitability.

Barriers to Entry

Entry barriers are advantages that incumbents have relative to new entrants. There are seven major sources:

Supply-side economies of scale: These economies arise when firms that produce at larger volumes enjoy lower costs per unit because they can spread fixed costs over more units, employ more efficient technology, or command better terms from suppliers. Supply-side scale economies deter entry by forcing the aspiring entrant either to come into the industry on a large scale, which requires dislodging entrenched competitors, or to accept a cost disadvantage. Scale economies can be found in virtually every activity in the value chain; which ones are most important varies by industry. In microprocessors, incumbents such as Intel are protected by scale economies in research, chip fabrication, and consumer marketing. For lawn care companies like Scotts Miracle-Gro, the most important scale economies are found in the supply chain and media advertising. In small-package delivery, economies of scale arise in national logistical systems and information technology.

Demand-side benefits of scale: These benefits, also known as network effects, arise in industries where a buyer’s willingness to pay for a
company’s product increases with the number of other buyers who also patronise the company. Buyers may trust larger companies more for a crucial product: Recall the old adage that no one ever got fired for buying from IBM (when it was the dominant computer maker). Buyers may also value being in a “network” with a larger number of fellow customers.

*Example:* Online auction participants are attracted to eBay because it offers the most potential trading partners. Demand-side benefits of scale discourage entry by limiting the willingness of customers to buy from a newcomer and by reducing the price the newcomer can command until it builds up a large base of customers.

**Customer switching costs:** Switching costs are fixed costs that buyers face when they change suppliers. Such costs may arise because a buyer who switches vendors must, for example, alter product specifications, retrain employees to use a new product, or modify processes or information systems. The larger the switching costs, the harder it will be for an entrant to gain customers.

*Example:* Enterprise Resource Planning (ERP) software is an example of a product with very high switching costs. Once a company has installed SAP’s ERP system, the costs of moving to a new vendor are astronomical because of embedded data, the fact that internal processes have been adapted to SAP, major retraining needs, and the mission-critical nature of the applications.

**Capital requirements:** The need to invest large financial resources in order to compete can deter new entrants. Capital may be necessary not only for fixed facilities but also to extend customer credit, build inventories, and fund start-up losses. The barrier is particularly great if the capital is required for unrecoverable and therefore harder-to-finance expenditures, such as up-front advertising or research and development. While major corporations have the financial resources to invade almost any industry, the huge capital requirements in certain fields limit the pool of likely entrants. Conversely, in such fields as tax preparation services or short-haul trucking, capital requirements are minimal and potential entrants plentiful. It is important not to overstate the degree to which capital requirements alone deter entry. If industry returns are attractive and are expected to remain so, and if capital markets are efficient, investors will provide entrants with the funds they need.

*Example:* For aspiring air carriers, financing is available to purchase expensive aircraft because of their high resale value, one reason why there have been numerous new airlines in almost every region.

**Incumbency advantages independent of size:** No matter what their size, incumbents may have cost or quality advantages not available to potential rivals. These advantages can stem from such sources as proprietary technology, preferential access to the best raw material sources, preemption of the most favourable geographic locations, established brand identities, or cumulative experience that has
allowed incumbents to learn how to produce more efficiently. Entrants try to bypass such advantages.

*Example:* Upstart discounters such as Target and Wal-Mart, have located stores in freestanding sites rather than regional shopping centres where established department stores were well entrenched.

**Unequal access to distribution channels:** The new entrant must, of course, secure distribution of its product or service. A new food item, for example, must displace others from the supermarket shelf via price breaks, promotions, intense selling efforts, or some other means. The more limited the wholesale or retail channels are and the more that existing competitors have tied them up, the tougher entry into an industry will be. Sometimes access to distribution is so high a barrier that new entrants must bypass distribution channels altogether or create their own. Thus, upstart low-cost airlines have avoided distribution through travel agents (who tend to favour established higher-fare carriers) and have encouraged passengers to book their own flights on the internet.

**Restrictive government policy:** Government policy can hinder or aid new entry directly, as well as amplify (or nullify) the other entry barriers. Government directly limits or even forecloses entry into industries through, for instance, licensing requirements and restrictions on foreign investment. Regulated industries like liquor retailing, taxi services, and airlines are visible examples. Government policy can heighten other entry barriers through such means as expansive patenting rules that protect proprietary technology from imitation or environmental or safety regulations that raise scale economies facing newcomers. Of course, government policies may also make entry easier – directly through subsidies, for instance, or indirectly by funding basic research and making it available to all firms, new and old, reducing scale economies. Entry barriers should be assessed relative to the capabilities of potential entrants, which may be start-ups, foreign firms, or companies in related industries. And, as some of our examples illustrate, the strategist must be mindful of the creative ways newcomers might find to circumvent apparent barriers.

### 5.3.3 EXPECTED RETALIATION

How potential entrants believe incumbents may react will also influence their decision to enter or stay out of an industry. If reaction is vigorous and protracted enough, the profit potential of participating in the industry can fall below the cost of capital. Incumbents often use public statements and responses to one entrant to send a message to other prospective entrants about their commitment to defending market share.

Newcomers are likely to fear expected retaliation if:

- Incumbents have previously responded vigorously to new entrants.
Incumbents possess substantial resources to fight back, including excess cash and unused borrowing power, available productive capacity, or clout with distribution channels and customers.

Incumbents seem likely to cut prices because they are committed to retaining market share at all costs or because the industry has high fixed costs, which create a strong motivation to drop prices to fill excess capacity.

Industry growth is slow so newcomers can gain volume only by taking it from incumbents.

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

5.3.4 POWER OF SUPPLIERS

Powerful suppliers capture more of the value for themselves by charging higher prices, limiting quality or services, or shifting costs to industry participants. Powerful suppliers, including suppliers of labour, can squeeze profitability out of an industry that is unable to pass on cost increases in its own prices.

Example: Microsoft has contributed to the erosion of profitability among personal computer makers by raising prices on operating systems. PC makers, competing fiercely for customers who can easily switch among them, have limited freedom to raise their prices accordingly.

Companies depend on a wide range of different supplier groups for inputs. A supplier group is powerful if:

- It is more concentrated than the industry it sells to. Microsoft’s near monopoly in operating systems, coupled with the fragmentation of PC assemblers, exemplifies this situation.

- The supplier group does not depend heavily on the industry for its revenues. Suppliers serving many industries will not hesitate to extract maximum profits from each one. If a particular industry accounts for a large portion of a supplier group’s volume or profit, however, suppliers will want to protect the industry through reasonable pricing and assist in activities such as R&D and lobbying.

- Industry participants face switching costs in changing suppliers.

Example: shifting suppliers is difficult if companies have invested heavily in specialised ancillary equipment or in learning how to operate a supplier’s equipment (as with Bloomberg terminals used by financial professionals). Or firms may have located their production lines adjacent to a supplier’s manufacturing facilities (as in the case of some beverage companies and container
manufacturers). When switching costs are high, industry participants find it hard to play suppliers off against one another. (Note that suppliers may have switching costs as well. This limits their power.)

- Suppliers offer products that are differentiated.
  
  *Example:* Pharmaceutical companies that offer patented drugs with distinctive medical benefits have more power over hospitals, health maintenance organisations, and other drug buyers, for example, than drug companies offering me-too or generic products.

- There is no substitute for what the supplier group provides.
  
  *Example:* Pilots’ unions, exercise considerable supplier power over airlines partly because there is no good alternative to a well-trained pilot in the cockpit.

- The supplier group can credibly threaten to integrate forward into the industry. In that case, if industry participants make too much money relative to suppliers, they will induce suppliers to enter the market.

### 5.3.5 POWER OF BUYERS

Powerful customers – the flip side of powerful suppliers – can capture more value by forcing down prices, demanding better quality or more service (thereby driving up costs), and generally playing industry participants off against one another, all at the expense of industry profitability. Buyers are powerful if they have negotiating leverage relative to industry participants, especially if they are price sensitive, using their clout primarily to pressure price reductions.

As with suppliers, there may be distinct groups of customers who differ in bargaining power. A customer group has negotiating leverage if:

- There are few buyers, or each one purchases in volumes that are large relative to the size of a single vendor. Large-volume buyers are particularly powerful in industries with high fixed costs, such as telecommunications equipment, offshore drilling, and bulk chemicals. High fixed costs and low marginal costs amplify the pressure on rivals to keep capacity filled through discounting.

- The industry’s products are standardised or undifferentiated. If buyers believe they can always find an equivalent product, they tend to play one vendor against another.

- Buyers face few switching costs in changing vendors.

- Buyers can credibly threaten to integrate backward and produce the industry’s product themselves if vendors are too profitable.

Producers of soft drinks and beer have long controlled the power of packaging manufacturers by threatening to make, and at times actually making, packaging materials themselves.
A buyer group is price sensitive if:

- The product it purchases from the industry represents a significant fraction of its cost structure or procurement budget. Here buyers are likely to shop around and bargain hard, as consumers do for home mortgages. Where the product sold by an industry is a small fraction of buyers’ costs or expenditures, buyers are usually less price sensitive.

- The buyer group earns low profits, is strapped for cash, or is otherwise under pressure to trim its purchasing costs. Highly profitable or cash-rich customers, in contrast, are generally less price sensitive (that is, of course, if the item does not represent a large fraction of their costs).

- The quality of buyers’ products or services is little affected by the industry’s product. Where quality is very much affected by the industry’s product, buyers are generally less price sensitive. When purchasing or renting production quality cameras, for instance, makers of major motion pictures opt for highly reliable equipment with the latest features. They pay limited attention to price.

- The industry’s product has little effect on the buyer’s other costs. Here, buyers focus on price. Conversely, where an industry’s product or service can pay for itself many times over by improving performance or reducing labour, material, or other costs, buyers are usually more interested in quality than in price.

Examples: Include products and services like tax accounting or well logging (which measures below-ground conditions of oil wells) that can save or even make the buyer money. Similarly, buyers tend not to be price sensitive in services such as investment banking, where poor performance can be costly and embarrassing.

Most sources of buyer power apply equally to consumers and to business-to-business customers. Like industrial customers, consumers tend to be more price sensitive if they are purchasing products that are undifferentiated, expensive relative to their incomes, and of a sort where product performance has limited consequences. The major difference with consumers is that their needs can be more intangible and harder to quantify.

Intermediate customers, or customers who purchase the product but are not the end user (such as assemblers or distribution channels), can be analysed the same way as other buyers, with one important addition. Intermediate customers gain significant bargaining power when they can influence the purchasing decisions of customers downstream. Consumer electronics retailers, jewellery retailers, and agricultural equipment distributors are examples of distribution channels that exert a strong influence on end customers.

Producers often attempt to diminish channel clout through exclusive arrangements with particular distributors or retailers or by marketing
directly to end users. Component manufacturers seek to develop power over assemblers by creating preferences for their components with downstream customers. Such is the case with bicycle parts and with sweeteners.

Example: DuPont has created enormous clout by advertising its Stainmaster brand of carpet fibres not only to the carpet manufacturers that actually buy them but also to downstream consumers. Many consumers request Stainmaster carpet even though DuPont is not a carpet manufacturer.

Threat of Substitutes

A substitute performs the same or a similar function as an industry’s product by a different means. Videoconferencing is a substitute for travel. Plastic is a substitute for aluminium. E-mail is a substitute for express mail. Sometimes, the threat of substitution is downstream or indirect, when a substitute replaces a buyer industry’s product.

Example: Lawn-care products and services are threatened when multifamily homes in urban areas substitute for single-family homes in the suburbs. Software sold to agents is threatened when airline and travel websites substitute for travel agents.

Substitutes are always present, but they are easy to overlook because they may appear to be very different from the industry’s product: To someone searching for a Father’s Day gift, neckties and power tools may be substitutes. It is a substitute to do without, to purchase a used product rather than a new one, or to do it yourself (bring the service or product in-house). When the threat of substitutes is high, industry profitability suffers. Substitute products or services limit an industry’s profit potential by placing a ceiling on prices. If an industry does not distance itself from substitutes through product performance, marketing, or other means, it will suffer in terms of profitability – and often growth potential. Substitutes not only limit profits in normal times, they also reduce the bonanza an industry can reap in good times.

Example: In emerging economies, the surge in demand for wired telephone lines has been capped as many consumers opt to make a mobile telephone their first and only phone line.

The threat of a substitute is high if:

- It offers an attractive price-performance trade-off to the industry’s product. The better the relative value of the substitute, the tighter is the lid on an industry’s profit potential.

Example: Conventional providers of long-distance telephone service have suffered from the advent of inexpensive internet-based phone services such as Vonage and Skype. Similarly, video rental outlets are struggling with the emergence of cable and satellite video-on-demand services, online video rental services...
such as Netflix, and the rise of internet video sites like Google’s YouTube.

- The buyer’s cost of switching to the substitute is low. Switching from a proprietary, branded drug to a generic drug usually involves minimal costs, for example, which is why the shift to generics (and the fall in prices) is so substantial and rapid.

Strategists should be particularly alert to changes in other industries that may make them attractive substitutes when they were not before. Improvements in plastic materials, for example, allowed them to substitute for steel in many automobile components. In this way, technological changes or competitive discontinuities in seemingly unrelated businesses can have major impacts on industry profitability. Of course the substitution threat can also shift in favour of an industry, which bodes well for its future profitability and growth potential.

5.3.6 RIVALRY AMONG EXISTING COMPETITORS

Rivalry among existing competitors takes many familiar forms, including price discounting, new product introductions, advertising campaigns, and service improvements. High rivalry limits the profitability of an industry. The degree to which rivalry drives down an industry’s profit potential depends, first, on the intensity with which companies compete and, second, on the basis on which they compete.

The intensity of rivalry is greatest if:

- Competitors are numerous or are roughly equal in size and power. In such situations, rivals find it hard to avoid poaching business. Without an industry leader, practices desirable for the industry as a whole go unenforced.

- Industry growth is slow. Slow growth precipitates fights for market share.

- Exit barriers are high. Exit barriers, the flip side of entry barriers, arise because of such things as highly specialised assets or management’s devotion to a particular business. These barriers keep companies in the market even though they may be earning low or negative returns. Excess capacity remains in use, and the profitability of healthy competitors suffers as the sick ones hang on.

- Rivals are highly committed to the business and have aspirations for leadership, especially if they have goals that go beyond economic performance in the particular industry. High commitment to a business arises for a variety of reasons.

*Example:* State-owned competitors may have goals that include employment or prestige. Units of larger companies may participate in an industry for image reasons or to offer a full line. Clashes of personality and ego have sometimes exaggerated
rivalry to the detriment of profitability in fields such as the media and high technology.

- Firms cannot read each other’s signals well because of lack of familiarity with one another, diverse approaches to competing, or differing goals.

Rivalry is especially destructive to profitability if it gravitates solely to price because price competition transfers profits directly from an industry to its customers. Price cuts are usually easy for competitors to see and match, making successive rounds of retaliation likely. Sustained price competition also trains customers to pay less attention to product features and service. Price competition is most liable to occur if:

- Products or services of rivals are nearly identical and there are few switching costs for buyers. This encourages competitors to cut prices to win new customers. Years of airline price wars reflect these circumstances in that industry.

- Fixed costs are high and marginal costs are low. This creates intense pressure for competitors to cut prices below their average costs, even close to their marginal costs, to steal incremental customers while still making some contribution to covering fixed costs. Many basic-materials businesses, such as paper and aluminium, suffer from this problem, especially if demand is not growing. So do delivery companies with fixed networks of routes that must be served regardless of volume.

- Capacity must be expanded in large increments to be efficient. The need for large capacity expansions, as in the polyvinyl chloride business, disrupts the industry’s supply-demand balance and often leads to long and recurring periods of overcapacity and price cutting.

- The product is perishable. Perishability creates a strong temptation to cut prices and sell a product while it still has value. More products and services are perishable than is commonly thought. Just as tomatoes are perishable because they rot, models of computers are perishable because they soon become obsolete, and information may be perishable if it diffuses rapidly or becomes outdated, thereby losing its value. Services such as hotel accommodations are perishable in the sense that unused capacity can never be recovered.

Competition on dimensions other than price—on product features, support services, delivery time, or brand image, for instance—is less likely to erode profitability because it improves customer value and can support higher prices. Also, rivalry focused on such dimensions can improve value relative to substitutes or raise the barriers facing new entrants. While non-price rivalry sometimes escalates to levels that undermine industry profitability, this is less likely to occur than it is with price rivalry. As important as the dimensions of rivalry is whether rivals compete on the same dimensions. When all or many competitors
aim to meet the same needs or compete on the same attributes, the result is zero-sum competition. Here, one firm’s gain is often another’s loss, driving down profitability. While price competition runs a stronger risk than non-price competition of becoming zero sum, this may not happen if companies take care to segment their markets, targeting their low-price offerings to different customers.

Rivalry can be positive sum, or actually increase the average profitability of an industry, when each competitor aims to serve the needs of different customer segments, with different mixes of price, products, services, features, or brand identities. Such competition can not only support higher average profitability but also expand the industry, as the needs of more customer groups are better met. The opportunity for positive-sum competition will be greater in industries serving diverse customer groups. With a clear understanding of the structural underpinnings of rivalry, strategists can sometimes take steps to shift the nature of competition in a more positive direction.

How to analyse Industry - (Michael Porter, HBR-Jan, 2008)

- Analyse average industry profitability over a period
- 3-5 year period can distinguish temporary/cyclical changes from structural changes
- Understand the underpinnings of competition and the root causes of profitability in an industry analysis, not important to declare an industry attractive or unattractive
- Analyse industry structure quantitatively, than qualitatively with lists of factors
- Quantify the 5 forces – % age of buyer’s total cost accounted for by industry’s product (to understand buyer price sensitivity); %age of industry sales required to fill a plant or operate logistical network of efficient scale (to assess barriers to entry); buyer’s switching cost (to determine inducement an entrant or rival must offer customers)
- Define relevant industry – Products, exclusive/indirect industry, scope, competition
- Identify and segment participants – buyers, suppliers, competitors, substitutes and potential entrants
- Assess drivers of each competitive force – determine which are strong and weak – Why
- Determine overall industry structure and consistency – profitability levels and reasons, controlling factors; are more profitable players better positioned wrt the 5 forces
- Analyse future changes (+/-) in each force
- Aspects of industry structure, influenced by company, competitors or new entrants
- Common Pitfalls
- Defining industry – too broadly or too narrowly
Notes

- Paying equal attention to all forces than focusing on the most important ones
- Confusing effect (price sensitivity) with cause (buyer economics)
- Using static analysis that ignores industry trends
- Confusing cyclical or transient changes with true structural changes
- Use framework for strategic choices than declare industry – attractive/unattractive

Self Assessment Questions

Fill in the blanks:

2. The job of the strategist is to understand and cope with ..................

3. A healthy industry structure should be as much a competitive concern to ................ as their company’s own position.

4. New entrants to an industry bring new capacity and a desire to gain market share that puts pressure on prices, costs, and the rate of ................... necessary to compete.

5. The threat of entry in an industry depends on the height of entry barriers that are present and on the reaction entrants can expect from .................

6. If reaction is vigorous and protracted enough, the profit potential of participating in the industry can fall below the ................

7. Substitutes not only limit profits in normal times, they also reduce the ................ an industry can reap in good times.

8. High rivalry limits the ................ of an industry.

9. The strength of rivalry reflects not just the ................ of competition but also the basis of competition.

10. The competitive forces reveal the ................ of industry competition.

Activity

Consider the metals and mining industry in India. Outline the competitive forces that shall affect strategy formulation of a new entrant into the industry.

Note

The strength of rivalry reflects not just the intensity of competition but also the basis of competition. The dimensions on which competition takes place, and whether rivals converge to compete on the same dimensions, have a major influence on profitability.
5.4 PESTLE ANALYSIS

Originally designed as a business environmental scan, the PEST or PESTLE analysis is an analysis of the external macro environment (big picture) in which a business operates. These are often factors which are beyond the control or influence of a business, however are important to be aware of when doing product development, business or strategy planning.

5.4.1 HISTORY OF PESTLE

The term ‘PESTLE’ has been used regularly in the last 10+ years and its true history is difficult to establish. From our research, the earliest known reference to tools and techniques for ‘Scanning the Business Environment’ appears to be by Francis J. Aguilar (1967) who discusses ‘ETPS’ – a mnemonic for the four sectors of his taxonomy of the environment: Economic, Technical, Political, and Social. Shortly after its publication, Arnold Brown for the Institute of Life Insurance (in the US) reorganised it as ‘STEP’ (Strategic Trend Evaluation Process) as a way to organise the results of his environmental scanning.

Thereafter, this ‘macro external environment analysis’, or ‘environmental scanning for change’, was modified yet again to become a so-called STEPE analysis (the Social, Technical, Economic, Political and Ecological taxonomies). In the 1980s, several other authors including Fahey, Narayanan, Morrison, Renfro, Boucher, Mecca and Porter included variations of the taxonomy classifications in a variety of orders: PEST, PESTLE, STEEPLE etc. Why the slightly negative connotations of PEST have proven to be more popular than STEP is not known. There is no implied order or priority in any of the formats.

Some purists claim that STEP or PEST still contain headings which are appropriate for all situations, others claim that the additional breakdown of some factors to help individuals and teams undertaking an environmental scan.

Quite who and when added what elements to the mnemonic is a mystery, but what we do know is that the actual order and words contained are common to certain parts of the world and streams of academic study. The term PESTLE is particularly popular on HR and introductory marketing courses in the UK. Others favour PEST, STEP or STEEPLE.

5.4.2 PESTLE ANALYSIS TOOL

PESTLE analysis is a useful tool for understanding the “big picture” of the environment, in which you are operating, and the opportunities and threats that lie within it. By understanding the environment in which you operate (external to your company or department), you can take advantage of the opportunities and minimise the threats. Specifically the PEST or PESTLE analysis is a useful tool for understanding risks
associated with market growth or decline, and as such the position, potential and direction for a business or organisation.

The PESTLE analysis is often used as a generic ‘orientation’ tool, finding out where an organisation or product is in the context of what is happening outside that will at some point effect what is happening inside an organisation.

A PESTLE analysis is a business measurement tool, looking at factors external to the organisation. It is often used within a strategic SWOT analysis (Strengths, Weaknesses, Opportunities and Threats analysis). PESTLE is an acronym for Political, Economic, Social, Technological, Legal and Environmental factors, which are used to assess the market for a business or organisational unit strategic plan.

<table>
<thead>
<tr>
<th>TABLE 5.1: DESCRIPTION OF PESTLE ACRONYM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political</td>
</tr>
<tr>
<td>Regulatory/legislative, policy, Trade practices, Macro and external environment</td>
</tr>
<tr>
<td>Technological</td>
</tr>
<tr>
<td>Technology, innovation, lifecycle</td>
</tr>
</tbody>
</table>

The PESTLE analysis headings are a framework for reviewing a situation, and can also be used to review a strategy or position, direction of a company, a marketing proposition, or idea. There are many variants on this model including PEST analysis and STEEPLE analysis.

Completing a PESTLE analysis can be a simple or complex process. It all depends how thorough you need to be. It is a good subject for workshop sessions, as undertaking this activity with only one perspective (i.e. only one person’s view) can be time consuming and miss critical factors.

Use PESTLE analysis for business and strategic planning, marketing planning, business and product development and research reports.

The PESTLE template below includes sample questions or prompts, whose answers can be inserted into the relevant section of the table. The questions are examples of discussion points, and should be altered depending on the subject of the analysis, and how you want to use it. Make up your own PESTLE questions and prompts to suit the issue being analysed and the situation (i.e. the people doing the work and the expectations of them).
It is important to clearly identify the subject of a PESTLE analysis (that is a clear goal or output requirement), because an analysis of this type is multi-faceted in relation to a particular business unit or proposition – if you dilute the focus you will produce an unclear picture – so be clear about the situation and perspective that you use PESTLE to analyze.

A market is defined by what is addressing it, be it a product, company, organisation, brand, business unit, proposition, idea, etc, so be clear about how you define the market being analysed, particularly if you use PESTLE analysis in workshops, team exercises or as a delegated task. The PESTLE subject should be a clear definition of the market being addressed, which might be from any of the following standpoints:

- A company looking at its market
- A product looking at its market
- A brand in relation to its market
- A local business unit or function in a business
- A strategic option, such as entering a new market or launching a new product
- A potential acquisition
- A potential partnership
- An investment opportunity

Be sure to describe the subject for the PESTLE analysis clearly so that people contributing to the analysis, and those seeing the finished PESTLE analysis, properly understand the purpose of the PESTLE assessment and implications.

5.4.3 ON TO SWOT ANALYSIS

To take the PESTLE analysis forward you can integrate the results into your SWOT.

The outputs from the BIR/SWOT will provide you with your internal strengths and weaknesses.

Have a look at the HIGH impacts from the PESTLE. Some will be positive in nature, others will be negative. List these on your SWOT analysis under OPPORTUNITIES and THREATS.

The PESTLE model is a useful environmental scan as part of a diagnostic process. The PESTLE analysis tool can be used in association with the Business Improvement Review (BIR) – a highly structured and holistic SWOT tool. The PESTLE models can help to identify the context in which a business operates and provide a context for change. A PESTLE analysis can provide a valuable agenda upon which to use a Business Improvement Review (BIR) to help identify the strengths and weaknesses (SWOT) of an organisation, as apart of an organisational change process.
5.4.4 PEST-G OR PEST-E

There have been some changes to the way PEST is being used in 2009, with the addition of G for Green or E for Environment. Within the PESTLE version of course this is already catered for.

It has taken some time, but now those faithful to PEST rather than PESTLE are starting to change and add a new variant.

Fill in the blanks:

11. Originally designed as a business environmental scan, the ............... or ............... analysis is an analysis of the external macro environment (big picture) in which a business operates.

12. A PESTLE analysis is a business measurement tool, looking at factors ............... to the organisation.

13. PESTLE is an acronym for ............... , ............... , ............... , ............... , ............... and ............... factors.

Walmart wants to enter into the Indian multi-brand retail industry. Conduct PESTLE analysis for Walmart’s entry strategy in India.

5.5 COMPETITION AND VALUE

The competitive forces reveal the drivers of industry competition. A company strategist who understands that competition extends well beyond existing rivals will detect wider competitive threats and be better equipped to address them. At the same time, thinking comprehensively about an industry’s structure can uncover opportunities: differences in customers, suppliers, substitutes, potential entrants, and rivals that can become the basis for distinct strategies yielding superior performance. In a world of more open competition and relentless change, it is more important than ever to think structurally about competition.

Understanding the Industry Structure

Understanding industry structure is equally important for investors as for managers. The five competitive forces reveal whether an industry is truly attractive, and they help investors anticipate positive or negative shifts in industry structure before they are obvious. The five forces distinguish short-term blips from structural changes and allow investors to take advantage of undue pessimism or optimism. Those companies whose strategies have industry-transforming potential become far clearer. This deeper thinking about competition is a more powerful way to achieve genuine investment success than the
financial projections and trend extrapolation that dominate today’s investment analysis.

**Common Pitfalls**

If both executives and investors looked at competition this way, capital markets would be a far more effective force for company success and economic prosperity. Executives and investors would both be focused on the same fundamentals that drive sustained profitability. The conversation between investors and executives would focus on the structural, not the transient. Imagine the improvement in company performance – and in the economy as a whole – if all the energy expended in “pleasing the Street” were redirected toward the factors that create true economic value.

**Differences in Industry Profitability**

The average return on invested capital varies markedly from industry to industry. Between 1992 and 2006, for example, average return on invested capital in U.S. industries ranged as low as zero or even negative to more than 50%. At the high end are industries like soft drinks and pre-packaged software, which have been almost six times more profitable than the airline industry over the period.

**ACTIVITY**

Do a company’s actions to “please the street” deprive it of genuine opportunities to create value? Discuss.

### 5.6 INDUSTRY STRUCTURE

Now after seeing the forces what force the companies to make their strategy we will see that what is the structure of industry and what are its determinants. A final dimension of industry that is important to the performance of new firms is industry structure. The structure of the industry refers to the nature of barriers to entry and competitive dynamics in the industry. Four characteristics of industry structure are particularly important to the performance of new firms in the industry: capital intensity, advertising intensity, concentration and average firm size.

Capital intensity measures the importance of capital as opposed to labour in the production process. Some industries, such as aerospace, involve a great deal of capital and relatively little labour. Other industries, such as textiles, involve relatively little capital and a great deal of labour.

New firms perform better in labour intensive industries (ones where work matters more than money) than in capital intensive ones. Why? At the time that they are founded, new firms lack cash flow from existing operations. Yet new firms need to expend capital to establish the organisation and create production and distribution
assets. Because new firms must expend capital before they have cash flow from operations, they must obtain capital from external capital markets. Capital obtained from financial markets is more expensive than internally generated capital. Investors demand a premium for bearing the risk that comes from the gap of information between investors and entrepreneurs. The magnitude of this premium is related to the size of the capital requirement necessary to create the business. The larger the capital requirement, the greater the disadvantage faced by new firms in the industry.

New firms are disadvantaged relative to established firms in more advertising intensive industries. Advertising is a mechanism through which companies develop the reputations that help them sell their products and services. To build a brand name reputation through advertising, two conditions need to be met. First, the advertising has to be repeated over time. The capacities of human beings are such that they can only absorb so much information at a time. Therefore, it takes time for new firms to build their brand names, during which time they have lesser reputations than existing firms. Second, economies of scale exist in advertising. The cost of advertising is largely fixed, regardless of the number of units of a product sold. As a result, the cost per unit of advertising decreases with the volume of sales. New firms tend to produce fewer units than established firms because they begin operations at a small scale, making their per unit advertising costs higher than those of established firms. Of course, this advertising disadvantage is more problematic the more important advertising is for an industry, making new firms less competitive with established firms in more advertising intensive industries than in less advertising intensive ones.

New firms are disadvantaged relative to established firms in more concentrated industries. Concentration is a measure of the market share that is held by the largest companies in an industry. For instance, in some industries, such as pharmaceuticals, the largest companies account for almost all of the market. In contrast, in more fragmented industries, like dry cleaning, virtually no firm has even 1 percent of the total market. In concentrated industries, such as telecommunications firms offering local phone service, established firms have the resources to keep new firms from establishing a beachhead in the industry. As a result, they use their monopoly or oligopoly profits to deter entry. Moreover, entry can be deterred more easily in concentrated industries than in fragmented industries for two reasons. First, in fragmented industries, there are small, vulnerable firms that can be challenged more successfully than the large, powerful firms that are the only competitors in concentrated industries. Second, in concentrated industries, established firms can collude to keep other firms from entering. For instance, they can collectively cut prices when a new
entrant comes into the industry until that entrant is driven out of business and then raise prices again. Because collusion only works if all of the colluders participate, it is much easier to pull off when there are few players in an industry than when there are many.

New firms perform better in industries in which the average size of firms is small. New firms tend to begin small as a way to minimise the risk of entrepreneurial miscalculation. That is, if entrepreneurs begin small, they have a lower downside loss if they are incorrect. In industries in which most firms are small, starting a new firm at a small scale does not create much of a disadvantage relative to the established firms in the industry. In contrast, in industries where the average firm size is large, starting small creates a number of disadvantages, such as the inability to purchase in volume and higher average manufacturing and distribution costs due to the absence of economies of scale. As an example, think of the difference between Web site developers and steel mills. Because the average Web site developer is small, a new small Web site developer is able to operate at almost the same scale, if not the same scale, as the established players. However, the average steel mill is quite large. So, if a new steel mill is started small, it is initially at a great disadvantage relative to the established firms with which it needs to compete.

5.6.1 FRAGMENTATION AND CONSOLIDATION OF INDUSTRIES

Industries are fragmented for a wide variety of reasons, with greatly differing implications for competing in them. Some industries are fragmented for historical reasons — because of the resources or abilities of the firms historically in them — and there is no fundamental economic basis for fragmentation. However, in many industries there are underlying economic causes and the principal ones seem to be as follows:

- **Low overall Entry Barriers**: Nearly all fragmented industries have low overall entry barriers. Otherwise they could not be populated by so many small firms. However, although a prerequisite to fragmentation, low entry barriers are usually not sufficient to explain it. Fragmentation is nearly always accompanied by one or more of the other causes discussed below.

- **Absence of Economies of Scale or Experience Curve**: Most fragmented industries are characterised by the absence of significant scale economies or learning curves in any major aspect of the business, whether it be manufacturing processes characterised by few if any economies of scale or experience cost declines, because the process is a simple fabrication or assembly operation (fibreglass and polyurethane molding), is a straightforward warehousing operation (electronic component distribution), has an inherently high labour content (security guards), has a high personal service content or is intrinsically hard to mechanise or routinise.
High Transportation Cost: High transportation costs limit the size of an efficient plant or production location despite the presence of economies of scale. Transportation costs balanced against economies of scale determine the radius a plant can economically service. Transportation costs are high in such industries as cement, fluid milk, and highly caustic chemicals. They are effectively high in many service industries because the service is “produced” at the customer’s premises or the customer must come to where the service is produced.

High Inventory Costs or Erratic Sales Fluctuations: Although there may be intrinsic economies of scale in the production process, they may not be reaped if inventory carrying costs are high and sales fluctuate. Here production has to be built up and down, which works against the construction of large-scale, capital-intensive facilities and operating them continuously. Similarly, if sales are very erratic and fluctuate over a wide range, then the firm with large-scale facilities may not have advantages over the smaller, more nimble firm, even if the large firm’s production operations are more efficient in a fully loaded state. Small-scale, less specialised facilities or distribution systems are usually more flexible in absorbing output shifts than large, more specialised ones, even though they may have higher operating costs at a steady operating rate.

No Advantages of Size in Dealing with Buyers or Suppliers: The structure of the buyer groups and supplier industries is such that a firm gains no significant bargaining power in dealing with these adjacent business from being large. Buyers, for example, might be so large that even a large firm in the industry would only be marginally better off in bargaining with them than a smaller firm. Sometimes powerful buyers or suppliers will be powerful enough to actually keep companies in the industry small, through intentionally spreading their business or encouraging entry.

Diseconomies of Scale in Some Important Aspect: Diseconomies of scale can stem from a variety of factors. Rapid product changes or style changes demand quick response and intense coordination among functions. Where frequent introductions and style changes are essential to competition, allowing only short lead times, a large firm may be less efficient than a smaller one – which seems to be true in women’s clothing and other industries in which style plays a major role in competition.

If maintaining a low overhead is crucial to success, this factor can favour the small firm under the iron hand of an owner-manager, unencumbered by pension plans and other corporate trappings and less subject to scrutiny by government regulators than the large firm.

A high diverse product line requiring customisation to individual users requires a great deal of user-manufacturer interface on small volumes of product and can favour the small firm over the larger one.
The business forms industry many be an example of one in which such product diversity has led to fragmentation.

Although there are exceptions, if heavy creative content is required, it is often difficult to maintain the productivity of creative personnel in a very large company. One sees no dominant firms in industries such as advertising and interior design.

If close local control and supervision of operations is essential to success the small firm may have an edge. In some industries, particularly services like nightclubs and eating places, an intense amount of close, personal supervision seems to be required. Absentee management works less effectively in such business, as a general rule, than an owner-manager who maintains close control over relatively small operation.

Smaller firms are often more efficient where personal service is the key to the business. The quality of personal service and the customer’s perception that individualised, responsive service is being provided often seem to decline with the size of the firm once a threshold is reached. This factor seems to lead to fragmentation in such industries as beauty care and consulting.

Where a local image and local contacts often are keys to the business the large firm can be at a disadvantage. In some industries like aluminium fabricating, building supply, and many distribution business, a local presence is essential to success. Intense business development, contact building, and sales effort on a local level are necessary to compete. In such industries a local or regional firm can often outperform a larger firm provided it faces no significant cost disadvantages.

- **Direct Market Needs:** In some industries buyers’ tastes are fragmented, with different buyers each desiring special varieties of a product and willing (and able) to pay a premium for it rather than accept a more standardised version. Thus the demand for any particular product variety is small, and adequate volume is not present to support production, distribution, or marketing strategies that would yield advantages to the large firm. Sometimes fragmented buyers’ tastes stem from regional or local differences in market needs, for example, in the fire engine industry. Every local fire department wants its own customised fire engine with many expensive bells, whistles and other options. The nearly every fire engine sold is unique. Production is job shop and almost purely assembly, and there are literally dozens of fire engine manufacturers, none of whom has a major market share.

- **High Product Differentiation, Particularly if Based on Image:** If product differentiation is very high based on image, it can place limits on a firm’s size and provide an umbrella that allows inefficient firms to survive. Large size may be inconsistent with an image of exclusivity or with the buyer’s desire to have a brand
all his or her own. Closely related to this situation is one in which key suppliers to the industry value exclusively or a particular image in the channel for their products or services. Performing artists, for example, may prefer dealing with a small booking agency or record label that carries the image they desire to cultivate.

- **Exit Barriers:** If there are exit barriers, marginal firms will tend to stay in the industry and thereby hold back consolidation. Aside from economic exit barriers, managerial exit barriers appear to be common in fragmented industries. There may be competitors with goals that are not necessarily profit-oriented. Certain businesses may have a romantic appeal or excitement that attracts competitors who want to be in the industry despite low or even nonexistent profitability. This factor seems to be common in such industries as fishing and talent agencies.

- **Basic approach to overcome fragmentation:** It recognises that the root cause of the fragmentation cannot be altered. Rather, the strategy is to neutralise the parts of the business subject to fragmentation to allow advantages of share in other aspects to come into play.

- **Make Acquisitions for a Critical Mass:** In some industries there may ultimately be some advantages to holding a significant share, but it is extremely difficult to build share incrementally because of the causes of fragmentation. For example, if local contacts are important in selling, it is difficult to invade the territory of other firms in order to expand. But if the firm can develop a threshold share, it can begin to reap any significant advantages of scale. In companies can be successful, provided the acquisitions can be integrated and managed.

- **Recognise Industry Trends Early:** Sometimes industries consolidate naturally as they mature, particularly if the primary source of fragmentation was the newness of the industry; or exogenous industry trends can lead to consolidation by altering the causes of fragmentation.

  **Example:** Computer service bureaus are facing increasing competition from minicomputers and microcomputers. This new technology means that even the small and medium-sized firm can afford to have its own computer. Thus, service bureaus increasingly have had to service the large, multilocation company to continue their growth and/or to offer sophisticated programming and other services in addition to just computer time. This development has increased the economies of scale in the service bureau industry and is leading to consolidation.

In the service bureau example, the threat of substitute products triggered consolidation by shifting buyers’ needs, and thereby stimulating changes in service that were increasingly subject to
economies of scale. In other industries, changes in buyers’ tastes, changes in the structure of distribution channels, and innumerable other industry trends may operate, directly or indirectly, on the causes of fragmentation. Government or regulatory changes can force consolidation by raising standards in the product or manufacturing process beyond the reach of small firms through the creation of economies of scale. Recognising the ultimate effect of such trends, and positioning the company to take advantage of them, can be an important way of overcoming fragmentation.

5.6.2 CONSOLIDATION

Consolidation has long been used to achieve and sustain power in the marketplace. Indeed, creating a monopoly position through consolidation can be one of the most effective ways of achieving economic returns through a business venture. This long history does not imply, however, that consolidation strategies have remained the same. Using historical documentation and an analysis of current merger and acquisition activity, we show how consolidation strategies have evolved through the past century, and how they could be improved using a more rigorous framework. As with the prior waves, consolidation is ultimately encouraged by changes in the external environment, and many factors align to drive the current boom. However, the current wave of consolidation is much broader, spanning industrial and service industries. In addition, specialised financial players have joined the traditional consolidators, resulting in even greater market activity.

We certainly recognise that success for a consolidation play relies significantly on implementation. Our 5 C’s may suggest that an industry is ripe for a consolidation play only to have the consolidator fail during implementation. Conversely, our framework may suggest that successful consolidation is unlikely but a superior consolidator could overcome the negative issues.

The framework is meant to guide thinking about consolidations and highlight the factors that will ultimately influence success. As depicted in Figure 5.2, the 5 C’s are Capital access restricted; Cultures and regions compatible; Customers and competitors receptive; Change catalysts unlikely; and Competitive advantage realizable for the consolidator. Each element of the framework will be detailed further in following sections, but we first present a quick note on the interaction between the variables. The outer four variables address the major industry issues and highlight potential pitfalls. They are focused on the industry as a whole and should apply somewhat uniformly across individual businesses.

They should be examined by asking: “Is this issue significant in this industry?” If the answer is affirmative, then consolidation may well be successful. However, the fifth and centre variable is more business specific and should be examined by asking: “Do these opportunities
exist and are they realizable?” Essentially, the ultimate success in a consolidation play relies upon the proper implementation of the fifth variable.

Underlying this analysis must be the broader question of: “Why is this industry fragmented now and what has changed to make consolidation possible?” According to Michael Porter in Competitive Strategy, industries are usually fragmented for five general reasons. These reasons will be addressed in turn as they pertain to each of our 5 C’s but it is useful to summarise them here. They are:

- Low entry barriers and/or high exit barriers
- Lack of power advantages with buyers and/or suppliers
- No economies of scale or scope
- Regional issues: high transport costs, high inventory costs, or diverse markets
- Regulatory issues

There is some obvious overlap with some of our 5 C’s. Porter’s reasons are a useful starting point for understanding industry fragmentation but fail to fully cover all potential issues of a consolidation strategy. We highlight his work because it provides a useful foundation upon which to more deeply examine a consolidation play using the 5 C’s. In the following sections, we will address each of the 5 C’s in turn and incorporate the issues that Porter raises into our discussion.

**Capital Access Enhanced**

Fragmented industries are populated with businesses that are almost by definition small, private companies. As such, these businesses may face a more expensive cost of capital than they could get from the public markets. Thus, growth and capital reinvestment in these small businesses is limited or at least costly, which explains the evolution of the fragmented industry.
To invest and grow, the businesses would either have enough size to go public or find more favourable private capital. Either way, obtaining a cheaper cost of capital may create an advantage within the industry and allow for growth. This is the attractiveness for consolidators of industries with restricted capital access. A consolidated firm will not face such high transaction and information costs in the capital markets because of the economies of scale it will enjoy. However, industries with few capital requirements and no need for growth may not necessarily need cheaper capital.

Thus, to determine if this variable is both significant within the industry and suggests that industry consolidation will be successful, we need to ask several questions:

- Do industry players face a high cost of capital that would be cheaper in a consolidated firm?
- Is capital a significant enough factor in the industry that cheaper capital would create a significant competitive advantage?
- Will the capital markets support a consolidation play in this industry?

If the answer is affirmative to all three, then this variable suggests that industry consolidation will be successful. While most industries will suggest an affirmative answer to the first two questions, there may be few industries where cheaper capital is somewhat irrelevant.

**Example:** The beauty salon industry has few capital requirements and is certainly fragmented. Many, if not all, salons are privately owned by small business owners. The industry is near saturation in most markets and thus, there are few opportunities for growth. The retail channels are evolving into the shopping malls but for the most part, capital requirements remain small. Thus, restricted capital access is not a major concern.

There may also be an example of a fragmented industry that enjoys cheap capital that could not gain even cheaper capital for a consolidated firm.

The final question is perhaps the most basic but also most important. Currently, the capital markets are strong and willing to support consolidation plays. An economic downturn will sour the market appetite for such plays and could spell disaster for a consolidated firm.

**Cultures and Regions Compatible**

Fragmented industries develop for a variety of reasons. These vary from market segments that require specialised businesses and products to the historical evolution of the industry. Using Porter’s work, low barriers to entry and lack of a power advantage over buyers and/or suppliers may account for the historical development of fragmentation of this industry. Porter also highlights regional issues, such as high transportation costs, as a reason for industry
fragmentation. Another potential reason for industry fragmentation may simply be the personalities of the firm owners, who want to run their own businesses.

The fundamental outcome of all of these factors is that the cultures and regions of the individual businesses may be very different. Cultural issues can be further subdivided into both regional and industry differences. Regional cultures may seem relatively straightforward but are often subtle and can be often overlooked. Industry cultures include not only the personalities of the operators in the industry but also the personalities and norms of the various individuals and organisations that interact with the industry. Finally, the industry may dictate a need for distinct regional operations that may hinder a consolidator’s ability to create competitive advantages.

Consolidators rarely mention this variable. Unfortunately, we suspect it is also one of the primary reasons for consolidation failure. Many times, these issues are downplayed or worse, overlooked. They emerge during implementation and may quickly sabotage other successes. An honest appraisal of the feasibility of consolidation among business cultures and across regions is essential. One must ask the following questions:

- Are there distinct cultures present within the industry and the individual businesses?
- Is there no economic reason for distinct regional orientation?
- Are the cultures and regions realistically compatible across businesses?

An affirmative answer to all three suggests that industry consolidation will succeed. However, assessing compatibility is extremely difficult, primarily because fully identifying and analysing cultures is so difficult. The auto service and home contracting industries have historically been attractive areas for a consolidation play. However, the culture of the businesses and the workers in such industries does not lend itself to compatibility.

In the home contracting business, workers operate as individual sub-contractors, generally responsible to themselves only. Home contractors face a continual management challenge to meet deadlines and budgets in the face of all these individuals. A consolidation of such an industry would require a break in the paradigm with which the workers have grown comfortable.

Example: The Fortress Group in Washington, DC is attempting to consolidate home building. (Mayer, 1997; Comer, 1997) Their primary obstacle (the main focus of the criticism against them) is that they will be unable to integrate the numerous independent operators into a unified business team.

There are several other examples of industries where consolidation has failed due to cultural and regional issues.
Example: The Foster Management Group attempted an unsuccessful consolidation in mental healthcare. Despite the economic benefits of consolidation, the primary roadblock to success was that the psychiatrists were unwilling to give up their autonomy to a large organisation.

Finally, the dental industry might, at first, seem like a potential consolidation play. However, many people probably enter dentistry as an opportunity to become small business owners. They are less attracted to the actual work of being a dentist. As such, they are unlikely to be receptive to a consolidation play that will strip away their ability to manage their own business.

Customers and Competitors Receptive

The historical evolution of fragmented industries has affected the customers and competitors. As Porter would assert, it is likely that there has been little, if any, power advantage over buyers and suppliers. Both the customers of the industry and the competitors within the industry are likely to be comfortable in their expectations. A consolidator entering the industry is likely to rock the boat and thus, the effect needs to be examined closely. This variable contains several deeper issues as well. With the customers, issues of branding and customer perception and acceptance are relevant. With competitors, issues of response tactics and willingness to be consolidated arise. All issues fundamentally rest on the goal of successfully ascertaining the overall market response to a consolidation play. The following general questions should be addressed:

- Is this a relatively static industry with set expectations among all participants?
- Will customers perceive a consolidator negatively?
- Are competitors likely to fight at every turn along multiple fronts?

An affirmative answer to all three suggests that a consolidator will face stiff opposition and may not be able to successfully consolidate the industry. In the funeral home industry, for example, the answers to the first two are affirmative. Customers are accustomed to family-owned funeral parlours that are members of the community. A national funeral parlour chain would certainly face negative customer perceptions. A consolidator looking to exploit economies of scale by performing embalming services at a central assembly-line style facility would not be well received. These issues can be resolved, but they must be recognised and addressed early. Service Corporation International has been able to consolidate funeral homes by preserving the compassionate front to the customer despite leveraging economies of scale.

Another example of customer perceptions as potential barriers to consolidation is the current backlash against Health Maintenance Organisations. As a result of consolidations in healthcare and...
the fallout on customers, big, economically efficient firms are perceived as cold and impersonal. These issues must be overcome for consolidation to succeed. With competitors, the consolidator will face two issues. First, will the competitive response be strong? While this might seem unlikely in a fragmented industry, there may be underlying relationships or other factors that may be exploited against the consolidator. Second, and possibly most important, will stiff competitive resistance force a consolidator to pay high premiums for acquisitions? This is certainly less preferred than consolidating an industry where businesses are more eager to sell. Quite simply, the higher the premium the consolidator is forced to pay, the harder it will be to eventually succeed in the industry.

Change Catalysts Favourable

Change catalysts can be both a positive and a negative issue for a consolidation play. In the positive light, change catalysts can alter a fragmented industry to enable successful consolidation. In the negative, change catalysts either prohibit successful consolidation or worse, disrupt a new or established consolidated industry. Regulatory issues and technological changes are the two most important factors in this variable. They are the primary change catalysts that can affect industries. Fragmented industries may have evolved under a particular regulatory or technological paradigm. When this paradigm shifts, with a new regulatory environment or a new technology, the industry may be immediately ripe for consolidation. Thus, the major questions for this variable are:

- Have change catalysts affected this industry?
- Are these change catalysts likely to further affect this industry?
- Does a consolidated firm stand to be affected negatively by new changes?

If the answer to all three questions is affirmative, then a consolidation play will likely be unsuccessful. The key here is that the industry should not be facing a tremendous amount of uncertainty in the future. While a catalyst may have created the opportunity for consolidation, the future industry should be relatively stable and free of major regulatory or technological factors.

A prime regulatory environment for consolidation may occur if there is no natural monopoly already and/or if there is one specific body that regulates the industry. In such a case, a consolidator can be assured that the likelihood of major change catalysts altering the industry is low. It is also useful to examine and understand the interaction between regulation and the fundamental economic forces that determine industry structure and would affect consolidation.

Currently, some of the major consolidation plays have arisen out of the change catalysts. The tower industry, for example, was extremely fragmented in the past. With the utilities deregulation and the
explosion of cellular services, the tower industry has been thrust into the limelight as a profitable consolidation play. However, as quickly as these catalysts can create a consolidation opportunity, they can spell doom for a consolidated industry.

**Competitive Advantage Realizable for the Consolidator**

Identification and full investigation of the first four primary variables is essential to this fifth variable. While the first four highlight the areas of concern that are not necessarily controllable by the consolidator, the fifth rests on the consolidator’s ability to implement successfully. Indeed, potential pitfalls raised among the first four issues may be addressed and overcome given complete analysis and proper implementation of the fifth variable.

The two primary competitive advantages for the consolidator are:

- The ability to exploit economies of scale and/or scope.
- The ability to leverage management talent.

These advantages are frequently cited in the popular literature today. The major issues that consolidators face, such as branding, tend to fall into one of these two buckets. Given that the nature of these advantages is well documented in strategy texts, we will not explain them in detail here. Suffice to say that properly identifying and realising these advantages may seem simpler in theory than in practice.

One particular example of successful execution is Wayne Huizenga. He created economies of scale through centralised purchasing and/or management of assets. In the video rental business, he gained scale with Blockbuster to negotiate cheaper video purchase prices. In Waste Management’s trash and recycling services, he gained scale to enable cheaper management and maintenance of a trash hauler fleet. Huizenga was able to leverage management by gobbling up mom and pop video stores and immediately converting them to the Blockbuster format with national management. Despite current analyst concerns for the companies, Huizenga’s consolidation plays were viewed as highly successful. Whether through an actual set of guidelines or just strong intuition, Huizenga has been able to identify potential industries where a consolidation play will work. More importantly, he has been able to implement their identified goals properly.

**Success Requires Careful Implementation**

Many agents have attempted consolidation over the past century of U.S. business. Some have been extraordinary successes, but some have failed. The new rise in attempted consolidation points to an even greater need for a systematic approach to developing consolidation strategies.

The 5 C’s framework should be used for identifying and analysing fragmented industries where a consolidation play will likely be
profitable. It is meant as a guide and tool to structure what is currently intuition and loose guidelines in most minds. The 5 C’s framework is a systematic structure in which to answer the following fundamental questions:

- Why is this industry fragmented?
- What are the opportunities and issues that must be addressed?
- Who are the industry stakeholders that a consolidation will affect?
- Where are the obstacles for a consolidation play?
- How can this consolidation best be implemented with these issues in mind?

As stated previously, implementation will be the key to eventual success regardless of the obstacles or opportunities identified by the framework. Despite the level of industry attractiveness, individual success is highly dependent on the approach and persistence of the consolidator. Beyond implementation, a final issue remains. How do you continue to succeed and grow beyond initial industry consolidation? This question is certainly beyond the scope of this framework but bears mentioning nonetheless. Slow growth and few opportunities may still characterise fragmented industries where a consolidation play will work. Huizenga has been criticised for bailing out on his ventures when growth of the consolidated company was slowing.

### Self Assessment Questions

Fill in the blanks:

14. ………… measures the importance of capital as opposed to labour in the production process.

15. ………… demand a premium for bearing the risk that comes from the gap of information between investors and entrepreneurs.

16. The cost of ………………… is largely fixed, regardless of the number of units of a product sold.

17. …………… has long been used to achieve and sustain power in the marketplace.

### Activity

Prepare a presentation on the steps taken by McDonalds to consolidate its position in the Indian QSR (quick service restaurant) industry.
The consolidator enters and realises competitive advantages over other industry players and may even gain most if not all of the market. However, at the end of the day, the consolidator will be left looking for new ways to grow in what may well be a boring deadend industry.

5.7 TECHNOLOGY LIFE CYCLE

The Technology Life Cycle (TLC) describes the commercial gain of a product through the expense of research and development phase, and the financial return during its “vital life”. Some technologies, such as steel, paper or cement manufacturing, have a long lifespan (with minor variations in technology incorporated with time) whilst in other cases, such as electronic or pharmaceutical products, the lifespan may be quite short.

The Technology Life Cycle associated with a product or technological service is different from Product Life Cycle (PLC) dealt with in Product Life Cycle Management. The latter is concerned with the life of a product in the market-place in respect of timing of introduction, marketing measures and business costs. The technology underlying the product (such as that of a uniquely flavoured tea) may be quite marginal but the process of creating and managing its life as a branded product will be very different.

Figure 5.3: Technology Life Cycle Path

The technology life cycle is related to the time and cost of developing the technology, the timeline of recovering cost and modes of making
the technology yield a profit proportionate to the costs and risks involved. The Technology Life Cycle may, further, be protected during its cycle with patents and trademark seeking to lengthen the cycle and to maximise the profit from it.

The development of a competitive product or process can have a major impact on the lifespan of the technology, making it shorter. Equally, the loss of patent rights through litigation, or loss of its secret elements (if any) through leakages also work to reduce its lifespan. Thus, it is apparent that the ‘management’ of the Technology Life Cycle is an important aspect of technology development.

In the simplest formulation, innovation can be thought of as being composed of research, development, demonstration, and deployment.

5.7.1 FOUR PHASES OF THE TECHNOLOGY LIFE CYCLE

The Technology Life Cycle may be seen as composed of four phases:

- The research and development (R&D) phase (sometimes called the “bleeding edge”) when incomes from inputs are negative and where the prospects of failure are high.
- The ascent phase when out-of-pocket costs have been recovered and the technology begins to gather strength by going beyond some Point A on the Technology Life Cycle (sometimes called the “leading edge”).
- The maturity phase when gain is high and stable, the region, going into saturation, marked by M.
- The decline (or decay phase), after a Point D, of reducing fortunes and utility of the technology.

5.7.2 LICENSING OPTIONS

In modern world’s business trends, with Technology Life Cycles are shortening due to competition and rapid innovation, a technology becomes technically licensable at all points of the Technology Life Cycle, whereas earlier, it was licensed only when it was past through its stage of maturity.

Large corporations develop technology for their own advantage and not with the objective of licensing. The tendency to license out technology only appears when there is a threat to the life of the Technology Life Cycle (business gain) as discussed later.

5.7.3 LICENSING IN THE R&D PHASE

There are always smaller firms (SMEs) who are improperly situated to finance the development of innovative Research and Development in the post-research and early technology phases. By sharing incipient technology under certain conditions, substantial risk financing can come from third parties. This is a form of quasi-licensing which takes various formats.
Even the big corporate houses may not wish to bear all costs of development in areas of crucial and high risk (such as aircraft development) and may seek means of spreading it to the stage that proof-of-concept is obtained.

In the case of small and medium firms, entities such as venture capitalists can enter the scene and help to materialise technologies. Venture capitalists accept both the costs and uncertainties of Research & Development, and that of market acceptance, in reward for high returns when the technology proves itself. Apart from finance, they may provide networking, management and marketing support. Venture capital connotes financial as well as human capital.

Large firms may opt for Joint Research and Development or work in a consortium for the early phase of development. Such vehicles are called strategic alliances – strategic partnerships.

With both venture capital funding and strategic (research) alliances, when business gains begin to neutralise development costs (the Technology Life Cycle crosses the X-axis), the ownership of the technology starts to undergo change.

In the case of smaller firms, venture capitalists help clients enter the stock market for obtaining substantially larger funds for development, maturation of technology, product promotion and to meet marketing costs.

**Example:** A major way is through Initial Public Offering (IPO) which invites risk funding by the public for potential high gain. At the same time, the IPOs enable venture capitalists to attempt to recover expenditures already incurred by them through part sale of the stock pre-allotted to them (subsequent to the listing of the stock on the stock exchange). When the IPO is fully subscribed, the assisted enterprise becomes a corporation and can more easily obtain bank loans, etc if required.

Strategic alliance partners, allied on research, pursue separate paths of development with the incipient technology of common origin but pool their accomplishments through instruments such as ‘cross-licensing’. Generally, contractual provisions among the members of the consortium allow a member to exercise the option of independent pursuit after joint consultation; in which case the opted owns all subsequent development.

### 5.7.4 LICENSING IN THE ASCENT PHASE

The ascent stage of the technology usually refers to some point above Point A in the Technology Life Cycle diagram but actually it commences when the Research and Development portion of the Technology Life Cycle curve inflects (only that the cash-flow is negative and unremunerative to Point A). The ascent is the strongest phase of the Technology Life Cycle because it is here that the technology is superior to alternatives and can command
premium profit or gain. The slope and duration of the ascent depends on competing technologies entering the domain, although they may not be as successful in that period. Strongly patented technology extends the duration period.

The Technology Life Cycle begins to flatten out (the region shown as M) when equivalent or challenging technologies come into the competitive space and begin to eat away market share.

Till this stage is reached, the technology-owning firm would tend to exclusively enjoy its profitability, preferring not to license it. If an overseas opportunity does present itself, the firm would prefer to set up a controlled subsidiary rather than license a third party.

5.7.5 LICENSING IN THE MATURITY PHASE

The maturity phase of the technology is a period of stable and remunerative income but its competitive viability can persist over the larger timeframe marked by its ‘vital life’. However, there may be a tendency to license out the technology to a third-parties during this stage to lower risk of decline in profitability (or competitively) and to expand financial opportunity.

The exercise of this option is, generally, inferior to seeking participatory exploitation; in other words, engagement in joint-venture, typically in regions where the technology would be in the ascent phase, as say, a developing country. In addition to providing financial opportunity it allows the technology-owner a degree of control over its use. Gain flows from the two streams of investment-based and royalty incomes. Further, the vital life of the technology is enhanced in such strategy.

5.7.6 LICENSING IN THE DECLINE PHASE

After reaching a point such as D in the Figure 5.3, the earnings from the technology begin to decline rather rapidly. To prolong the life cycle, owners of technology might try to license it out at some point L when it can still be attractive to firms in other markets. This, then, traces the lengthening path, LL’. Further, since the decline is the result of competing rising technologies in this space, licenses may be attracted to the general lower cost of the older technology (than what prevailed during its vital life).

Licenses obtained in this phase are ‘straight licenses’. They are free of direct control from the owner of the technology (as would otherwise apply, say, in the case of a joint-venture). Further, there may be fewer restrictions placed on the licensee in the employment of the technology.

The utility, viability, and thus the cost of straight-licenses depends on the estimated ‘balance life’ of the technology. For instance, should the key patent on the technology have expired, or would expire in a short while, the residual viability of the technology may be limited, although balance life may be governed by other criteria viz. know-how which could have a longer life if properly protected.
It is important to note that the license has no way of knowing the stage at which the prime, and competing technologies, are on their TLCs. It would, of course, be evident to competing licensor firms, and to the originator, from the growth, saturation or decline of the profitability of their operations.

The license may, however, be able to approximate the stage by vigorously negotiating with the licensor and competitors to determine costs and licensing terms. A lower cost, or easier terms, may imply a declining technology.

In any case, access to technology in the decline phase is a large risk that the licensee accepts. (In a joint-venture this risk is substantially reduced by licensor sharing it). Sometimes, financial guarantees from the licensor may work to reduce such risk and can be negotiated.

There are instances when, even though the technology declines to becoming a technique, it may still contain important knowledge or experience which the licensee firm cannot learn of without help from the originator. This is often the form that technical service and technical assistance contracts take (encountered often in developing country contracts). Alternatively, consulting agencies may fill this role.

### Self Assessment Questions

Fill in the blank:

18. ...................... describes the commercial gain of a product through the expense of research and development phase, and the financial return during its “vital life”.

### Activity

Parle has launched the first coffee flavoured soft drink in India called Café Cuba. Would it be prudent on the part of Parle to license the underlying technology in the present time?

### 5.8 Industry Analysis in Practice

- Good industry analysis looks rigorously at the structural underpinnings of profitability. A first step is to understand the appropriate time horizon. One of the essential tasks in industry analysis is to distinguish temporary or cyclical changes from structural changes. A good guideline for the appropriate time horizon is the full business cycle for the particular industry. For most industries, a three-to-five-year horizon is appropriate, although in some industries with long lead times, such as mining, the appropriate horizon might be a decade or more. It is average profitability over this period, not profitability in any particular year that should be the focus of analysis.
The point of industry analysis is not to declare the industry attractive or unattractive but to understand the underpinnings of competition and the root causes of profitability. As much as possible, analysts should look at industry structure quantitatively, rather than be satisfied with lists of qualitative factors. Many elements of the five forces can be quantified: the percentage of the buyer’s total cost accounted for by the industry’s product (to understand buyer price sensitivity); the percentage of industry sales required to fill a plant or operate a logistical network of efficient scale (to help assess barriers to entry); the buyer’s switching cost (determining the inducement an entrant or rival must offer customers).

The strength of the competitive forces affects prices, costs, and the investment required to compete; thus the forces are directly tied to the income statements and balance sheets of industry participants. Industry structure defines the gap between revenues and costs.

*Example:* Intense rivalry drives down prices or elevates the costs of marketing, R&D, or customer service, reducing margins. How much? Strong suppliers drive up input costs. How much? Buyer power lowers prices or elevates the costs of meeting buyers’ demands, such as the requirement to hold more inventory or provide financing. How much? Low barriers to entry or close substitutes limit the level of sustainable prices. How much? It is these economic relationships that sharpen the strategist’s understanding of industry competition.

Finally, good industry analysis does not just list pluses and minuses but sees an industry in overall, systemic terms. Which forces are underpinning (or constraining) today’s profitability? How might shifts in one competitive force trigger reactions in others? Answering such questions is often the source of true strategic insights.

**Activity**

Towards the end of the last decade activity in the Indian aviation industry grew greatly. Many of the new entrants of the then aviation industry have since either sold out to rivals or have shut down. The industry looks all poised for action with the entry of the Tata Group (Air Asia and the Tata-SIA joint venture). Have the fundamentals of the Indian aviation industry changed over the last few years? Discuss.

**5.9 Defining the relevant industry**

Defining the industry in which competition actually takes place is important for good industry analysis, not to mention for developing strategy and setting business unit boundaries. Many strategy
errors emanate from mistaking the relevant industry, defining it too broadly or too narrowly. Defining the industry too broadly obscures differences among products, customers, or geographic regions that are important to competition, strategic positioning and profitability. Defining the industry too narrowly overlooks commonalities and linkages across related products or geographic markets that are crucial to competitive advantage. Also, strategists must be sensitive to the possibility that industry boundaries can shift. The boundaries of an industry consist of two primary dimensions. First is the scope of products or services. For example, is motor oil used in cars part of the same industry as motor oil used in heavy trucks and stationary engines, or are these different industries? The second dimension is geographic scope. Most industries are present in many parts of the world. However, is competition contained within each state, or is it national? Does competition take place within regions such as Europe or North America, or is there a single global industry?

The five forces are the basic tool to resolve these questions. If industry structure for two products is the same or very similar (that is, if they have the same buyers, suppliers, barriers to entry, and so forth), then the products are best treated as being part of the same industry. If industry structure differs markedly, however, the two products may be best understood as separate industries. In lubricants, the oil used in cars is similar or even identical to the oil used in trucks, but the similarity largely ends there. Automotive motor oil is sold to fragmented, generally unsophisticated customers through numerous and often powerful channels, using extensive advertising. Products are packaged in small containers and logistical costs are high, necessitating local production. Truck and power generation lubricants are sold to entirely different buyers in entirely different ways using a separate supply chain. Industry structure (buyer power, barriers to entry, and so forth) is substantially different. Automotive oil is thus a distinct industry from oil for truck and stationary engine uses. Industry profitability will differ in these two cases, and a lubricant company will need a separate strategy for competing in each area.

Differences in the five competitive forces also reveal the geographic scope of competition. If an industry has a similar structure in every country (rivals, buyers, and so on), the presumption is that competition is global, and the five forces analysed from a global perspective will set average profitability. A single global strategy is needed. If an industry has quite different structures in different geographic regions, however, each region may well be a distinct industry. Otherwise, competition would have levelled the differences. The five forces analysed for each region will set profitability there.

The extent of differences in the five forces for related products or across geographic areas is a matter of degree, making industry definition often a matter of judgment. A rule of thumb is that where the differences in any one force are large, and where the differences involve more than one force, distinct industries may well be present. Fortunately,
however, even if industry boundaries are drawn incorrectly, careful five forces analysis should reveal important competitive threats. A closely related product omitted from the industry definition will show up as a substitute, for example, or competitors overlooked as rivals will be recognised as potential entrants. At the same time, the five forces analysis should reveal major differences within overly broad industries that will indicate the need to adjust industry boundaries or strategies.

**ACTIVITY**

Consider a diversified business conglomerate like ITC. How has ITC tweaked its business model and strategic thrust areas in the recent past?

### 5.10 TYPICAL STEPS IN INDUSTRY ANALYSIS

- **Define the relevant industry:**
  - What products are in it? Which ones are part of another distinct industry?
  - What is the geographic scope of competition?

- **Identify the participants and segment them into groups, if appropriate.** Who are:
  - the buyers and buyer groups?
  - the suppliers and supplier groups?
  - the competitors?
  - the substitutes?
  - the potential entrants?

- **Assess the underlying drivers of each competitive force to determine which forces are strong and which are weak and why.**

- **Determine overall industry structure, and test the analysis for consistency:**
  - Why is the level of profitability what it is?
  - Which are the controlling forces for profitability?
  - Is the industry analysis consistent with actual long-run profitability?
  - Are more-profitable players better positioned in relation to the five forces?

- **Analyze recent and likely future changes in each force, both positive and negative.**

- **Identify aspects of industry structure that might be influenced by competitors, by new entrants, or by your company.**
Common Pitfalls

In conducting the analysis avoid the following common mistakes:

- Defining the industry too broadly or too narrowly.
- Making lists instead of engaging in rigorous analysis.
- Paying equal attention to all of the forces rather than digging deeply into the most important ones.
- Confusing effect (price sensitivity) with cause (buyer economics).
- Using static analysis that ignores industry trends.
- Confusing cyclical or transient changes with true structural changes.
- Using the framework to declare an industry attractive or unattractive rather than using it to guide strategic choices.

**ACTIVITY**

The mobile computing industry has seen some major changes with the advent of the Android operating system. Is it a cyclical or transient change? Discuss.

### 5.11 SUMMARY

- A competently conducted industry and competitive analysis generally tells a clear, easily understood story about the company’s external environment. Managers become better strategists when they know what questions to pose and what tools to use.
- The real meaning of strategy formulation is coping with competition. Yet it is easy to view competition too narrowly and too pessimistically.
- Understanding the competitive forces, and their underlying causes, reveals the roots of an industry’s current profitability while providing a framework for anticipating and influencing competition (and profitability) over time.
- The threat of entry in an industry depends on the height of entry barriers that are present and on the reaction entrants can expect from incumbents. If entry barriers are low and newcomers expect little retaliation from the entrenched competitors, the threat of entry is high and industry profitability is moderated.
- Originally designed as a business environmental scan, the PEST or PESTLE analysis is an analysis of the external macro environment (big picture) in which a business operates. These are often factors which are beyond the control or influence of a business, however are important to be aware of when doing product development, business or strategy planning.
The Technology Life Cycle (TLC) describes the commercial gain of a product through the expense of research and development phase, and the financial return during its “vital life”.

**KEY WORDS**

- **Industry Analysis**: Industry analysis is a market strategy tool used by businesses to determine if they want to enter a product or service market. Company management must carefully analyze several aspects of the industry to determine if they can make a profit selling goods and services in the market.

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

- **Retaliation**: The act of responding violently to an act of harm or perceived injustice.

- **Economies of Scale**: The decrease in unit cost of a product or service resulting from large-scale operations, as in mass production.

- **Technology Life Cycle**: The Technology Life Cycle (TLC) describes the commercial gain of a product through the expense of research and development phase, and the financial return during its “vital life”.

### 5.12 DESCRIPTIVE QUESTIONS

1. What is the strategist’s goal in fighting with the competitive forces?

2. Which five forces shape the strategy of an organisation? Explain.

3. How the power of buyer’s influences the strategy of an organisation?

4. How industry analysis is significant for strategy formulation?

5. What are the typical steps in industry analysis?

6. Discuss the reasons for fragmentation and consolidation of industries.

7. What do you mean by Licensing Options? Explain the several phases of Licensing.

8. What do you understand by Technology Life Cycle? Explain its four phases in detail.

9. Explain the PEST Analysis tool.

10. How relevant industry can be defined?
### 5.13 ANSWERS AND HINTS

#### ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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#### HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 5.2

   The corporate strategist’s goal is to find a position in the industry where his or her company can best defend itself against these forces or can influence them in its favour. The collective strength of the forces may be painfully apparent to all the antagonists; but to cope with them, the strategist must delve below the surface and analyse the sources of each. Knowledge of these underlying sources of competitive pressure provides the groundwork for a strategic agenda of action.

2. Refer to 5.3,5.3.2,5.3.3,5.3.4,5.3.5 & 5.3.6

   The five forces which shape the strategy of an organization are - Threat of New Entrants, Bargaining power of buyers, Threat of
NOTES

Substitute Products or Services, Bargaining power of suppliers and Rivalry among existing competitors.

3. Refer to 5.3.5

Powerful customers – the flip side of powerful suppliers – can capture more value by forcing down prices, demanding better quality or more service (thereby driving up costs), and generally playing industry participants off against one another, all at the expense of industry profitability. Buyers are powerful if they have negotiating leverage relative to industry participants, especially if they are price sensitive, using their clout primarily to pressure price reductions.

4. Refer to 5.8

Good industry analysis looks rigorously at the structural underpinnings of profitability. A first step is to understand the appropriate time horizon. One of the essential tasks in industry analysis is to distinguish temporary or cyclical changes from structural changes. A good guideline for the appropriate time horizon is the full business cycle for the particular industry. For most industries, a three-to-five-year horizon is appropriate, although in some industries with long lead times, such as mining, the appropriate horizon might be a decade or more. It is average profitability over this period, not profitability in any particular year that should be the focus of analysis.

5. Refer to 5.10

Typical Steps in Industry analysis are: define the relevant industry; identify the participants and segment them into groups, if appropriate; assess the underlying drivers of each competitive force to determine which forces are strong and which are weak and why; determine overall industry structure, and test the analysis for consistency; analyze recent and likely future changes in each force, both positive and negative and lastly, identify aspects of industry structure that might be influenced by competitors, by new entrants, or by your company.

6. Refer to 5.6.1

Industries are fragmented and consolidated for a wide variety of reasons. These are- Low overall entry barriers, absence of economies of scale or experience curve, high transportation cost, high inventory cost or erratic sales fluctuations, no advantage of size in dealing with buyers or suppliers, diseconomies of scale in some important aspect, direct market needs, high product differentiation particularly if based on image, exit barriers basic approach to overcome fragmentation, make acquisitions for a critical mass and recognition of early industry trends.
7. Refer to 5.7.2, 5.7.3, 5.7.4, 5.7.5 & 5.7.6

In modern world’s business trends, with Technology Life Cycles are shortening due to competition and rapid innovation, a technology becomes technically licensable at all points of the Technology Life Cycle, whereas earlier, it was licensed only when it was past through its stage of maturity. Large corporations develop technology for their own advantage and not with the objective of licensing. The tendency to license out technology only appears when there is a threat to the life of the Technology Life Cycle (business gain). The several phases of Licensing are – licensing in the R&D phase, licensing in the Ascent phase, licensing in the Maturity phase and licensing in the decline phase.

8. Refer to 5.7 & 5.7.1

The Technology Life Cycle (TLC) describes the commercial gain of a product through the expense of research and development phase, and the financial return during its “vital life”. The four phases of Technological Life Cycle (TLC) are- Technology in the R&D phase, Technology in the Ascent phase, Technology in the maturity phase and Technology in the decline phase.

9. Refer to 5.4.2

PESTLE analysis is a useful tool for understanding the “big picture” of the environment, in which you are operating, and the opportunities and threats that lie within it. By understanding the environment in which you operate (external to your company or department), you can take advantage of the opportunities and minimise the threats. Specifically the PEST or PESTLE analysis is a useful tool for understanding risks associated with market growth or decline, and as such the position, potential and direction for a business or organisation.

10. Refer to 5.9

Defining the industry in which competition actually takes place is important for good industry analysis, not to mention for developing strategy and setting business unit boundaries. Many strategy errors emanate from mistaking the relevant industry, defining it too broadly or too narrowly. Defining the industry too broadly obscures differences among products, customers, or geographic regions that are important to competition, strategic positioning and profitability. Defining the industry too narrowly overlooks commonalities and linkages across related products or geographic markets that are crucial to competitive advantage.

5.14 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS

**NOTES**


**E-REFERENCES**

- [http://pestleanalysis.com/](http://pestleanalysis.com/)
- [http://www.slideshare.net/MBAMithlesh/technology-life-cycle-17957782](http://www.slideshare.net/MBAMithlesh/technology-life-cycle-17957782)
STRATEGIC MANAGEMENT PROCESS

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STRATEGIC PROCESSES AND IMPLEMENTATION OF BAJAJ MOTORS

The advertisement campaign with the punch line of “hunto” (meaning unbelievable in Japanese) is synonymous with the audacity of Rajiv Bajaj to challenge the likes of Honda Motors in the sports bike segment of the competitive two-wheeler industry. Ask about the strategic management process and all you need to do is, delve into the doctrines of a famous homeopath Dr. James Tyler Kent!

Ever since Rajiv Bajaj has assumed office at Bajaj Motors, he has carved out a strategic management process that relies on the homeopathic principle of the three-legged stool. In the two-wheeler industry, a company can get easily lost in the milling crowds of existing two-wheeler models unless it opts for specialisation. Specialisation demands focus and sacrifice. Hence, the age-old scooter models of Bajaj got the axe. Bajaj decided to focus on the sports bike segment and launch new models in succession.

The challenge was to analyse the situation, prepare a list of options, check out for constraints that limited strategic choice and then decide on the strategic implementation. Bajaj understood the simple logic that brands pass through the stages of the brand lifecycle, get old and then fade out. Good companies are premised on their ability to say “no.” Hence, keeping in mind the changing scenario of the Indian two-wheeler industry in India, scooters had to make way for fast, stylish and powerful bikes.

Focus in terms of strategy also meant answering another question: “one product for all markets or all products in one market?” Bajaj decided to narrow down the band of products in accordance with the world-wide market trend. Hence, Africa got Boxer, US, Europe and Australia got the KTM and south Asian markets got the Pulsar and Discover. How did he decide on the brands that were launched? He framed his answer in terms of the three legged stool principle. Every product had to satisfy three criteria in the context of the concerned market. Hence, if a bike could not yield an EBIDTA of 20%, it was shelved. EBIDTA is Earnings, before Interest, Taxes, Depreciation and Amortization. EBIDTA is an indicator of a company’s financial performance which is calculated by deducting expenses (excluding tax, interest, depreciation and amortization) from revenues.

Coming down to implementation, Bajaj decided to compete in terms of the economics of manufacturing units. Other companies that were technology-based players had a high component of fixed costs and hence had a high operating leverage. Baja took reverse gear. So he opted for just 60 acres of land and an investment of rupees one fifty crore for the Pantnagar plant. He assessed the annual production capacity at one million bikes and annual revenue at rupees three thousand crore. The manufacturing units were equipped with lean manufacturing to reduce organisational flab and maintain cost discipline. Manufacturing of several non-core components was outsourced. The result was that the company had the advantage of working with negative working capital.
After studying this chapter, you should be able to:

- Describe the purposes of strategic management process
- Explain the steps involved in the strategic management process
- Define strategy formulation and strategy implementation
- Identify the strategic control and assessment

### 6.1 Introduction

A strategy is developed within a firm. The final product will necessarily be shaped by the background of that firm, the processes it has in place for arriving at basic business decisions and the interests and perspectives of its senior managers. Typically, these factors come together in a formal strategy process through which strategy is defined and evaluated by the firm’s managers.

The term ‘Strategic Management Process’ refers to the steps by which management converts a firm’s mission, objectives and goals into a workable strategy. In a dynamic environment each firm needs to tailor its strategic management process in ways that best suit its own capabilities and situational requirements. Viewed broadly, the strategic management process has two parts: an information process and a decision process. The information process involves collecting and analysing information about the external and internal environments. External factors are taken into account to find major opportunities and threats that now or will confront the organisation. To survive and grow, every organisation, invariably, must find how the situational factors have affected its past and current performance. This must be followed by an internal analysis to determine the organisation’s strategic direction. Strategists carry out internal analysis to have a ‘feel’ of where their organisation has been and where it now is, particularly with regard to internal strengths and weaknesses. Information about the organisation’s strengths and weaknesses, when combined with information about external opportunities and threats, offers a stronger foundation for informed decisions about strategic direction.

The decision process covers four important steps: development of alternatives, choice, implementation and assessment. Based on the external and internal analysis, strategists first identify possible strategic alternatives and pick up those that help the organisation reach its mission and objectives. In the next step, the planners decide how and when to translate strategic choices into action, followed by an evaluation of the effectiveness and efficiency of the strategic direction the organisation has followed.
6.2 PURPOSES OF STRATEGIC MANAGEMENT PROCESS

Strategic management basically aims at formulating and implementing effective strategies.

Effective strategies, of course, are those that help a superior ‘fit’ between the organisation and its environment and the achievement of strategic goals (Andrews).

Strategies necessarily change over time to suit environmental changes but, to remain competitive, organisations develop strategies that focus on core competence, develop synergy and create value for customers.

- **Core Competence**: An organisation’s core competence is something it does exceptionally well in comparison to its competitors. It reflects a distinct competitive advantage (like superior research and development, mastery of a technology, distribution channel, manufacturing efficiency or customer service) that provides the firm (a) access to a variety of products/markets (b) contributes greatly to customer benefits in the end products and (c) is an exclusive and inimitable preserve of the firm that is long-lasting and cannot be easily copied by competitors.

- **Synergy**: When organisational parts interact to produce a joint effort that is greater than the sum of the parts acting alone, synergy occurs. Some call this the $1 + 1 = 3$ effect. In strategic management, managers are urged to achieve as much market, cost, technology and management synergy as possible when arriving at strategic decisions (such as mergers, acquisitions, new products, new technology etc.). When one product or service strengthens the sales of one or more other products or services, market synergy occurs. Wal-Mart’s new Supercentres and Super K marts that put a discount store and a grocery store under one huge roof (Crossroads, Mumbai; Spencer’s in Chennai) are a good example of market synergy in action. Cost synergy can occur in almost every dimension of organised effort. When two or more products can be designed by the same engineers, produced in the same facilities, distributed through the same channels, or sold by the same sales persons, overall costs will be lower than if each product received separate treatment. In Europe, today, banks and insurance companies are linking up in an effort to market a wide array of financial products that each would have trouble selling on its own (Wall Street Journal). Technology synergy involves transferring technology from one application to another, thus opening up new markets. In management synergy also a similar kind of technology transfer is needed. Management synergy would be achieved, for example, if a software product
company with weak roots in training and education line hires a new CEO with strong academic and training credentials. Ideally the new CEO would transfer his technical skills to good effect.

Value Creation: Exploiting core competencies and achieving synergy help organisations create value for their customers.

Fill in the blanks:
1. An organisation’s ……………………………. is something it does exceptionally well in comparison to its competitors.
2. Exploiting core competencies and achieving synergy help organisations create value for their ……………………….
3. Strategic ……………………………. is achieved when a firm successfully formulates and implements a value creating strategy.

Maruti Suzuki is undoubtedly one of the most successful joint ventures in the Indian automobile industry. Prepare a presentation outlining the synergies accruing from the joint venture.

Value is the sum total of benefits received and costs paid by the customer in a given situation. Ideally, the purpose of a strategy should be to create a lasting value that is greater than the cost of resources that are used to create the same.

6.3 STEPS INVOLVED IN THE STRATEGIC MANAGEMENT PROCESS

Dynamic in nature, the strategic management process is the full set of commitments, decisions and actions needed for a firm to achieve strategic competitiveness and earn above average returns. Strategic competitiveness is achieved when a firm successfully formulates and implements a value creating strategy. When a firm implements such a strategy that other firms are unable to duplicate or find too costly to imitate, this firm has a sustainable competitive advantage. By achieving strategic competitiveness and successfully exploiting its competitive advantage, the firm is able to achieve above average returns which are returns in excess of what an investor expects to earn from other investments with a similar amount of risk. ‘Risk’ here refers to an investor’s uncertainty about the economic gains or losses that will result from a particular investment (Hitt et al.).
Relevant strategic inputs from analyses of the internal and external environments are needed for effective strategy formulation, implementation and evaluation. In turn, effective strategic actions are essential to achieve desired outcomes in the form of strategic competitiveness and above average returns. The various steps involved in the strategic management process may be stated thus:

**Vision, Mission and Objectives:** In the organisational context, vision is a picture of the organisation: the core values for which an organisation stands and a clear description of what the organisation wishes to become in the years ahead. A mission statement, on the other hand, specifies what an organisation is and why it exists. The strategic management process begins with an evaluation of the organisation’s current vision, mission, objectives and strategy. The principal value of a mission statement lies in its specification of a firm’s ultimate aims. It offers a sense of shared expectations among all levels and generations of employees. It consolidates values over time and across individuals and interest groups. It projects a glorified sense of worth and intent that can be identified and assimilated by external groups too. It also exhibits a firm’s commitment to responsible action in line with the firm’s internal (survival, growth, profitability) as well as external (ethics, corporate governance, social responsibility) objectives.

**External Analysis:** The firm’s external environment is challenging and complex. Because of the impact the external environment has on performance, the firm must develop requisite skills to identify opportunities and threats existing in that environment. The external environment has three important parts:

- General environment (elements in the broader society that affect industries and their firms)
- Industry environment (factors that influence a firm, its competitive actions and responses, and the industry’s profit potential) and
Competitive environment (in which the firm examines each major rival’s future objectives, current strategies, assumptions and capabilities).

**Internal Analysis:** In order to exploit environmental opportunities to its advantage, a firm must have internal resources and capabilities. A systematic internal appraisal helps a firm find:

- Where it stands in terms of its strengths and weaknesses
- Pick up opportunities that are in tune with its resource base
- Take steps to bridge any resource gaps and
- Select appropriate areas that help consolidate its position in the industry.

A major task of strategists, while carrying out internal analysis, is to match the conditions of the external environment with the firm’s internal strengths and weaknesses. If a firm can perform an activity better than its rivals, it then possesses a distinctive (or core) competence that helps the firm to build its own source of competitive advantage. In the final analysis, the choice of which strategy to pursue should be based on using and exploiting the firm’s competitive advantage.

After the external and internal analysis, the firm tries to formulate explicit strategic plans at three levels: corporate, business and functional. These are then put into action using leadership, structural designs, information systems and human resources to good advantage.

**Fill in the blank:**

4. The information process involves collecting and analysing ................. about the external and internal environments.

**How do the vision and mission of a company affect the strategic management process? Discuss.**

### 6.4 STRATEGIC MANAGEMENT PROCESS

The strategic management process is made up of four elements: situation analysis, strategy formulation, strategy implementation and strategy evaluation. These elements are steps that are performed, in order, when developing a new strategic management plan. Existing businesses that have already developed a strategic management plan will revisit these steps as the need arises, in order to make necessary changes and improvements.

#### 6.4.1 SITUATION ANALYSIS

Situation analysis is the first step in the strategic management process.
The situation analysis provides the information necessary to create a company mission statement. It involves “scanning and evaluating the organisational context, the external environment, and the organisational environment.”

This analysis can be performed using several techniques. Observation and communication are two very effective methods.

To begin this process, organisations should observe the internal company environment. This includes employee interaction with other employees, employee interaction with management, manager interaction with other managers, and management interaction with shareholders. In addition, discussions, interviews, and surveys can be used to analyse the internal environment.

Organisations also need to analyse the external environment. This would include customers, suppliers, creditors, and competitors. Several questions can be asked which may help analyse the external environment. What is the relationship between the company and its customers? What is the relationship between the company and its suppliers? Does the company have a good rapport with its creditors? Is the company actively trying to increase the value of the business for its shareholders? Who is the competition? What advantages do competitors have over the company?

6.4.2 STRATEGY FORMULATION

Strategy formulation involves designing and developing the company strategies. Determining company strengths aids in the formulation of strategies. Strategy formulation is generally broken down into three organisational levels: operational, competitive and corporate.

Operational strategies are short-term and are associated with the various operational departments of the company, such as human resources, finance, marketing, and production. These strategies are department specific. For example, human resource strategies would be concerned with the act of hiring and training employees with the goal of increasing human capital.

Competitive strategies are those associated with methods of competing in a certain business or industry. Knowledge of competitors is required in order to formulate a competitive strategy. The company must learn who its competitors are and how they operate, as well as identify the strengths and weaknesses of the competition. With this information, the company can develop a strategy to gain a competitive advantage over these competitors.

Corporate strategies are long-term and are associated with “deciding the optimal mix of businesses and the overall direction of the organisation”. Operating as a sole business or operating as a business with several divisions are both part of the corporate strategy.
6.4.3 STRATEGY IMPLEMENTATION

Strategy implementation involves putting the strategy into practice. This includes developing steps, methods, and procedures to execute the strategy. It also includes determining which strategies should be implemented first. The strategies should be prioritised based on the seriousness of underlying issues. The company should first focus on the worst problems, then move onto the other problems once those have been addressed.

“The approaches to implementing the various strategies should be considered as the strategies are formulated.” The company should consider how the strategies will be put into effect at the same time that they are being created. For example, while developing the human resources strategy involving employee training, things that must be considered include how the training will be delivered, when the training will take place, and how the cost of training will be covered.

6.4.4 STRATEGY EVALUATION

Strategy evaluation involves “examining how the strategy has been implemented as well as the outcomes of the strategy.” This includes determining whether deadlines have been met, whether the implementation steps and processes are working correctly, and whether the expected results have been achieved. If it is determined that deadlines are not being met, processes are not working, or results are not in line with the actual goal, then the strategy can and should be modified or reformulated.

Both management and employees are involved in strategy evaluation, because each is able to view the implemented strategy from different perspectives. An employee may recognise a problem in a specific implementation step that management would not be able to identify.

### SELF ASSESSMENT QUESTIONS

Fill in the blanks:

5. The decision process covers four important steps: development of alternatives, choice, ......................... and assessment.

6. Strategic management aims at ................ and implementing effective strategies.

7. The strategic management process begins with an ................ of the organisation’s current vision, mission, objectives and strategy.

8. In order to exploit environmental opportunities to its advantage, a firm must have internal ................ and ..................

9. The situation analysis provides the information necessary to create a company ..................

10. Strategy formulation involves designing and ................ the company strategies.
Which is the toughest part in the strategic management process? In which step do companies face challenges? Discuss.

The strategy evaluation should include challenging metrics and timetables that are achievable. If it is impossible to achieve the metrics and timetables, then the expectations are unrealistic and the strategy is certain to fail.

6.5 STRATEGY FORMULATION

6.5.1 CORPORATE LEVEL STRATEGY FORMULATION

Corporate level strategy pertains to the organisation as a whole and the combination of business units and product lines that make up the corporate entity. It addresses the overall strategy that an organisation will follow. The process generally involves selecting a grand strategy and using portfolio strategy approaches to determine the types of businesses in which the organisation should be engaged.

Grand strategy is the general plan of major action by which a firm intends to achieve its long-term goals. It provides basic direction for the strategic actions of a firm. Grand strategies fall into four general categories: growth/expansion, stability, retrenchment and combination.

Growth/Expansion Strategy: Organisations generally seek growth in sales, market share or some other measure as a primary objective. When growth becomes a passion and organisations try to seek sizeable growth (as against slow and steady growth), it takes the shape of an expansion strategy. The firm tries to redefine the business, enter new businesses that are related or unrelated or look at its product portfolio more intensely. The firm can have as many alternatives as it wants by changing the mix of products, markets and functions. Thus, the growth opportunities may come internally or externally. Internal growth possibilities may be exploited through intensification or diversification. External growth options include mergers, takeovers and joint ventures.

Stability Strategy: A stability strategy involves maintaining the status quo or growing in a methodical, but slow, manner. The firm follows a safety-oriented, status-quo-type strategy without effecting any major changes in its present operations. The resources are put on existing operations to achieve moderate, incremental growth. As such, the primary focus is on current products, markets and functions, maintaining the same level of effort as at present.

Retrenchment Strategy: It is a corporate level, defensive strategy followed by a firm when its performance is disappointing or when
its survival is at stake. When a firm is confronted with a precipitous
drop in demand for its products and services, it is forced to effect
across-the-board cuts in personnel and expenditures. Retrenchment
strategy, as such, is adopted out of necessity, not by deliberate choice.

**Combination Strategies:** Large, diversified organisations generally
use a mixture of stability, expansion or retrenchment strategies either
simultaneously (at the same time in various businesses) or sequentially
(at different times in the same business). For example, growth could
be achieved by an organisation through acquisition of new businesses
or divesting itself of unprofitable ventures. Depending on situational
demands, therefore, an organisation can employ various strategies to
survive, grow and remain profitable.

### 6.5.2 BUSINESS LEVEL STRATEGY FORMULATION

Business level strategy deals with how a particular business competes.
The principal focus is on meeting competition, protecting market share
and earning profit at the business unit level. The strategies of growth,
stability and retrenchment, discussed above, apply at the business
level as well as the corporate level, but they are accomplished through
competitive actions rather than by the acquisition or divestment of
other businesses.

### 6.5.3 FUNCTIONAL LEVEL STRATEGY FORMULATION

Functional strategies are formulated by specialists in each area of a
business such as marketing, production, finance, human resources
and research and development. Functional strategies outline the
action plans that must be put into practice to execute business level
strategy. Business level and functional specialists must coordinate
their activities to ensure that the strategies pursued by them are
consistent and lead to achievement of overall goals.

- **Research and Development Strategy:** Businesses cannot grow
  and survive without new products. It is the role of R&D specialists
to generate new product ideas, nurture them carefully and develop
them fully into commercially viable propositions. Where innovation
proves to be a costly exercise, imitation could also be tried as a
fruitful option. Many Japanese electronics companies were quite
successful in copying American technology and by avoiding R&D
costs, improved their competitive strength significantly.

- **Operations Strategy:** This strategy outlines steps to keep costs
  under check and improve operational efficiency. The focus is
  on arriving at decisions regarding plant layout, plant capacity,
  production processes, inventory management etc.

- **Financial Strategy:** It deals with financial planning, evaluating
  investment proposals, securing funds for various investments
  and controlling financial resources. Thus raising funds, acquiring
  assets, allocating funds to operations, using funds efficiently etc
  are all part of this strategy.
Marketing Strategy: It deals with strategies relating to product, pricing, distribution and promotion of a company’s offerings. Important issues here cover what type of products, at what prices, through which distribution channel and by the use of which promotional tool and sales force etc.

Human Resource Strategy: HR strategy deals with hiring, training, assessing, developing, rewarding, motivating and retaining the number and types of employees required to run the business effectively. Internal (union contracts, productivity indices, labour turnover, absenteeism, accidents etc.) and external factors (labour laws, sons of the soil, reservation, equal employment opportunity, employment of children and women etc.) need to be carefully evaluated while formulating HR strategies.

Self Assessment Questions:

Fill in the blanks:

11. ............ are formulated by specialists in each area of a business such as marketing, production, finance, human resources and research and development.

12. ................. strategy outlines steps to keep costs under check and improve operational efficiency.

13. ................. strategy deals with product, pricing, distribution and promotion of a company’s offerings. Important issues here cover what type of products, at what prices, through which distribution channel and by the use of which promotional tool and sales force etc.

Activity:

Is it better to take a bottom up approach to the three levels of strategic decision-making or traditional top down approach? Discuss.

6.6 Constraints and Strategic Choice

Viewed collectively, the R&D strategy should encourage innovation; marketing should stress brand loyalty and reliable distribution channels; production should maintain long production runs, cost reduction and routinisation; finance should focus on cash flows and positive returns and HR department should develop strategies for retaining and developing a stable workforce. Of course, organisations do come across constraints while formulating functional level strategies in several forms; how to finance the proposals, what kind of risk to be taken, how to combine strong production skills of the company with its own weak marketing skills, how to keep suppliers and channel partners happy, how to encounter competitive retaliation etc.
In any case while selecting appropriate strategies at corporate, business and functional level, the following criteria should be kept in mind (David Aaker).

Strategy Selection Criteria
- They are responsive to the external environment.
- They offer a sustainable competitive advantage.
- They are consistent with other strategies in the organisation.
- They provide adequate flexibility for the business and the organisation.
- They conform to the organisation’s mission and long-term objectives.
- They are organisationally feasible.

ACTIVITY

“Good companies are based on saying no.” Discuss the significance of these words of Al Ries.

6.7 STRATEGY IMPLEMENTATION

Strategy implementation is the process of translation of strategies and policies into action through the development of programmes, budgets and procedures. It is typically conducted by the middle and lower level management but is reviewed by the top management. However, programmes and procedures are simply more detailed plans for the eventual implementation of strategy. Unless the corporation is appropriately organised, programmes are adequately staffed and activities are properly directed, these operational plans fail to deliver the goods. To be effective, a strategy must be implemented through the right organisation structure and appropriate management practices. In addition, management must also ensure that there is progress towards objectives according to plan by instituting a rigorous process of control over important activities.

6.7.1 ORGANISING

In a classic study of large American Corporations (Du Pont, General Motors, Sears Roebuck, Standard Oil), Chandler concluded that structure follows strategy (Strategy and Structure, MIT Press 1962). Changes in corporate strategy have invariably led to changes in corporate structure. Chandler found that most corporations begin with a centralised organisation structure. As they add new product lines and create independent distribution networks, the centralised structure is discarded by the organisations in favour of a decentralised structure which permits the creation of semi-autonomous product divisions. Burns and Stalker also found that mechanistic structures (centralised decision making and bureaucratic rules) seem to be
appropriate to organisations operating in stable environments. However, organic structures, in contrast (decentralisation and flexible procedures), seem to be appropriate to organisations operating in a constantly changing environment. The research conducted later on also supports Chandler’s proposal that an appropriate organisation structure is necessary to meet changes in corporate strategy. The firm should, therefore, work to make its structure congruent with its strategy.

6.7.2 STAFFING

Effective strategy implementation calls for utilisation of human resources fully. For implementing growth strategies, new people should be recruited and given requisite training. Retrenchment strategies call for a sound basis for firing people, i.e., seniority, performance, absenteeism, etc. In order to translate the strategy into action, the services of capable and committed people are necessary. To this end, management should institute proper performance appraisal systems which permit people to compare their performance with others and find out where they are. These systems also help the management to identify ‘star’ performers easily and reward them adequately. Perspiration does not go far without a little bit of inspiration.

6.7.3 DIRECTING

People should be motivated to implement a new strategy in desired ways. It is not sufficient merely to have people who can do the job; it is also necessary to have people who want to do the job the way you need it done. In addition to traditional motivational techniques, managers should also make use of modern techniques in order to inspire people to peak performance.

6.7.4 MOTIVATIONAL TECHNIQUES

The traditional motivational techniques are based on a reward-punishment psychology and involve the use of performance appraisals and performance-based incentive programmes. These approaches, including MBO (Management by Objectives, termed by Peter Drucker which states that it is a process of defining objectives within an organization so that management and employees agree to the objectives and understand what they need to do in the organization in order to attain them), indicate that specific results are best achieved by clearly outlining realistic goals and then suitably rewarding those managers who achieve them. They are overly reliant on money as the primary motivator, while overlooking other factors that might be truly motivating to many managers. According to Morse and Martin, motivating the organisation to implement strategy requires:

Supportive Culture

The successful implementation of strategy must take into account the history of an organisation and dominant values or culture which
The corporate culture is a system of shared beliefs and values that the people within the corporation hold. Some of the critical dimensions of culture are:

- **Clarity of direction**: How well the company’s goal and plans for achieving them are known, understood and found to be motivating throughout the organisation.

- **Decision making structure and processes**: Whether the culture is decision-oriented or decision-avoidant and whether decisions are made on the basis of sound information or ‘seat of the pants’ intuition.

- **Management style**: Whether too little or too much participation in making decisions exists at each level of the company.

- **Integration of effort**: Whether teamwork, sharing and smooth meshing of activities – or the opposite – accurately describes the culture.

- **Performance orientation**: Whether managers feel accountable for end results and whether rewards are related to performance or not.

- **Compensation**: Whether it is equitably fairly administered and motivational, or not.

- **Human resource development**: How much this characterises the culture.

- **Organisational vitality**: That drive to perform – that sense of urgency and desire to be a winner – which some organisations have and others do not.

- **Risk taking**: Whether it is encouraged or punished, and

- **Competitive image**: Whether company views itself as faster, sharper and better than the competitor, or vice versa.

Every company should try to measure these dimensions of culture and determine what kind of culture and what kind of subcultures will best support the company’s strategy. Senior executives should determine the desired culture taking the short-term requirements of the company.

**Short-term Motivational Environment**

Whereas a company’s culture affects strategy implementation over the long haul, the short-term motivational environment affects strategy implementation today. The short-term environment reflects the immediate mood of the company’s employees and contributes to the way they face immediate problems. Building such an environment involves actions very similar to public relations activities.

- Communication programmes
- Morale-building conferences
Visibility of charismatic leaders
Use of awards, language, symbols, gestures etc.

Performance Management
The traditional motivators (MBO, performance appraisal, etc.) should be logically and firmly linked to what is called an integrated performance management process. To this end detailed budgets and programmes should be drawn. Individuals should also know exactly what piece of the organisation structure they are accountable for and what goals and objectives they must attain this year to stay on plan.

Individual Motivators
In addition to the traditional motivating techniques, the organisation should also provide for individual motivators for achieving results competently. Over-reliance on bonuses and incentives may not fully motivate individual managers in today’s world. Top management should, therefore, fully understand the individual differences and devise an appropriate motivational strategy. Though it is difficult to categorise individual motivators, some of the important ones may be stated thus:

- **Mastery**: The act of mastering a new skill or gain control over a challenging problem is most motivating to many individuals.
- **Approval**: Lack of approval can hamper and constrict the performance of talented and bright managers.
- **Risk and Adventure**: High visibility positions having risk and adventure are mostly preferred by managers possessing entrepreneurial talents.
- **Security**: In order to perform effectively and efficiently, managers need to feel that there is little at risk with respect to their careers.
- **Power and Influence**: Organisational positions that enable managers to gain power and control over human as well as non-human resources are highly motivating.

Fill in the blank:
14. Whereas a company’s ...... affects strategy implementation over the long haul, the short-term .......... environment affects strategy implementation today.

The top management sets the tone for strategy implementation by means of motivation, visible leadership and work culture. Discuss.
Performance management ensures that rewards and sanctions result from measures of good or poor performance. It links human resources planning with the firm’s strategy formulation and performance appraisal processes so as to guide the future efforts of the company.

### 6.8 STRATEGIC CONTROL AND ASSESSMENT

Strategic control, the last step of the strategic management process, is monitoring and evaluating the strategy management process as a whole in order to make sure that it is operating properly. The focus is clearly on activities involved in environmental analysis, organisational direction, strategy formulation, strategy implementation – ensuring that all steps of the strategy management process are appropriate, compatible and functioning properly. There are three basic steps to the strategic control process (Roush et al).

**Measure Performance**

Strategic audits are used to find what is actually happening in the organisation. Both qualitative and quantitative tools are employed for this purpose. According to S Tilles, the qualitative measurement looks into five questions:

- Is the strategy internally consistent?
- Is it consistent with its environment?
- Is it appropriate given organisational resources?
- Is it too risky?
- Is the time horizon of the strategy appropriate?

Quantitative tools like return on investment (the relationship between the amount of income generated and the amount of assets required to operate the organisation); z score (an analysis that numerically weighs and sums five measures – working capital/total assets; retained earnings/total assets; earning before interest and taxes/total assets; market value of equity/book value of total liabilities and sales/total assets – to find whether the company in question is likely to go sick and become bankrupt) and shareholders’ audit etc. are used to measure organisational performance.

**Compare Performance to Goals and Standards**

Here management builds a case for concluding whether the performance is according to the predetermined standards in respect of certain key areas. At General Electric, the following eight types of standards are set for comparing performance at a later stage; profitability, market position, productivity, product leadership,
personnel growth, employee attitude, social responsibility and standards reflecting balance between short-range and long-range goals.

**Corrective Action**

If the actual performance is not in line with predetermined standards set for the purpose, corrective action is necessary. In such a case, every attempt is made to modify the enterprise’s strategies and their implementation so that the organisations’ ability to accomplish its goals will be improved.

**ACTIVITY**

The euphoria surrounding the strategic blueprint of Infosys 3.0 had fizzed out. N R Narayana Murthy’s return has led to a fifty percent rise in Infosys stock prices. Prepare a presentation on the corrective action taken by him.

**6.9 SUMMARY**

- The strategic management process is a continuous process. “As performance results or outcomes are realised – at any level of the organisation – organisational members assess the implications and adjust the strategies as needed.”

- In addition, as the company grows and changes, so will the various strategies. Existing strategies will change and new strategies will be developed. This is all part of the continuous process of improving the business in an effort to succeed and reach company goals.

- Strategic management basically aims at formulating and implementing effective strategies. Effective strategies, of course, are those that help a superior ‘fit’ between the organisation and its environment and the achievement of strategic goals (Andrews).

- Dynamic in nature, the strategic management process is the full set of commitments, decisions and actions needed for a firm to achieve strategic competitiveness and earn above average returns. Strategic competitiveness is achieved when a firm successfully formulates and implements a value creating strategy.

- The strategic management process is made up of four elements: situation analysis, strategy formulation, strategy implementation and strategy evaluation. These elements are steps that are performed, in order, when developing a new strategic management plan.

- A strategic business unit is a distinct business, with its own business mission, product line, market share and competitors that can be managed reasonably independently of other businesses within the organisation.
KEY WORDS

- **Business Level Strategy**: A competitive strategy that focuses on meeting competition, protecting market share and achieving profits at the business unit level.

- **Corporate Level Strategy**: The strategy formulated by the top management for the overall company.

- **Differentiation**: A competitive strategy that seeks to distinguish an organisation's products or services from competitors.

- **Diversification**: A strategy in which an organisation operates in several businesses that are linked or not linked with one another.

- **Focus**: It is a competitive strategy that emphasises making an organisation more competitive by targeting a specific regional market or buyer group.

- **Functional Level Strategy**: The strategy pursued by each functional area of a business unit such as finance, marketing, personnel, production etc.

- **Grand Strategy**: A general plan of major action by which a firm intends to achieve its long-term goals.

- **Strategic Business Unit**: A strategic business unit is a distinct business, with its own business mission, product line, market share and competitors that can be managed reasonably independently of other businesses within the organisation.

- **Strategic Competitiveness**: It is achieved when a firm successfully formulates and implements a value creating strategy.

- **Strategic Control**: Monitoring and evaluating the strategic management process as a whole, in order to make sure that it is operating properly.

- **Strategic Intent**: It is the leveraging of a firm's internal resources, capabilities and core competencies to accomplish the firm's goals in a competitive environment.

- **Strategic Management Process**: A management process designed to achieve the firm's missions and objectives.

- **Strategy Formulation**: The process of determining appropriate courses of action for achieving organisational objectives and thereby accomplishing organisational purpose.

- **Strategy Implementation**: Putting formulated strategy into action.

- **Value Chain**: The notion that an enterprise receives inputs from suppliers of resources transforms them into outputs and channels the outputs to buyers, adding value at each point in the process.

- **Value**: Sum total of benefits received and costs paid by the customer in a given situation.
6.10 DESCRIPTIVE QUESTIONS

1. What aspect of strategy formulation, do you think, requires the most time? Why?

2. Outline the major components of the strategic management process. Explain why engaging in strategic management is likely to be beneficial for an organisation.

3. Each firm needs to tailor its strategic management process in ways that best suits its own specific context and situation. Do you agree? Why? And why not?

4. Discuss in detail the process of strategy implementation.

5. Explain the procedure of Strategy Formulation.

6. What are the purposes of strategic management process? Describe them in detail.

7. What kinds of constraints an organization aims to achieve while formulating strategies? Discuss the strategy selection criteria.

8. Explain motivational techniques as a basis of strategy implementation.

9. “Strategy formulation is generally broken down into three organisational levels”. Which are they? Explain in detail.

10. Explain three basic steps to the strategic control process. How strategic assessment is being done by companies?

6.11 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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10. Developing

Strategy Formulation

11. Functional strategies

12. Operations

13. Marketing

Strategy Implementation

14. culture, motivational

HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 6.4.1

Situation analysis is the first step in the strategic management process. The situation analysis provides the information necessary to create a company mission statement. Situation analysis involves “scanning and evaluating the organisational context, the external environment, and the organisational environment.” This analysis can be performed using several techniques. Observation and communication are two very effective methods.

2. Refer to 6.3

The various steps involved in the strategic management process are: Vision, Mission and Objectives, External Analysis and Internal Analysis. By achieving strategic competitiveness and successfully exploiting its competitive advantage, the firm is able to achieve above average returns which are returns in excess of what an investor expects to earn from other investments with a similar amount of risk.

3. Refer to 6.4.4

Yes, firms need to tailor its strategic management process in ways that best suits its own specific context and situation. By engaging themselves in strategic evaluation which means “examining how the strategy has been implemented as well as the outcomes of the strategy.” This includes determining whether deadlines have been met, whether the implementation steps and processes are working correctly, and whether the expected results have been achieved. If it is determined that deadlines are not being met, processes are not working, or results are not in line with the actual goal, then the strategy can and should be modified or reformulated.

4. Refer to 6.7,6.7.1,6.7.2,6.7.3 & 6.7.4

The process of strategy implementation are – organizing, staffing, directing and motivational techniques.

5. Refer to 6.5,6.5.1,6.5.2 & 6.5.3

Corporate Level Strategy Formulation, Business level strategy formulation and functional level strategy formulation.
6. Refer to 6.2

Strategies necessarily change over time to suit environmental changes but, to remain competitive, organisations develop strategies that focus on core competence, develop synergy and create value for customers.

7. Refer to 6.6

Viewed collectively, the R&D strategy should encourage innovation; marketing should stress brand loyalty and reliable distribution channels; production should maintain long production runs, cost reduction and routinisation; finance should focus on cash flows and positive returns and HR department should develop strategies for retaining and developing a stable workforce. Of course, organisations do come across constraints while formulating functional level strategies in several forms; how to finance the proposals, what kind of risk to be taken, how to combine strong production skills of the company with its own weak marketing skills, how to keep suppliers and channel partners happy, how to encounter competitive retaliation etc.

8. Refer to 6.7.4

Motivational techniques comprises of supportive culture, short-term motivational environment, performance management and individual motivators.

9. Refer to 6.4.2

Strategy formulation is generally broken down into three organisational levels: operational, competitive and corporate.

10. Refer to 6.8

There are three basic steps to the strategic control process: measuring performance, compare performance to goals and standards and corrective action. Strategic assessment is being done by companies in building up a case for concluding whether the performance is according to the predetermined standards in respect of certain key areas. If the actual performance is not in line with predetermined standards set for the purpose, corrective action is necessary. In such a case, every attempt is made to modify the enterprise’s strategies and their implementation so that the organisations’ ability to accomplish its goals will be improved.

6.12 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS


E-REFERENCES

- http://www.strategicmanagementinsight.com/topics/strategic-planning-process.html
- http://onstrategyhq.com/resources/strategic-implementation/
# Chapter 7

## Formulating Corporate Level Strategy

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INTRODUCTORY CASELET

EXPANSION OF ITC LIMITED BUSINESSES

Over the years, ITC Limited, basically a tobacco company set up in 1910, has ballooned to gigantic proportions (with 26,000 employees in 60 locations across India with a turnover of over $7 billion) through excellent diversification moves into areas such as hotels, information technology, packaging, paperboards, speciality paper, agri-businesses, foods, lifestyle and retailing, education and stationery and personal care.

The objective of ITC’s entry into the hotels business was rooted in the concept of creating value for the nation. ITC chose the hotels business for its potential to earn high levels of foreign exchange, create tourism infrastructure and generate large scale direct and indirect employment. Since then, ITC’s Hotels business has grown to occupy a position of leadership, with over 100 owned and managed properties spread across India.

In 1985, ITC set up Surya Tobacco Co. in Nepal as an Indo-Nepal and British joint venture. Since inception, its shares have been held by ITC, British American Tobacco and various independent shareholders in Nepal. In August 2002, Surya Tobacco became a subsidiary of ITC Limited and its name was changed to Surya Nepal Private Limited (Surya Nepal).

In 1990, ITC acquired Tribeni Tissues Limited, a specialty paper manufacturing company and a major supplier of tissue paper to the cigarette industry. The merged entity was named the Tribeni Tissues Division (TTD). TTD was merged with the Bhadrachalam Paperboards Division to form the Paperboards & Specialty Papers Division in November 2002. ITC acquired the paperboard manufacturing facility of BILT Industrial Packaging Co. Ltd (BIPCO), near Coimbatore, Tamil Nadu. Paperkraft entered new categories in the office consumable segment with the launch of Textliners, Permanent Ink Markers and White Board Markers in 2009.

In 1990, leveraging its agri-sourcing competency, ITC set up the Agri-Business Division for export of agri-commodities. The Division is today one of India’s largest exporters. ITC’s unique and now widely acknowledged e-Choupal initiative began in 2000 with soya farmers in Madhya Pradesh. Now it extends to 10 states covering over 4 million farmers. ITC’s first rural mall, christened ‘Choupal Saagar’ was inaugurated in August 2004 at Sehore. On the rural retail front, 24 ‘Choupal Saagars’ are now operational in the 3 states of Madhya Pradesh, Maharashtra and Uttar Pradesh.

In 2000, ITC forayed into the Greeting, Gifting and Stationery products business with the launch of Expressions range of greeting cards. A line of premium range of notebooks under brand ‘Paperkraft’ was launched in 2002. To augment its offering and to reach a wider student population, the popular range of notebooks was launched under brand ‘Classmate’ in 2003.

Contd...
ITC also entered the Lifestyle Retailing business with the Wills Sport range of international quality relaxed wear for men and women in 2000. The Wills Lifestyle chain of exclusive stores later expanded its range to include Wills Classic formal wear (2002) and Wills Clublife evening wear (2003). ITC also initiated a foray into the popular segment with its men's wear brand, John Players in 2002. In 2006, Wills Lifestyle became title partner of the country's most premier fashion event - Wills Lifestyle India Fashion Week - that has gained recognition from buyers and retailers as the single largest B-2-B platform for the Fashion Design industry. To mark the occasion, ITC launched a special 'Celebration Series', taking the event forward to consumers.

In 2000, ITC spun off its information technology business into a wholly owned subsidiary, ITC Infotech India Limited, to more aggressively pursue emerging opportunities in this area. Today ITC Infotech is one of India’s fastest growing global IT and IT-enabled services companies and has established itself as a key player in offshore outsourcing, providing outsourced IT solutions and services to leading global customers across key focus verticals: Manufacturing, BFSI (Banking, Financial Services & Insurance), CPG&R (Consumer Packaged Goods & Retail), THT (Travel, Hospitality and Transportation) and Media & Entertainment.

ITC’s foray into the foods segment began in August 2001 with the introduction of Kitchens of India’s ready-to-eat Indian gourmet dishes. In 2002, ITC entered the confectionery and staples segments with the launch of the brands mint-o and Candyman confectionery and Aashirvaad atta (wheat flour). 2003 witnessed the introduction of Sunfeast as the Company entered the biscuits segment. ITC entered the fast growing branded snacks category with Bingo in 2007. In eight years, the Foods business has grown to a significant size with over 200 differentiated products under six distinctive brands, with an enviable distribution reach, a rapidly growing market share and a solid market standing.

ITC’s foray into the marketing of Agarbattis (incense sticks) in 2003, marked the manifestation of its partnership with the cottage sector. ITC’s popular agarbattis brands include Spriha and Mangaldeep across a range of fragrances like Rose, Jasmine, Bouquet, Sandalwood, Madhur, Sambrani and Nagchampa.

ITC introduced Essenza Di Wills, an exclusive range of fine fragrances and bath & body care products for men and women in July 2005. Inizio, the signature range under Essenza Di Wills provides a comprehensive grooming regimen with distinct lines for men (Inizio Homme) and women (Inizio Femme). Continuing with its tradition of bringing world class products to Indian consumers, the Company launched ‘Fiama Di Wills’, a premium range of Shampoos, Shower Gels and Soaps in September, October and December 2007, respectively. The Company also launched the ‘Superia’ range of Soaps and Shampoos in the mass-market segment at select markets in October 2007 and Vivel De Wills & Vivel range of soaps in February and Vivel range of shampoos in June 2008.
After studying this chapter, you should be able to:

- Explain the meaning of corporate strategy formulation
- Describe the balanced scorecard: a balanced approach
- Know the importance of grand strategies: strategic alternatives
- Discuss the growth/expansion strategy
- Assess the diversification strategy
- Understand the significance of stability strategy
- Explain the retrenchment strategy
- Identify the combination strategy

7.1 INTRODUCTION

The results obtained through external and internal analysis provide the inputs needed by a firm to develop its strategic intent and strategic mission. Strategic intent shows how resources, capabilities and core competencies will be leveraged to achieve desired results in a competitive environment. The mission is used to specify the product markets and customers a firm intends to serve through various strategies (at the corporate, business unit and functional level). This chapter, basically, throws light on corporate strategies that help firms to leverage their resources and skills to extend their competitive advantage to new areas of activity.

Corporate strategy is basically concerned with the choice of businesses, products and markets. It tries to answer certain key questions:

- What businesses the firm should be in, in terms of the range of products it supplies?

  Answer 1: Punjab Tractors is a specialised company which is involved almost exclusively in the manufacturing of tractors.

  Answer 2: Hindustan Lever Ltd. is highly diversified with interests in soaps, tea, washing powders, detergents, tooth pastes, shampoo, creams, salt, hair oils etc.

- What should be the optional geographic spread of activities for a firm?

  Answer: In the restaurant business, most firms serve small local markets, whereas McDonald’s operates in more than one hundred countries throughout the world.

- What range of vertically linked activities should the firm encompass?

  Answer: Reliance Industries is a key player in each of the products in the Petrochemical – Fibre intermediate chain (synthetic textiles, PSF, PFY, PTA MEG).
How the corporate office should manage its group of businesses?

Answer: Corporate strategy spells out the businesses in which the firm will participate, the markets it will serve and the customer needs it will satisfy.

Corporate-level strategy, thus, pertains to the organisation as a whole and the combination of business units and product lines that make up the corporate entity. It addresses the overall strategy that an organisation will follow. The process generally involves selecting a grand strategy and using portfolio strategy approaches to determine the types of businesses in which the organisation should be engaged.

7.2 BALANCED SCORE CARD: A BALANCED APPROACH

R S Kaplan and D P Norton came out with a popular, balanced scorecard approach in early 90s linking corporate goals with strategic actions undertaken at the business unit, departmental and individual level.

The arguments run thus:

- A firm can offer superior returns to stockholders if it has a competitive advantage in its product or service offerings when compared to its rivals.
- In order to sustain a competitive advantage, a firm must offer superior value to customers.
- This, in turn, requires development of operations with necessary capabilities.
- In order to develop the needed operational capabilities, a firm requires the services of employees having requisite skills, creativity, diversity and motivations.

Thus, the performance as assessed in one perspective supports performance in other areas – as given below:

- **Financial Perspective:** Does the firm offer returns in excess of the total cost of capital, as suggested by the Economic Value Added (EVA) model? EVA is the spread between a firm’s return on invested capital minus its weighted average cost of capital, multiplied by the amount of capital invested. In other words, EVA is what is left over after a firm has covered all its factors of production (operating expenses, overheads, interest, taxes, plus fair return to shareholders). “To succeed financially, how should we appear to our shareholders?” is the question to be answered here.
NOTES

- **Customer's Perspective**: Does the firm provide the customer with superior value in terms of product differentiation, low cost and quick response?

- **Operations Perspective**: How effectively and efficiently do the core processes that produce customer value perform? What are the most important sources of customer value that need improvising to offer greater customer value?

- **Organisational Perspective**: Can the firm adapt to changes in its environment? Is their workforce committed to shared goals? Does the organisation learn from its past mistakes? When confronted with a problem, does it work towards identifying the root causes or does it start from the beginning?

A properly constructed scorecard helps a firm strike a fine balance between short-and long-term financial measures; financial and non-financial measures; internal and external performance perspectives. A firm’s long-term strategy should take all the above perspectives into account while trying to match a firm’s internal resources and capabilities with external opportunities.

As mentioned previously, competitive advantage comes from a firm’s ability to perform activities (using its unique, durable, specialised, hard-to-imitate resources and skills etc. while serving the needs of customers) more effectively than rivals.

### SELF ASSESSMENT QUESTIONS

Fill in the blanks:

1. Corporate strategy is basically concerned with the choice of ......................., products and markets.

2. The score-card allows managers to evaluate a firm from different complementary ....................

3. Corporate success, depends on how well a firm is able to extend its ...................... to new areas over a long period of time.

### ACTIVITY

Which is a better way to link corporate goals with strategic actions – shareholder value model or the balanced scorecard approach?

### NOTE

Corporate success, ultimately, depends on how well a firm is able to extend its competitive advantage to new areas over a long period of time.
7.3 GRAND STRATEGIES: STRATEGIC ALTERNATIVES

Grand strategy is the general plan of major action by which a firm intends to achieve its long-term goals. It provides basic direction for the strategic actions of a firm. Most firms begin their operations as single-business units. Some firms continue to thrive due to their specialised operations and exclusive focus on a limited business arena. McDonald’s, for instance, has been able to develop a steadily improved product line and keep its costs low by focusing on the fast food business alone. Likewise, Infosys Technologies had exploited the low cost advantage of software services initially in India and after consolidating its position is now seeking to extend its business by developing competencies in new and emerging technologies. Wal-Mart, too, has benefited primarily from the retailing industry. However, operating primarily in one industry may make the firm vulnerable to business cycles. Should the industry attractiveness decline (Software, Telecom businesses in late 90s) through a permanent decrease in consumer demand for the firm’s products or competition intensifies from existing or new competitors, the firm’s performance is likely to suffer. These limitations can be overcome by operating in different fields through diversification. “The firm could diversify into related (to exploit its core strengths) or unrelated businesses (to tap profit opportunities in other areas). Of course, unrelated diversifications may results in uncertainties associated with losing touch with the fundamentals of each business and the difficulty of analysing the numerous disaggregate external opportunities and threats inherent in unrelated industries” (Wright et al.). Managers have to be extremely cautious in choosing the various strategic alternatives aimed at improving customer value.

4. Fill in the blank:

**Self Assessment Questions**

4. Grand strategy is the general plan of major action by which a firm intends to achieve its \______________ goals.

**Activity**

Diversification is essentially a risk mitigation strategy. Discuss.

**Note**

Grand strategies fall into four general categories: growth/expansion, stability, retrenchment and combination.

7.4 GROWTH/EXPANSION STRATEGY

Organisations generally seek growth in sales, market share or some other measure as a primary objective.
When growth becomes a passion and organizations try to seek sizeable growth, (as against slow and steady growth) it takes the shape of an expansion strategy. The firm tries to redefine the business, enter new businesses, that are related or unrelated or look at its product portfolio more intensely. The firm can have as many alternatives as it wants by changing the mix of products, markets and functions. Thus, the growth opportunities may come internally or externally. Internal growth possibilities may be exploited through intensification or diversification. External growth options include mergers, takeovers and joint ventures.

7.4.1 WHEN TO ADOPT A GROWTH STRATEGY?

There are certain inherent limits to corporate growth and a firm intending to grow beyond a particular limit, should look into the pros and cons carefully before embarking upon an ambitious growth strategy. This compels us to examine the issue as to when corporations should look for a growth strategy:

- **Growth must be manageable:** It should enable the organisation to stabilise its operations over a period of time and ensure profitability. When an organisation achieves stability after a time, it can pursue growth strategies in the same field or in diversified fields depending on its strengths.

- **Growth must take into account environmental demands:** The limitations imposed by various pieces of legislation (for example FDI limits in print media, banking etc.) must be carefully looked into before going ‘all out’. Growth, as a matter of fact, should be in consonance with environmental demands. An organisation can grow only to the extent permitted by (all the above factors) the environment. This, however, requires advance thinking and careful planning.

- **Growth should be the natural choice** where the environment presents several opportunities and special concessions and incentives are readily available. For example, the government offers special benefits to small scale industries and industries set up in backward areas. Whenever such opportunities exist in the environment, organisations can pursue ‘growth strategies’ diligently.

7.4.2 WHY TO PURSUE GROWTH STRATEGY?

Growth strategies are extremely popular because most managers tend to equate growth with success. Obviously, a firm that fails to move ahead may fall behind in the competitive race. The firm that operates in a dynamic environment must grow in order to survive. Growth implies greater sales and an opportunity to take advantage
of the environmental opportunities. As the firm grows in size and experience, it gets better at what it is doing and reduces costs and improves productivity. A growing firm can cover up mistakes and inefficiencies more easily than can a stable one. There are more opportunities for advancement, promotion and interesting jobs in a growing firm. Growth per se is exciting and ego-enhancing for managers. A corporation tends to be seen as a winner or on the move by the market place and by potential investors. Growth strategies gain importance if a firm’s industry is growing quickly and competitors are engaging in price wars so as to slice out a larger share of the market. If the firm is not able to find a profitable niche, (for example Anchor vegetarian toothpaste, triple-refined Dandi Salt) it can not flourish in a volatile environment. More specifically, the compelling motives for pursuing growth strategies may be furnished thus:

- **To Ensure Survival:** In the long run growth is necessary for the very survival of the organisation, especially when the environment is turbulent and highly competitive. If the organisation does not grow, it may be pushed out of the market by new entrants. Ambassador car, Ideal Jawa, Diner’s Credit Card business, are the inglorious examples in this regard, where the organisations failed to take stock of competitive reactions and were eventually forced out of business.

- **To Obtain Scale Economies:** Growth is tempting because of innumerable benefits offered by large scale operations. Fixed costs could be spread over a large volume of units and the resultant savings could be recycled into the product and offer the same at economical rates ensuring continued organisational success. Great penetration into the market is ensured thereby.

- **To Stimulate Talent:** Managers and entrepreneurs with a high degree of achievement and recognition would prefer to work in companies always on the move rather than companies where there are limited opportunities to exploit their talents fully. The stupendous rate of growth achieved by Hero Honda, Infosys, Wipro in recent years bears ample testimony to this fact.

- **To Reach Commanding Heights:** Growth ensures market control. It means prestige and power. It means securing investor confidence. Companies such as Nestle, Britannia, ITC, HLL etc. have a high level of reputation in the corporate world owing to this reason. They are held high and rated as ‘winners’ in the corporate world owing to their relentless efforts to grow in various profitable directions. Growth, obviously, brings satisfaction to employees, investors in particular and innumerable benefits to society in the form of increased employment, low-price-high-quality-goods, and so on. Growth allows the organisation to reach commanding heights in the economy; it can increase its market share, secure a high degree of control over the market and influence market behaviour in a significant way.
7.4.3 PROBLEMS CREATED BY GROWTH

Growth, however, is not an unmixed blessing. In some firms, as pointed out previously, growth beyond an optimum limit creates many problems. According to P.F. Drucker, a business that grows at an exponential rate, would soon gobble up the world and all its resources. Growth at a high rate and for an extended period makes a business exceedingly vulnerable. It makes it all but impossible to manage it properly. Even from the financial point of view, a growing company does not offer sound investment opportunities. Sooner or later the firm runs into tremendous losses, has to write off vast sums, and become, in effect, unmanageable. It takes years then for such a firm to recover and establish itself in the market.

7.4.4 HOW TO MANAGE – GROWTH?

It is true that a firm has to grow in order to survive in a competitive environment. Without this strategy it would be impossible for the firm to attract, motivate, and hold men of talent and competence on a permanent basis. However, the desire to grow must be supported by a rational growth policy, having the following objectives:

- **Minimum Growth:** The firm, initially, must set its growth targets both for the short-term and the long-term. It must meet these targets, of course, without losing its standing (in terms of sales, margins, market share) in the marketplace. It should be able to grow in economic performance and economic results. According to Drucker, growth objectives have to be economic objectives rather than volume objectives. This requires the company to slough off its unprofitable lines and concentrate on products that have growth potential.

- **Optimum Growth:** The company should be able to strike a happy balance between risk and return on resources. It should be able to combine activities, products and business in a useful manner. Growth should be at least the minimum growth. But it should not exceed the optimum point. Growth, like any other business policy, requires objectives, priorities and strategy necessary to exploit the strengths of the business successfully. More importantly, growth goals should be rational and grounded in the objective reality of a business, of its markets, of its technologies, rather than in financial fantasy.

- **Internal Preparation:** Growth requires internal preparation. As pointed out by Drucker “When the opportunity for rapid growth will come in the life of a company cannot be predicted. But a company has to be ready. If a company is not ready, opportunity moves on and knocks at somebody else’s door”. Growth should be based on the strengths of a company. It requires financial planning and, above all, requires a human organisation capable of achieving different and bigger things continuously. However, the controlling factor in managing growth is management.
“For a company to be able to grow, top management must be willing and able to change itself, its role, its relationship, and its behaviour”.

5. When an organisation achieves stability after a time, it can pursue growth strategies in the same field or in ................. depending on its strengths.

6. ................. are extremely popular because most managers tend to equate growth with success.

Growth for the sake of growth is the ideology of the cancer cell. Discuss.

7.5 DIVERSIFICATION STRATEGY

A single-product strategy is always a risky one. Because the firm has staked its survival on a single product (or a small basket of products like Colgate) the organisation has to work very hard to ensure the success of that product. If the product is not accepted by the market (like taking a big call on Indica by TELCO) or is replaced by a new one (the challenge of Close-Up from HLL to Colgate) the firm will suffer. Given the risk of a single-product strategy, most large organisations today operate in several different businesses, industries or markets. Diversification describes the number of different businesses that an organisation is engaged in and the extent to which these businesses are related to one another. Diversification involves entry into fields where both products and markets are significantly different than those of a firm’s initial base. Related diversification occurs when a firm expands into industries similar to its initial business in terms of at least one major function (when the firm enjoys distinctive competence such as marketing, distribution, engineering etc). Unrelated diversification involves expansion into fields that do not share any financial or skill-based interrelationship with a firm’s initial business.

Diversification is said to minimise risks associated with confining the business to one or very few products. The company can enter new lines of business to preempt potential competitors or to gain superiority over competitors entering the market at an early stage. It can introduce new products, satisfying a variety of needs. This helps in consolidating its position in the industry. The company can put its resources and related capabilities to good effect. The existing businesses might have saturated a bit and the only way to grow could be through diversification, exploiting opportunities in the environment. Diversification, of course, is not a sure bet. Diversification may lead
to neglect of old business. The managers may fail to understand the intricacies of new business as well – because they have entered the field without full knowledge and adequate preparation. To make matters worse, competitors may retaliate with full force, adversely impacting even the existing businesses. To be successful, diversification requires careful planning and meticulous preparation. The company must have deep pockets and strong staying power. Building competitive advantages takes time and involves lot of money. The company must have relevant core competency in the field that it is trying to look at now. The chosen field must be attractive and the company should have capable managers to handle the associated risks in a competent way. The cost of entry should also be reasonable. To be safe, the company should screen and pretest the proposals carefully and proceed in a cautious manner.

7.5.1 RELATED DIVERSIFICATION

Horizontal integration takes place when some firms expand by acquiring other companies in the same line of business (adding new products or services to the existing product or service line). Such acquisitions eliminate competitors and provide the acquiring organisation with access to new markets. Horizontal integration could come, thus, through mergers and acquisitions. The purchase of one firm by another firm of approximately the same size is called a merger. It is called an acquisition when one of the organisations involved is considerably larger than the other. Most software companies use the mergers and acquisitions route to acquire complementary businesses, products or services linked by a common technology and common customers.

Concentric diversification: It occurs when an organisation diversifies into a related, but distinct business. With concentric diversification, the new businesses can be related to existing businesses through products, markets or technology. The new product is a spin-off from the existing facilities, products and processes. For example, Philip’s the electronics major, decided to diversify into related businesses such as cellular phones, telecommunication equipment, electronic components etc. to exploit its core advantages in the form of related technology, strong distribution network etc. IBM has used a concentric diversification strategy right from 60s onwards. In early 60s IBM concentrated on the mainframe computer business. Today the company’s products include small computers, terminals, communication’s equipment, etc.

Concentric diversifications may occur due to factors such as common distribution channel, marketing skills, common brand name, and common customers. Organisations such as Philip Moris, Nabisco, Proctor & Gamble operate multiple businesses related by a common distribution network (grocery stores) and common marketing skills (advertising). Disney and Universal rely on strong brand names and reputations to link their diverse businesses which include movie studios and theme parks. Pharmaceutical firms such as Cipla, Ranbaxy sell numerous products to a single set of customers: hospitals, doctors, patients and drugstores.
7.5.2 UNRELATED DIVERSIFICATION

Conglomerate diversification takes place when an organisation diversifies into areas that are unrelated to its current business. The decision to diversify into unrelated areas is generally undertaken by firms in volatile industries that are subject to rapid technological change. The obvious purpose is to reduce risk. It is also assumed that by restructuring the portfolio of businesses, the firm would be in a position to create value. Similarity in products, technology or marketing knowledge between the two firms is not an issue here, the acquiring firm simply wants to make an attractive investment. Unrelated diversification was a very popular strategy in the 1960s and early 1970s. For example, the ITC’s diversification into edible oils, hotels, financial services etc. is conglomerate diversification (likewise NEPC group’s foray into agro foods, textiles, paper, airlines, wind energy, tea plantations etc; Ballarpur Industries’ unrelated diversification, into chemicals, nylon fibre, leather etc., in addition to paper. Essar’s foray into shipping, oil, sponge iron, marine construction, telecom, power, etc.).

Economic Motives

It is worth noting the principal difference between concentric and conglomerate diversification here. Concentric diversification emphasises some commonality in markets, products, or technology, whereas conglomerate diversification is based on profit considerations only. The firm thinks that it is able to spot an attractive investment opportunity faster than the market and commits its resources accordingly. Of course, it is always open to doubt whether the new business justifies its acquisition cost. Thus, the selection of attractive acquisition candidates is largely a matter of managerial judgement. The basic source of value in a conglomerate is senior management’s ability to time the market to buy and sell businesses. Consistent success in such matters, however, cannot be guaranteed. Throughout the 1990s, not surprisingly, many conglomerates failed to deliver the goods. Unrelated diversification moves have actually destroyed value instead of creating it (dyssynergy, in which individual businesses may actually be worth more on their own rather than when placed under a larger corporate umbrella with other unrelated units). Conglomerates have failed in most cases because of various reasons: inadequate focus, failure to understand the business fully, competitive disadvantage compared to organisations that use related diversification.

7.5.3 COSTS OF DIVERSIFICATION

Evidently, diversification into related or unrelated areas is not a sure bet. Problems could surface suddenly from multifarious – known as well as unknown-factors. Let’s examine these more closely (Pitts and Lei).

Cost of Ignorance: Entering a new, unknown field is risky. The firm does not know the extent of competition. It may fail to read
the mind of the consumer properly. Technological developments, environmental factors may compel the firm to shift gears continuously. Mistakes might be committed when the firm is navigating through uncharted waters.

- **Cost of Neglect**: A company trying to expand through unrelated diversifications may have to divert its attention from its core businesses – at least temporarily. First, it must decide the areas where it wants to operate. Second, if acquisition is the route; it must identify suitable targets for purchase. Third, top managers must integrate the new units with the existing businesses. All these steps would dilute the attention of the firm towards its own, original business. The costs of ignorance and neglect might prove to be crippling, especially in a highly competitive rapidly changing environment. Let’s consider the cases of Indian companies which have gone out of business, because of hasty, unrelated diversifications into too many different areas.

### 7.5.4 WHEN TO DIVERSIFY?

Diversification will be fruitful only when the benefits generated by diversification outweigh the related costs. To contain costs, the firm should focus attention on familiar fields and by diversifying internally rather than by acquisition. In any case, as summarised by Pears and Robinson, diversification is the most preferred route:

- When the firm intends extraordinary growth in assets, revenues and profits.
- When the firm wants to counter vulnerability arising out of a single-product concentration – by creating a large portfolio of diverse businesses.
- When the environment presents an unusually large number of exciting opportunities to be exploited by the firm’s resource base.
- When there is great environmental uncertainty, firms embark on a constant search for new businesses.
- When the firm finds diversification to be more profitable than intensification.
- When the firm has surplus resources that could be profitability deployed in new ventures.
- When the firm finds synergy in its existing businesses and the new ones that it intends to set up.

When diversification is likely to produce fewer benefits than costs, the firm should turn its attention to restructuring its operations with a view to enhance shareholder value. The various possibilities in this connection include:

- **Selective Focus**: Target carefully selected new segments when the firm is able to expand its market share quickly even though the industry in which it operates is on the decline.
Spin-off: Spinning off businesses means selling those units or parts of a business that no longer contribute to or fit the firm’s core competence. Spinning off non-core or less related businesses help produce renewed focus on remaining core operations. It also helps shareholders capture the full value of assets being used by management.

SELF ASSESSMENT QUESTIONS

Fill in the blanks:
7. Diversification is said to minimise risks associated with ...................... the business to one or very few products.
8. Horizontal integration takes place when some firms expand by ...................... other companies in the same line of business.
9. Conglomerate diversification takes place when an organisation ...................... into areas that are unrelated to its current business.
10. Diversification is fruitful only when the benefits generated by diversification ...................... the related costs.

ACTIVITY

Prepare a presentation on the diversification strategy of Tata Sons in light of their entry into the aviation industry recently.

7.6 STABILITY STRATEGY

A stability strategy involves maintaining the status quo or growing in a methodical, but slow, manner. The firm follows a safety-oriented, status-quo-type strategy without effecting any major changes in its present operations. The resources are put on existing operations to achieve moderate, incremental growth. As such, the primary focus is on current products, markets and functions, maintaining the same level of effort as at present. Organisations might follow a stability strategy for a variety of reasons:

- Why rock the boat?: If the company is doing reasonably well, managers may not like to take the risks or hassles associated with more aggressive growth.

- Why not stop for a while?: Stability allows the firm to stop for a while, re-examine what it has already done and proceed cautiously. An organisation that has stretched its resources during a period of accelerated growth may want to attain stability before it attempts further accelerated growth.

- Why to swallow risk?: If managers believe that growth prospects are low, they may follow a stability strategy with a view to hold on to their current market share. Stability strategy, is however, not a ‘do-nothing’ strategy. To maintain current position, the organisation definitely needs to carry out marginal improvements in performance in line with changing trends.
Where are the resources?: Introducing new products, entering new markets, undertaking major organisational changes—all require huge investments. Where there is an internal resource constraint, a stability strategy is preferred. If the organisation’s strategic advantages lie in the current business and market, it pursues the stability strategy to exploit its competitive advantages fully.

Limitations

Stability strategies would work only when the firm is doing well and the environment is not excessively volatile. However, present day organisations have to grapple with change continually. They have to operate in highly competitive and turbulent environments. So strategies of functioning along existing lines would work initially when the firm is able to carve out a niche for itself but would fail to work as new firms enter into the market or new developments in the business environment occur. It is true that future means change and adjustments to new situations and conditions. But it is better to indulge in proactive planning through strategic planning systems rather than living with low profits and low stockholder dividends year after year. Failure to improve profits over the long term means corporate death. The corporate graveyard is filled with the corpses of companies that failed to respond to changes in the environment.

So organisations must practice pro-active planning. They must practise strategic planning in order to manage change successfully. The manager who is able to anticipate and prepare for possible changes in the business work has more control than the manager who does not plan ahead, and is content with the present set-up and status quo arrangements. The consequences of taking a short-term perspective can be severe. Only a few years ago the U.S. auto industry was the marvel of the world. Textbooks cited it for its examples of good management practice. But what has happened to the auto industry during the 1970s? Blinded by its success, it made the biggest mistake of all—it failed to adapt to the changing requirements and wants of the market place. Japanese and other foreign auto companies moved into fill the market void (need for fuel-efficient cars). By the early 1980s General Motors and Ford were losing hundreds of millions of dollars and Chrysler was fighting off bankruptcy. One of the important advantages of planning is that it helps a manager or organisation to affect rather than accept the future. In a competitive environment, resting on past laurels would prove to be suicidal. No change strategies force managers to live with wrong products and wrong markets. In volatile industries, a stability strategy can mean short-run success, long-run death. In order to progress in an orderly manner, every firm must employ appropriate growth strategies that help in improving present as well as future performance in the market place.
Fill in the blank:

11. Stability strategies works only when the firm is doing well and the environment is not excessively .........................

In the first decade of the new millennium, Infosys had the second largest cash reserves worth ₹ 22,000 crore. Yet it let go several acquisition opportunities. Was it case of trading caution for aggression?

7.7 RETRENCHMENT STRATEGY

Retrenchment strategy is a corporate level, defensive strategy followed by a firm when its performance is disappointing or when its survival is at stake for a variety of reasons. Economic recessions, production inefficiencies, and innovative breakthroughs by competitors are only three causes. Managers choose retrenchment when they think that the firm is neither competitive enough to succeed through a counter attack (on market forces affecting its sales negatively) nor nimble enough (effecting fast changes) to be a fast follower. However, retrenchment does not mean death knell for every business under attack. Many healthy companies have faced life-threatening competitive situations in the past, successfully addressed their weaknesses and restored themselves.

Retrenchment calls for a radical surgery to cut the ‘extra fat’—say, laying off employees, dropping items from a production line, eliminating low-margin customer groups, avoiding elaborate promotional efforts etc. Apart from the above cost reductions, retrenchment calls for drastic steps to improve cash flows through sale of assets. Retrenchment strategy, as such, is adopted out of necessity, not by deliberate choice. In actual practice, retrenchment may take one of the following forms:

- Outright sale to another company,
- Leveraged Buy-out (LBO), and
- Spin-off.

Reasons for Divestment

- **Strong Focus**: Spinning off unviable units may help a firm focus on its core business more closely and regain the lost ground quickly.
- **Unlock Critical Funds**: The firm can sell those assets whose values have plateaued or declined as a result of ignorance or neglect.
Invest in Emerging Technologies: Firms can use the cash generated through spin offs in emerging or future technologies that better leverage or revitalise their core competencies.

A Maker of Policy: Sometimes the firm may spin off units in fields where it has no dominance. If the firm wants to be in the top slot, it must naturally get out of all those ventures where it is only a marginal player (like what K.M. Birla did in paper, sugar and steel – all peripheral businesses in Birla’s kitty).

From Red to Black: Assets bought at inflated prices might drain out cash flows, especially if they are funded through debt capital. Spinning off such assets would help a firm liquidate debts, improve the cash flow position and recharge its operations in areas where it has immense strength.

Unviable Projects: If the business becomes unviable due to stiff competition or change in government policy it is better to get out quickly.

Jack Welch the former CEO of GE used retrenchment to great effect to the extent that he was nicknamed “Neutron Jack”. What implications does retrenchment have on the employer brand in the long term? Discuss.

A leveraged buy out occurs when a company’s shareholders are bought out (hence buyout) by the company’s management and other private investors using borrowed funds (hence leveraged). In the last case, the parent company creates a new company, then distributes its shares to shareholders of the parent.

7.8 TURNAROUND STRATEGIES

A turnaround is designed to reverse a negative trend and bring the organisation back to normal health and profitability. The basic purpose of a turnaround is to transform the corporation into a leaner and more efficient firm. It usually involves getting rid of unprofitable products, trimming the workforce, pruning distribution outlets, and finding other useful ways of making the organisation more efficient. If the turnaround is successful, the organisation may then focus on growth strategy.

7.8.1 CONDITIONS FOR TURNAROUND STRATEGIES

Firms often lose their grip over markets due to various internal and external factors. If they have to survive and flourish in a competitive environment, they have to identify the danger signals quite early and
undertake rectificational steps immediately. Such negative trends are not difficult to trace.

- Continuous cash flow problems.
- Declining profits; lower profit margins.
- Dwindling market share.
- High employee turnover.
- Low morale of employees.
- Underutilisation of capacity.
- Raw material supply problems.
- Rising input prices.
- Strikes and lockouts.
- Increased competition, uncompetitive products or services.
- Recession.
- Mismanagement etc.

### 7.8.2 ACTION PLANS FOR TURNAROUND

The action plans for achieving a turnaround aim at yielding immediate results focusing attention on certain key areas like quality improvement, cost reduction, new product development, rejuvenated marketing effort etc. Such short-term action plans usually tackle the following issues:

- Change the leader.
- Change the prices – depending on the elasticity of demand.
- Focus attention on specific customer and specific products.
- Extend the product’s life through product improvements.
- Replace existing products with new ones.
- Focus on ‘power brands’ that are valued, visible and bring in most of the revenues of the firm; in short, rationalising the products line.
- Liquidating assets for generating cash.
- Better internal coordination.
- Emphasis on selling, advertising etc.

### SELF ASSESSMENT QUESTIONS

Fill in the blank:

12. A turnaround is designed to reverse a negative trend and bring the organisation back to normal health and ......................
In the aftermath of the global meltdown of 2008, Vikram Pandit the then CEO of Citibank Corporation was credited with the turnaround of business. Yet his term as CEO was not extended. Are turnaround strategies mere stopgap adjustments to brave the storm?

7.9 COMBINATION STRATEGIES

Large, diversified organisations generally use a mixture of stability, expansion or retrenchment strategies either simultaneously (at the same time in various businesses) or sequentially (at different times in the same business). For example, growth could be achieved by an organisation through acquisition of new businesses or divesting itself of unprofitable ventures. Depending on situational demands, therefore, an organisation can employ various strategies to survive, grow and remain profitable.

In recent times, three more strategies have gained popularity namely, joint ventures, strategic alliances and consortia.

- **Joint Ventures:** When two or more firms pool resources to accomplish a task that a firm could not accomplish, or that can be done more effectively by joining, the result is a joint venture. Like a merger or acquisition, a joint venture is not a strategy but a way of implementing a strategy. It helps a firm to undertake giant projects by spreading risks more efficiently. Examples include, the joint ventures between Thermax and Babcock and Wilcox; Maruti Udyog and Suzuki; TELCO and Hitachi Construction Company etc; in addition the Tata’s, the Birla’s, the Oberoi’s, the Kirloskar’s and many software giants also have joint ventures with global partners from outside the country. To be successful, however, joint venture partners should be willing to share technology in the real sense, resolve cultural differences clearly and integrate operations at various locations in a more compact manner. In any case, “joint ventures often limit the discretion, control and profit potential of partners, while demanding managerial attention and other resources that might be directed toward the firm’s mainstream activities”.

- **Strategic Alliances:** In a joint venture, the companies involved take an equity stake in one another. In strategic alliances, however, the partners contribute their skills and expertise to a cooperatively conceived and executed project for a specific period. Partners, during the said period, try to peep into each other’s know-how and learn from one another. Alliances could take the shape of a licensing agreement too, where licensor would transfer his property right over patents, trade marks, technical know-how etc., to a licensee for a specified time in return for a royalty, Outsourcing is another useful approach to strategic alliances that helps firms to gain a competitive advantage...
(especially in technology intensive fields such as software, telecommunications, electronics, bio-technology etc.)

- **Consortia**: Consortia are interlocking relationships between businesses of an industry. It works more or less like a Japanese Keiretsu involving upto 50 different firms that are joined around a large trading company or bank and are coordinated through interlocking directories and stock exchanges (like Sumitomo, Mitsui, Mitsubishi, Sanwa).

### SELF ASSESSMENT QUESTIONS

13. .......... are interlocking relationships between businesses of an industry.

14. In a .........., the companies involved take an equity stake in one another.

### ACTIVITY

Combination strategies are unpredictable to competitors and hence better than focus strategies. Discuss.

### 7.10 CORPORATE RESTRUCTURING STRATEGY

Corporate restructuring is one of the most complex and fundamental phenomena that management confronts. Each company has two opposite strategies from which to choose: to diversify or to refocus on its core business. While diversifying represents the expansion of corporate activities, refocus characterises a concentration on its core business. From this perspective, corporate restructuring is reduction in diversification.

Corporate restructuring is an episodic exercise, not related to investments in new plant and machinery which involve a significant change in one or more of the following:

- Pattern of ownership and control
- Composition of liability
- Asset mix of the firm.

It is a comprehensive process by which a co. can consolidate its business operations and strengthen its position for achieving the desired objectives:

- Synergetic
- Competitive
- Successful
It involves significant re-orientation, re-organisation or realignment of assets and liabilities of the organisation through conscious management action to improve future cash flow stream and to make more profitable and efficient.

### 7.10.1 MEANING AND NEED FOR CORPORATE RESTRUCTURING

Corporate restructuring is the process of redesigning one or more aspects of a company. The process of reorganising a company may be implemented due to a number of different factors, such as positioning the company to be more competitive, survive a currently adverse economic climate, or poised the corporation to move in an entirely new direction. Here are some examples of why corporate restructuring may take place and what it can mean for the company.

Restructuring a corporate entity is often a necessity when the company has grown to the point that the original structure can no longer efficiently manage the output and general interests of the company. For example, a corporate restructuring may call for spinning off some departments into subsidiaries as a means of creating a more effective management model as well as taking advantage of tax breaks that would allow the corporation to divert more revenue to the production process. In this scenario, the restructuring is seen as a positive sign of growth of the company and is often welcome by those who wish to see the corporation gain a larger market share.

Corporate restructuring may also take place as a result of the acquisition of the company by new owners. The acquisition may be in the form of a leveraged buyout, a hostile takeover, or a merger of some type that keeps the company intact as a subsidiary of the controlling corporation. When the restructuring is due to a hostile takeover, corporate raiders often implement a dismantling of the company, selling off properties and other assets in order to make a profit from the buyout. What remains after this restructuring may be a smaller entity that can continue to function, albeit not at the level possible before the takeover took place.

In general, the idea of corporate restructuring is to allow the company to continue functioning in some manner. Even when corporate raiders break up the company and leave behind a shell of the original structure, there is still usually a hope, what remains can function well enough for a new buyer to purchase the diminished corporation and return it to profitability.

### 7.10.2 PURPOSE OF CORPORATE RESTRUCTURING

To enhance the shareholder value, the company should continuously evaluate its:

- Portfolio of businesses.
- Capital mix, Ownership & Asset arrangements to find opportunities to increase the shareholder’s value.
- To focus on asset utilisation and profitable investment opportunities.
- To reorganise or divest less profitable or loss making businesses/products.
- The company can also enhance value through capital restructuring, it can innovate securities that help to reduce cost of capital.

### 7.10.3 CHARACTERISTICS OF CORPORATE RESTRUCTURING

Following are the basic characteristics of corporate restructuring:

- To improve the company’s balance sheet, (by selling unprofitable division from its core business).
- To accomplish staff reduction (by selling/closing of unprofitable portion)
- Changes in corporate management
- Sale of underutilised assets, such as patents/brands.
- Outsourcing of operations such as payroll and technical support to a more efficient third party.
- Relocating certain business units like Manufacturing unit to a cost-effective location.
- Reorganisation of functions such as sales, marketing, and distribution
- Renegotiation of labour contracts to reduce overhead
- Refinancing of corporate debt to reduce interest payments.
- A major public relations campaign to reposition the co., with consumers.

### 7.10.4 CATEGORY OF CORPORATE RESTRUCTURING

Corporate restructuring entails a range of activities including financial restructuring and organisation restructuring.

**Financial Restructuring**

Financial restructuring is the reorganisation of the financial assets and liabilities of a corporation in order to create the most beneficial financial environment for the company. The process of financial restructuring is often associated with corporate restructuring, in that restructuring the general function and composition of the company is likely to impact the financial health of the corporation. When completed, this reordering of corporate assets and liabilities can help the company to remain competitive, even in a depressed economy.

Just about every business goes through a phase of financial restructuring at one time or another. In some cases, the process of
Restructuring takes place as a means of allocating resources for a new marketing campaign or the launch of a new product line. When this happens, the restructure is often viewed as a sign that the company is financially stable and has set goals for future growth and expansion.

**Need for Financial Restructuring**

The process of financial restructuring may be undertaken as a means of eliminating waste from the operations of the company. For example, the restructuring effort may find that two divisions or departments of the company perform related functions and in some cases duplicate efforts. Rather than continue to use financial resources to fund the operation of both departments, their efforts are combined. This helps to reduce costs without impairing the ability of the company to still achieve the same ends in a timely manner.

In some cases, financial restructuring is a strategy that must take place in order for the company to continue operations. This is especially true when sales decline and the corporation no longer generates a consistent net profit. A financial restructuring may include a review of the costs associated with each sector of the business and identify ways to cut costs and increase the net profit. The restructuring may also call for the reduction or suspension of production facilities that are obsolete or currently produce goods that are not selling well and are scheduled to be phased out.

Financial restructuring also take place in response to a drop in sales, due to a sluggish economy or temporary concerns about the economy in general. When this happens, the corporation may need to reorder finances as a means of keeping the company operational through this rough time. Costs may be cut by combining divisions or departments, reassigning responsibilities and eliminating personnel, or scaling back production at various facilities owned by the company. With this type of corporate restructuring, the focus is on survival in a difficult market rather than on expanding the company to meet growing consumer demand.

All businesses must pay attention to matters of finance in order to remain operational and to also hopefully grow over time. From this perspective, financial restructuring can be seen as a tool that can ensure the corporation is making the most efficient use of available resources and thus generating the highest amount of net profit possible within the current set economic environment.

**Organisational Restructuring**

In organisational restructuring, the focus is on management and internal corporate governance structures. Organisational restructuring has become a very common practice amongst the firms in order to match the growing competition of the market. This makes the firms to change the organisational structure of the company for the betterment of the business.
Need for Organisation Restructuring

- New skills and capabilities are needed to meet current or expected operational requirements.
- Accountability for results are not clearly communicated and measurable resulting in subjective and biased performance appraisals.
- Parts of the organisation are significantly over or under staffed.
- Organisational communications are inconsistent, fragmented, and inefficient.
- Technology and/or innovation are creating changes in workflow and production processes.
- Significant staffing increases or decreases are contemplated.
- Personnel retention and turnover is a significant problem.
- Workforce productivity is stagnant or deteriorating.
- Morale is deteriorating.

Some of the most common features of organisational restructures are:

- **Regrouping of business**: This involves the firms regrouping their existing business into fewer business units. The management then handles these lesser number of compact and strategic business units in an easier and better way that ensures the business to earn profit.

- **Downsizing**: Often companies may need to retrench the surplus manpower of the business. For that purpose offering Voluntary Retirement Schemes (VRS) is the most useful tool taken by the firms for downsizing the business’s workforce.

- **Decentralisation**: In order to enhance, the organisational response to the developments in dynamic environment, the firms go for decentralisation. This involves reducing the layers of management in the business so that the people at lower hierarchy are benefited.

- **Outsourcing**: Outsourcing is another measure of organisational restructuring that reduces the manpower and transfers the fixed costs of the company to variable costs.

- **Enterprise Resource Planning**: Enterprise resource planning is an integrated management information system that is enterprise-wide and computer-base. This management system enables the business management to understand any situation in faster and better way. The advancement of the information technology enhances the planning of a business.

- **Business Process Engineering**: It involves redesigning the business process so that the business maximises the operation and value added content of the business while minimising everything else.
**Total Quality Management:** The businesses now have started to realise that an outside certification for the quality of the product helps to get a good will in the market. Quality improvement is also necessary to improve the customer service and reduce the cost of the business.

The perspective of organisational restructuring may be different for the employees. When a company goes for the organisational restructuring, it often leads to reducing the manpower and hence meaning that people are losing their jobs. This may decrease the morale of employee in a large manner. Hence many firms provide strategies on career transitioning and outplacement support to their existing employees for an easy transition to their next job.

**Leveraged Buyout, Hostile Takeover & Merger**

Corporate restructuring may take place as a result of the acquisition of the company by new owners. The acquisition may be in the form of a leveraged buyout, a hostile takeover, or a merger of some type that keeps the company intact as a subsidiary of the controlling corporation.

**Hostile Takeover**

A hostile takeover is a type of corporate takeover which is carried out against the wishes of the board of the target company. This unique type of acquisition does not occur nearly as frequently as friendly
takeovers, in which the two companies work together because the takeover is perceived as beneficial. Hostile takeovers can be traumatic for the target company, and they can also be risky for the other side, as the acquiring company may not be able to obtain certain relevant information about the target company.

Companies are bought and sold on a daily basis. There are two types of sale agreements. In the first, a merger, two companies come together, blending their assets, staff, facilities, and so forth. After a merger, the original companies cease to exist, and a new company arises instead. In a takeover, a company is purchased by another company. The purchasing company owns all of the target company’s assets including company patents, trademarks, and so forth. The original company may be entirely swallowed up, or may operate semi-independently under the umbrella of the acquiring company.

Typically, a company which wishes to acquire another company approaches the target company’s board with an offer. The board members consider the offer, and then choose to accept or reject it. The offer will be accepted if the board believes that it will promote the long term welfare of the company, and it will be rejected if the board dislike the terms or it feels that a takeover would not be beneficial. When a company pursues takeover after rejection by a board, it is a hostile takeover. If a company bypasses the board entirely, it is also termed a hostile takeover.

Publicly traded companies are at risk of hostile takeover because opposing companies can purchase large amounts of their stock to gain a controlling share. In this instance, the company does not have to respect the feelings of the board because it already essentially owns and controls the firm. A hostile takeover may also involve tactics like trying to sweeten the deal for individual board members to get them to agree.

An acquiring firm takes a risk by attempting a hostile takeover. Because the target firm is not cooperating, the acquiring firm may unwittingly take on debts or serious problems, since it does not have access to all of the information about the company. Many firms also have trouble getting financing for hostile takeovers, since some banks are reluctant to lend in these situations.

Merger

A merger occurs when two companies combine to form a single company. A merger is very similar to an acquisition or takeover, except that in the case of a merger existing stockholders of both companies involved retain a shared interest in the new corporation. By contrast, in an acquisition one company purchases a bulk of a second company’s stock, creating an uneven balance of ownership in the new combined company.

The entire merger process is usually kept secret from the general public, and often from the majority of the employees at the involved
companies. Since the majority of merger attempts do not succeed, and most are kept secret, it is difficult to estimate how many potential mergers occur in a given year. It is likely that the number is very high, however, given the amount of successful mergers and the desirability of mergers for many companies.

A merger may be sought for a number of reasons, some of which are beneficial to the shareholders, some of which are not. One use of the merger, for example, is to combine a very profitable company with a losing company in order to use the losses as a tax write-off to offset the profits, while expanding the corporation as a whole.

Increasing one’s market share is another major use of the merger, particularly amongst large corporations. By merging with major competitors, a company can come to dominate the market they compete in, giving them a freer hand with regard to pricing and buyer incentives. This form of merger may cause problems when two dominating companies merge, as it may trigger litigation regarding monopoly laws.

Another type of popular merger brings together two companies that make different, but complementary, products. This may also involve purchasing a company which controls an asset your company utilises somewhere in its supply chain. Major manufacturers buying out a warehousing chain in order to save on warehousing costs, as well as making a profit directly from the purchased business, is a good example of this. PayPal’s merger with eBay is another good example, as it allowed eBay to avoid fees they had been paying, while tying two complementary products together.

A merger is usually handled by an investment banker, who aids in transferring ownership of the company through the strategic issuance and sale of stock. Some have alleged that this relationship causes some problems, as it provides an incentive for investment banks to push existing clients towards a merger even in cases where it may not be beneficial for the stockholders.

Mergers and acquisitions are means by which corporations combine with each other. Mergers occur when two or more corporations become one. To protect shareholders, state law provides procedures for the merger. A vote of the board of directors and then a vote of the shareholders of both corporations is usually required. Following a merger, the two corporations cease to exist as separate entities. In the classic merger, the assets and liabilities of one corporation are automatically transferred to the other. Shareholders of the disappearing company become shareholders in the surviving company or receive compensation for their shares.

Mergers may come as the result of a negotiation between two corporations interested in combining, or when one or more corporations “target” another for acquisition. Combinations that occur with the approval and encouragement of the target company’s management are called “friendly” mergers; combinations that occur
despite opposition from the target company are called “hostile” mergers or takeovers. In either case, these consolidations can bring together corporations of roughly the same size and market power, or corporations of vastly different sizes and market power.

The term “acquisition” is typically used when one company takes control of another. This can occur through a merger or a number of other methods, such as purchasing the majority of a company’s stock or all of its assets. In a purchase of assets, the transaction is one that must be negotiated with the management of the target company. Compared to a merger, an acquisition is treated differently for tax purposes, and the acquiring company does not necessarily assume the liabilities of the target company.

A “tender offer” is a popular way to purchase a majority of shares in another company. The acquiring company makes a public offer to purchase shares from the target company’s shareholders, thus by passing the target company’s management. In order to induce the shareholders to sell, or “tender,” their shares, the acquiring company typically offers a purchase price higher than market value, often substantially higher. Certain conditions are often placed on a tender offer, such as requiring the number of shares tendered be sufficient for the acquiring company to gain control of the target. If the tender offer is successful and a sufficient percentage of shares are acquired, control of the target company through the normal methods of shareholder democracy can be taken and thereafter the target company’s management replaced. The acquiring company can also use their control of the target company to bring about a merger of the two companies.

Often, a successful tender offer is followed by a “cash-out merger.” The target company (now controlled by the acquiring company) is merged into the acquiring company, and the remaining shareholders of the target company have their shares transformed into a right to receive a certain amount of cash.

Another common merger variation is the “triangular” merger, in which a subsidiary of the surviving company is created and then merged with the target. This protects the surviving company from the liabilities of the target by keeping them within the subsidiary rather than the parent. A “reverse triangular merger” has the acquiring company create a subsidiary, which is then merged into the target company. This form preserves the target company as an ongoing legal entity, though its control has passed into the hands of the acquirer.

In general, mergers and other types of acquisitions are performed in the hopes of realising an economic gain. For such a transaction to be justified, the two firms involved must be worth more together than they were apart. Some of the potential advantages of mergers and acquisitions include achieving economies of scale, combining complementary resources, garnering tax advantages, and eliminating inefficiencies. Other reasons for considering growth through
acquisitions include obtaining proprietary rights to products or services, increasing market power by purchasing competitors, shoring up weaknesses in key business areas, penetrating new geographic regions, or providing managers with new opportunities for career growth and advancement. Since mergers and acquisitions are so complex, however, it can be very difficult to evaluate the transaction, define the associated costs and benefits, and handle the resulting tax and legal issues.

When a small business owner chooses to merge with or sell out to another company, it is sometimes called “harvesting” the small business. In this situation, the transaction is intended to release the value locked up in the small business for the benefit of its owners and investors. The impetus for a small business owner to pursue a sale or merger may involve estate planning, a need to diversify his or her investments, an inability to finance growth independently, or a simple need for change. In addition, some small businesses find that the best way to grow and compete against larger firms is to merge with or acquire other small businesses.

In principle, the decision to merge with or acquire another firm is a capital budgeting decision much like any other. But mergers differ from ordinary investment decisions in at least five ways. First, the value of a merger may depend on such things as strategic fits that are difficult to measure. Second, the accounting, tax, and legal aspects of a merger can be complex. Third, mergers often involve issues of corporate control and are a means of replacing existing management. Fourth, mergers obviously affect the value of the firm, but they also affect the relative value of the stocks and bonds. Finally, mergers are often “unfriendly.”

Benefits of Mergers and Acquisitions

Merger refers to the process of combination of two companies, whereby a new company is formed. An acquisition refers to the process whereby a company simply purchases another company. In this case there is no new company being formed. Benefits of mergers and acquisitions are quite a handful.

Mergers and acquisitions generally succeed in generating cost efficiency through the implementation of economies of scale. It may also lead to tax gains and can even lead to a revenue enhancement through market share gain. The principal benefits from mergers and acquisitions can be listed as increased value generation, increase in cost efficiency and increase in market share.

Mergers and acquisitions often lead to an increased value generation for the company. It is expected that the shareholder value of a firm after mergers or acquisitions would be greater than the sum of the shareholder values of the parent companies. An increase in cost efficiency is affected through the procedure of mergers and acquisitions. This is because mergers and acquisitions lead to economies of scale. This in turn promotes cost efficiency. As the parent
firms amalgamate to form a bigger new firm the scale of operations of the new firm increases. As output production rises there are chances that the cost per unit of production will come down.

Demerger

Demergers are situations in which divisions or subsidiaries of parent companies are split off into their own independent corporations. The process for a demerger can vary slightly, depending on the reasons behind the implementation of the split. Generally, the parent company maintains some degree of financial interest in the newly formed corporation, although that interest may not be enough to maintain control of the functionality of the new corporate entity.

A demerger results in the transfer by a company of one or more of its undertakings to another company. The company whose undertaking is transferred is called the demerged company and the company (or the companies) to which the undertaking is transferred is referred to as the resulting company.

A demerger may take the form of: A spin-off or a split-up.

7.10.5 METHODS OF CORPORATE RESTRUCTURING

- Joint ventures
- Sell off and spin off
- Divestitures
- Equity carve out
- Leveraged Buy Outs (LBO)
- Management buy outs
- Master limited partnerships
- Employee Stock Ownership Plans (ESOP)

Joint Venture

Joint ventures are new enterprises owned by two or more participants. They are typically formed for special purposes for a limited duration. It is a combination of subsets of assets contributed by two (or more) business entities for a specific business purpose and a limited duration. Each of the venture partners continues to exist as a separate firm, and the joint venture represents a new business enterprise. It is a contract to work together for a period of time each participant expects to gain from the activity but also must make a contribution.

Example: GM-Toyota JV: GM hoped to gain new experience in the management techniques of the Japanese in building high-quality, low-cost compact & subcompact cars. Whereas, Toyota was seeking to learn from the management traditions that had made GE the no. 1 auto producer in the world and in addition to learn how to operate an auto company in the environment under the conditions in the
US, dealing with contractors, suppliers, and workers. DCM group and Daewoo motors entered in to JV to form DCM Daewoo Ltd. to manufacture automobiles in India.

**Reasons for Forming a Joint Venture**
- Build on company’s strengths.
- Spreading costs and risks.
- Improving access to financial resources.
- Economies of scale and advantages of size.
- Access to new technologies and customers.
- Access to innovative managerial practices.

**Rational for Joint Ventures**
- To augment insufficient financial or technical ability to enter a particular line or business.
- To share technology and generic management skills in organisation, planning and control.
- To diversify risk.
- To obtain distribution channels or raw materials supply.
- To achieve economies of scale.
- To extend activities with smaller investment than if done independently.
- To take advantage of favourable tax treatment or political incentives (particularly in foreign ventures).

**Tax Aspects of Joint Venture**
If a corporation contributes a patent technology to a Joint Venture, the tax consequences may be less than on royalties earned though a licensing arrangements.

*Example:* One partner contributes the technology, while another contributes depreciable facilities. The depreciation offsets the revenues accruing to the technology. The J.V. may be taxed at a lower rate than any of its partner & the partners pay a later capital gain tax on the returns realised by the J.V. if and when it is sold. If the J.V. is organised as a corporation, only its assets are at risk. The partners are liable only to the extent of their investment, this is particularly important in hazardous industries where the risk of workers, production, or environmental liabilities is high.

**Spin-off**
Spin-offs are a way to get rid of underperforming or non-core business divisions that can drag down profits.
**Process of Spin-off**

- The company decides to spin off a business division.
- The parent company files the necessary paperwork with the Securities and Exchange Board of India (SEBI).
- The spin-off becomes a company of its own and must also file paperwork with the SEBI.
- Shares in the new company are distributed to parent company shareholders.
- The spin-off company goes public.

Notice that the spin-off shares are distributed to the parent company shareholders. There are two reasons why this creates value:

- Parent company shareholders rarely want anything to do with the new spin-off. After all, it’s an underperforming division that was cut off to improve the bottom line. As a result, many new shareholders sell immediately after the new company goes public.
- Large institutions are often forbidden to hold shares in spin-offs due to the smaller market capitalisation, increased risk, or poor financials of the new company. Therefore, many large institutions automatically sell their shares immediately after the new company goes public.

Simple supply and demand logic tells us that such large number of shares on the market will naturally decrease the price, even if it is not fundamentally justified. It is this temporary mispricing that gives the enterprising investor an opportunity for profit. There is no money transaction in spin-off. The transaction is treated as stock dividend and tax free exchange.

**Split-off and Split-up**

**Split-off:** It is a transaction in which some, but not all, parent company shareholders receive shares in a subsidiary, in return for relinquishing their parent company’s share. In other words some parent company shareholders receive the subsidiary’s shares in return for which they must give up their parent company shares.

**Features:** A portion of existing shareholders receives stock in a subsidiary in exchange for parent company stock.

**Split-up:** It is a transaction in which a company spins off all of its subsidiaries to its shareholders & ceases to exist.

- The entire firm is broken up in a series of spin-offs.
- The parent no longer exists and
- Only the new offspring survive.
In a split-up, a company is split up into two or more independent companies. As a sequel, the parent company disappears as a corporate entity and in its place two or more separate companies emerge.

**Squeeze-out:** The elimination of minority shareholders by controlling shareholders.

**Sell-off**
Selling a part or all of the firm by any one of means: sale, liquidation, spin-off & so on or General term for divestiture of part/all of a firm by any one of a no. of means: sale, liquidation, spin-off and so on.

**Partial Sell-off**
- A partial sell-off/slump sale, involves the sale of a business unit or plant of one firm to another.
- It is the mirror image of a purchase of a business unit or plant.
- From the seller’s perspective, it is a form of contraction; from the buyer’s point of view it is a form of expansion.

*Example*: When Coromandal Fertilizers Limited sold its cement division to India Cement Limited, the size of Coromandal Fertilizers contracted whereas the size of India Cements Limited expanded.

**Motives for Sell-off**
- Raising capital.
- Curtailment of losses.
- Strategic realignment.
- Efficiency gain.

**Strategic Rationale:** Divesting a subsidiary can achieve a variety of strategic objectives, such as:

- **Unlocking hidden value:** Establish a public market valuation for undervalued assets and create a pure-play entity that is transparent and easier to value.
- **Non-diversification:** Divest non-core businesses and sharpen strategic focus when direct sale to a strategic or financial buyer is either not compelling or not possible.
- **Institutional sponsorship:** Promote equity research coverage and ownership by sophisticated institutional investors, either of which tend to validate SpinCo as a standalone business.
- **Public currency:** Create a public currency for acquisitions and stock-based compensation programs.
- **Motivating management:** Improve performance by better aligning management incentives with Spin Co’s performance (using Spin Co’s, rather than Parent Company, stock-based
awards), creating direct accountability to public shareholders, and increasing transparency into management performance.

- **Eliminating dissynergies**: Reduce bureaucracy and give Spin Company management complete autonomy.

- **Anti-trust**: Break up a business in response to anti-trust concerns.

- **Corporate defense**: Divest “crown jewel” assets to make a hostile takeover of Parent Company less attractive.

**Divestitures**

Divesture is a transaction through which a firm sells a portion of its assets or a division to another company. It involves selling some of the assets or division for cash or securities to a third party which is an outsider.

Divestiture is a form of contraction for the selling company means of expansion for the purchasing company. It represents the sale of a segment of a company (assets, a product line, a subsidiary) to a third party for cash and or securities.

Mergers, assets purchase and takeovers lead to expansion in some way or the other. They are based on the principle of synergy which says $2 + 2 = 5!$, divestiture on the other hand is based on the principle of “anergy” which says $5 - 3 = 3!$

Among the various methods of divestiture, the most important ones are partial sell-off, demerger (spin-off & split off) and equity carve out. Some scholars define divestiture rather narrowly as partial sell off and some scholars define divestiture more broadly to include partial sell offs, demergers and so on.

**Motives for Divestitures**

- Change of focus or corporate strategy
- Unit unprofitable can mistake
- Sale to pay off leveraged finance
- Antitrust
- Need cash
- Defend against takeover
- Good price.

**Equity Carve Out**

A transaction in which a parent firm offers some of a subsidiaries common stock to the general public, to bring in a cash infusion to the parent without loss of control. In other words equity carve outs are those in which some of a subsidiaries shares are offered for a sale to the general public, bringing an infusion of cash to the parent firm
without loss of control. Equity carve out is also a means of reducing their exposure to a riskier line of business and to boost shareholders value.

**Features of Equity Carve Out**
- It is the sale of a minority or majority voting control in a subsidiary by its parents to outsider investors. These are also referred to as “split-off IPO’s”.
- A new legal entity is created.
- The equity holders in the new entity need not be the same as the equity holders in the original seller.
- A new control group is immediately created.

**Difference between Spin-off and Equity Carve Outs**
- In a spin off, distribution is made pro rata to shareholders of the parent company as a dividend, a form of non cash payment to shareholders. In equity carve out; stock of subsidiary is sold to the public for cash which is received by parent company.
- In a spin off, parent firm no longer has control over subsidiary assets. In equity carve out, parent sells only a minority interest in subsidiary and retains control.

**Leveraged Buyout**
A buyout is a transaction in which a person, group of people, or organisation buys a company or a controlling share in the stock of a company. Buyouts great and small occur all over the world on a daily basis. Buyouts can also be negotiated with people or companies on the outside. For example, a large candy company might buy out smaller candy companies with the goal of cornering the market more effectively and purchasing new brands which it can use to increase its customer base. Likewise, a company which makes widgets might decide to buy a company which makes thingamabobs in order to expand its operations, using an establishing company as a base rather than trying to start from scratch.

In a leveraged buyout, the company is purchased primarily with borrowed funds. In fact, as much of 90% of the purchase price can be borrowed. This can be a risky decision, as the assets of the company are usually used as collateral, and if the company fails to perform, it can go bankrupt because the people involved in the buyout will not be able to service their debt. Leveraged buyouts wax and wane in popularity depending on economic trends.

The buyers in the buyout gain control of the company’s assets, and also have the right to use trademarks, service marks, and other registered copyrights of the company. They can use the company’s name and reputation, and may opt to retain several key employees who can make the transition as smooth as possible. However, people in senior
management may find that they are not able to keep their jobs because the purchasing company does not want redundant personnel, and it wants to get its personnel into key positions to manage the company in accordance with their business practices.

A leveraged buyout involves transfer of ownership consummated mainly with debt. While some leveraged buyouts involve a company in its entirety, most involve a business unit of a company. Often the business unit is bought out by its management and such a transaction is called management buyout (MBO). After the buyout, the company (or the business unit) invariably becomes a private company.

**What does debt do?**

A leveraged buyout entails considerable dependence on debt.

**What does it imply?**

Debt has a bracing effect on management, whereas equity tends to have a soporific influence. Debt spurs management to perform whereas equity lulls management to relax and take things easy.

**Risks and Rewards**

The sponsors of a leveraged buyout are lured by the prospect of wholly (or largely) owning a company or a division thereof, with the help of substantial debt finance. They assume considerable risks in the hope of reaping handsome rewards. The success of the entire operation depends on their ability to improve the performance of the unit, contain its business risks, exercise cost controls, and liquidate disposable assets. If they fail to do so, the high fixed financial costs can jeopardise the venture.

**Purpose of Debt Financing for Leveraged Buyout**

- The use of debt increases the financial return to the private equity sponsor.
- The tax shield of the acquisition debt, according to the Modigliani-Miller theorem with taxes, increases the value of the firm.

**Features of Leveraged Buyout**

- Low existing debt loads;
- A multi-year history of stable and recurring cash flows;
- Hard assets (property, plant and equipment, inventory, receivables) that may be used as collateral for lower cost secured debt;
- The potential for new management to make operational or other improvements to the firm to boost cash flows;
- Market conditions and perceptions that depress the valuation or stock price.
Example:

- Acquisition of Corus by Tata.
- Kohlberg Kravis Roberts, the New York private equity firm, has agreed to pay about $900 million to acquire 85 percent of the Indian software maker Flextronics Software Systems is the largest leveraged buyout in India.

Management Buyout

In this case, management of the company buys the company, and they may be joined by employees in the venture. This practice is sometimes questioned because management can have unfair advantages in negotiations, and could potentially manipulate the value of the company in order to bring down the purchase price for themselves. On the other hand, for employees and management, the possibility of being able to buy out their employers in the future may serve as an incentive to make the company strong. It occurs when a company’s managers buy or acquire a large part of the company. The goal of an MBO may be to strengthen the managers’ interest in the success of the company.

Purpose of MBO

From management point of view may be:

- To save their jobs, either if the business has been scheduled for closure or if an outside purchaser would bring in its own management team.
- To maximise the financial benefits they receive from the success they bring to the company by taking the profits for themselves.
- To ward off aggressive buyers.

The goal of an MBO may be to strengthen the manager’s interest in the success of the company. Key considerations in MBO are fairness to shareholders price, the future business plan, and legal and tax issues.

Benefits of MBO

- It provides an excellent opportunity for management of undervalued co’s to realise the intrinsic value of the company.
- Lower agency cost: cost associated with conflict of interest between owners and managers.
- Source of tax savings: since interest payments are tax deductible, pushing up gearing rations to fund a management buyout can provide large tax covers.

Master Limited Partnership

Master Limited Partnership’s are a type of limited partnership in which the shares are publicly traded. The limited partnership
interests are divided into units which are traded as shares of common stock. Shares of ownership are referred to as units. MLPs generally operate in the natural resource (petroleum and natural gas extraction and transportation), financial services, and real estate industries.

The advantage of a Master Limited Partnership is it combines the tax benefits of a limited partnership (the partnership does not pay taxes from the profit - the money is only taxed when unit holders receive distributions) with the liquidity of a publicly traded company.

There are two types of partners in this type of partnership:

- The limited partner is the person or group that provides the capital to the MLP and receives periodic income distributions from the Master Limited Partnership’s cash flow.
- The general partner is the party responsible for managing the Master Limited Partnership’s affairs and receives compensation that is linked to the performance of the venture.

**Employees Stock Option Plan (ESOP)**

An Employee Stock Option is a type of defined contribution benefit plan that buys and holds stock. ESOP is a qualified, defined contribution, employee benefit plan designed to invest primarily in the stock of the sponsoring employer. Employee Stock Options are “qualified” in the sense that the ESOP’s sponsoring company, the selling shareholder and participants receive various tax benefits.

With an ESOP, employees never buy or hold the stock directly.

**Features**

- Employee Stock Ownership Plan (ESOP) is an employee benefit plan.
- The scheme provides employees the ownership of stocks in the company.
- It is one of the profit sharing plans.
- Employers have the benefit to use the ESOP’s as a tool to fetch loans from a financial institute.
- It also provides for tax benefits to the employers.

**Benefits for the Company**

Increased cash flow, tax savings, and increased productivity from highly motivated workers. The benefit for the employees: is the ability to share in the company’s success.

**How it Works?**

- Organisations strategically plan the ESOPs and make arrangements for the purpose.
They make annual contributions in a special trust set up for ESOPs.

An employee is eligible for the ESOP’s only after he/she has completed 1000 hours within a year of service.

After completing 10 years of service in an organisation or reaching the age of 55, an employee should be given the opportunity to diversify his/her share up to 25% of the total value of ESOP’s.

Fill in the blanks:

15. ........ is a form of contraction for the selling company means of expansion for the purchasing company.

16. ........ is a qualified, defined contribution, employee benefit plan designed to invest primarily in the stock of the sponsoring employer.

Hindustan Motors, the maker of the Ambassador car shut down recently. Write a 200-words report on prima facie corporate restructuring of the company.

Corporate-level strategy involves determining in what business or businesses, the firm expects to compete.

For companies with a single market or a few closely related markets, the corporate-level strategy involves developing an overall strategy.

Most large corporations, however, have complicated organisational structures with stand-alone, often unrelated, business units or divisions, each with different products, markets and competitors.

The corporate-level strategy then involves making decisions on whether to add divisions and product lines to manage the business’s portfolio of businesses.

Corporations are responsible for creating value through their businesses. They do so by managing their portfolio of businesses, ensuring that the businesses are successful over the long-term, developing business units, and sometimes ensuring that each business is compatible with others in the portfolio.

Restructuring a corporate entity is often a necessity when the company has grown to the point that the original structure can no longer efficiently manage the output and general interests of the company.
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<th>KEY WORDS</th>
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<td><strong>Combination Strategy</strong>: It is a mixture of stability, expansion or retrenchment strategies applied simultaneously or sequentially.</td>
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<td><strong>Conglomerates</strong>: Firms that practice unrelated diversification.</td>
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<tr>
<td><strong>Corporate Strategy</strong>: It spells out the business in which the firm will participate, the markets it will serve and the customer needs it will satisfy.</td>
</tr>
<tr>
<td><strong>Grand Strategy</strong>: A general plan of major action by which a firm intends to achieve its long-term goals.</td>
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<tr>
<td><strong>Horizontal Integration</strong>: It takes place when some firms expand by acquiring other companies in the same line of business (adding new products or services to the existing product or service line).</td>
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<tr>
<td><strong>Market Development</strong>: It consists of marketing present products, often with only cosmetic changes, to customers in related market areas by adding channels of distribution or by changing the content of advertising or promotion.</td>
</tr>
<tr>
<td><strong>Product Development</strong>: It involves the substantial modification of existing products or the creation of new but related products that can be marketed to current customers through established channels.</td>
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<tr>
<td><strong>Related Diversification</strong>: It extends the firm’s distinctive competence into new industries that are similar to the firm’s original business (in terms of markets, products or technology).</td>
</tr>
<tr>
<td><strong>Retrenchment Strategy</strong>: It is a defensive strategy adopted as a reaction to operational problems such as internal mismanagement, surprises caused by competitors, changing market conditions etc.—involving reduction of any existing product or service line to improve its performance.</td>
</tr>
<tr>
<td><strong>Spin-off</strong>: It means selling those units or parts of a business that no longer contribute to or fit the firm’s core competence.</td>
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<tr>
<td><strong>Stability Strategy</strong>: It involves maintaining the status quo or growing in a methodical but slow manner.</td>
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<tr>
<td><strong>Synergy</strong>: An economic effect in which the different parts of the company contribute a unique source of heightened value to the firm when managed as a single unified entity.</td>
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<tr>
<td><strong>Turnover Strategy</strong>: A turnaround strategy is designed to reverse a negative trend and bring the organisation back to normal health and profitability.</td>
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<tr>
<td><strong>Unrelated Diversification</strong>: It occurs when a firm seeks to enter new industries without relying on a distinctive competence to link up business units.</td>
</tr>
<tr>
<td><strong>Vertical Integration</strong>: It exists when a firm is producing its own inputs (backward integration) or owns its own sources of distribution of outputs (forward integration).</td>
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7.12 DESCRIPTIVE QUESTIONS

1. What is a Balanced Score Card Approach? How it supports the performance in other areas?

2. Describe the different forms of diversification and give an example of each.

3. Do you believe that in the current year 2014 large firms will be more or less diversified than they were in several previous years? Discuss.

4. Explain the costs of diversification and when firms should diversify.

5. What do you mean by retrenchment and combination strategies?

6. Write short notes on:
   (a) Stability Strategy
   (b) Backward Integration
   (c) Forward Integration

7. Distinguish between concentric diversification and conglomerate diversification as strategic alternatives.

8. Why do organizations need expansion strategy? When they should adopt a growth strategy? Why it is necessary to pursue growth? Explain problems created by growth strategy? How firms manage it?

9. Explain the nature and objectives of a turnaround strategy. What kind of steps should be undertaken to implement the same?


7.13 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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<thead>
<tr>
<th>Topic</th>
<th>Q. No.</th>
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<td>corporate level strategy</td>
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Contd...
HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 7.2 & 7.5

R S Kaplan and D P Norton came out with a popular, balanced score card approach in early 90s linking corporate goals with strategic actions undertaken at the business unit, departmental and individual level. The score-card allows managers to evaluate a firm from different complementary perspectives. From the financial Perspective: Does the firm offer returns in excess of the total cost of capital, as suggested by the Economic Value Added (EVA) model? EVA is the spread between a firm's return on invested capital minus its weighted average cost of capital, multiplied by the amount of capital invested. In other words, EVA is what is left over after a firm has covered all its factors of production (operating expenses, overheads, interest, taxes, plus fair return to shareholders). “To succeed financially, how should we appear to our shareholders?” is the question to be answered here.

2. Refer to 7.5.1 & 7.5.2

Horizontal integration takes place when some firms expand by acquiring other companies in the same line of business (adding new products or services to the existing product or service line). Concentric diversification occurs when an organisation diversifies into a related, but distinct business. Conglomerate diversification takes place when an organisation diversifies into areas that are unrelated to its current business.

3. Refer to 7.5.1 & 7.5.2

Most software companies use the mergers and acquisitions route to acquire complementary businesses, products or services linked
by a common technology and common customers. The decision to diversify into unrelated areas is generally undertaken by firms in volatile industries that are subject to rapid technological change. The obvious purpose is to reduce risk. It is also assumed that by restructuring the portfolio of businesses, the firm would be in a position to create value.

4. Refer to 7.5.3 & 7.5.4

Cost of Ignorance: Entering a new, unknown field is risky. The firm does not know the extent of competition. It may fail to read the mind of the consumer properly. Technological developments, environmental factors may compel the firm to shift gears continuously. Mistakes might be committed when the firm is navigating through uncharted waters. Cost of Neglect: A company trying to expand through unrelated diversifications may have to divert its attention from its core businesses – at least temporarily.

5. Refer to 7.7 & 7.9

Retrenchment strategy is a corporate level, defensive strategy followed by a firm when its performance is disappointing or when its survival is at stake for a variety of reasons. Economic recessions, production inefficiencies, and innovative breakthroughs by competitors are only three causes. Large, diversified organisations generally use a mixture of stability, expansion or retrenchment strategies either simultaneously (at the same time in various businesses) or sequentially (at different times in the same business). Joint Ventures, Strategic Alliance and Consortia are used in combination strategies.

6. Refer to 7.6 & 7.10

A stability strategy involves maintaining the status quo or growing in a methodical, but slow, manner. The firm follows a safety-oriented, status-quo-type strategy without effecting any major changes in its present operations. Backward integration exists when a firm is producing its own inputs and in case of forward integration, it owns its own sources of distribution of outputs.

7. Refer to 7.5.1 & 7.5.2

Concentric diversification occurs when an organisation diversifies into a related, but distinct business. With concentric diversification, the new businesses can be related to existing businesses through products, markets or technology. The new product is a spin-off from the existing facilities, products and processes. Conglomerate diversification takes place when an organisation diversifies into areas that are unrelated to its current business.
8. Refer to 7.4, 7.4.1, 7.4.2, 7.4.3 & 7.4.4

Organisations generally seek growth in sales, market share or some other measure as a primary objective. When growth becomes a passion and organisations try to seek sizeable growth, (as against slow and steady growth) it takes the shape of an expansion strategy. There are certain inherent limits to corporate growth and a firm intending to grow beyond a particular limit, should look into the pros and cons carefully before embarking upon an ambitious growth strategy. This compels us to examine the issue as to when corporations should look for a growth strategy. Growth implies greater sales and an opportunity to take advantage of the environmental opportunities. As the firm grows in size and experience, it gets better at what it is doing and reduces costs and improves productivity. A growing firm can cover up mistakes and inefficiencies more easily than can a stable one. There are more opportunities for advancement, promotion and interesting jobs in a growing firm. Growth per se is exciting and ego-enhancing for managers. A corporation tends to be seen as a winner or on the move by the market place and by potential investors.

9. Refer to 7.8, 7.8.1 & 7.8.2

A turnaround is designed to reverse a negative trend and bring the organisation back to normal health and profitability. The basic purpose of a turnaround is to transform the corporation into a leaner and more efficient firm. It usually involves getting rid of unprofitable products, trimming the workforce, pruning distribution outlets, and finding other useful ways of making the organisation more efficient. If the turnaround is successful, the organisation may then focus on growth strategy. The action plans for achieving a turnaround aim at yielding immediate results focusing attention on certain key areas like quality improvement, cost reduction, new product development, rejuvenated marketing effort etc.

10. Refer to 7.10, 7.10.1 & 7.10.5

Corporate restructuring is the process of redesigning one or more aspects of a company. The process of reorganising a company may be implemented due to a number of different factors, such as positioning the company to be more competitive, survive a currently adverse economic climate, or poise the corporation to move in an entirely new direction. Financial restructuring, Organizational restructuring, Leveraged Buyout, Hostile Takeover, Mergers and Demergers are the methods of corporate restructuring.
SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS


E-REFERENCES

- http://www.slideshare.net/anandsubramaniam/turnaround-strategies
- http://www.intermerger.eu/transaction-support-service/
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ACHIEVING COMPETITIVE ADVANTAGES BY DELL

The AICPA Information Technology Executive Committee recently visited the Dell Server Production facility in Austin, Texas to see first-hand how Dell has revolutionised the concept of Mass Customisation. Dell has recently become the number one maker of file servers in the US as well as holding the number two position worldwide. The production process from order to delivery is managed electronically, which allows Dell to build servers very efficiently and their customers to know where their server is during each step of the process.

The production process begins with the customer ordering the server and individual components (over 50% are ordered via the Dell website or a customised page created for business customers). This information is placed in a production queue that breaks out every component that is to be assembled into the server. The required inventory is then allotted to the assembly area to make sure that it is adequately queued. Dell partners with suppliers to provide them with the production pipeline, so they can have inventory readily available on the loading docks (that are connected to the factory floor). This allows Dell to maintain only two hours of actual inventory on the factory floor.

The detailed specifications and listing of components are then printed on a ‘traveller’ form, which includes the assigned customer service tag for the server. The actual production begins with the chassis, motherboard and memory assembled and moved to the ‘kit’ area where the various internal components (such as drives, cards and connectors) are added to the tray. These kits then move to the assembly area where they are automatically routed to the next available assembler (the server facility we visited had 80 such stations with individuals producing between 18 and 26 servers in two shifts each day). The traveller form then lists each item in the order to be implemented and the assembler scans the bar code to ‘check’ it off the completed list, so no part can be left out. Remarkably, as the assembler is building the current server, they are simultaneously performing primary testing on up to four additional servers they have built. Dell originally had two individuals assembling each computer, but found they could increase production 30-40% by having certified individuals responsible for the entire build. Each assembler only builds the servers they are certified on (which can be up to fifteen different models).

During preliminary testing, if a problem is encountered that cannot be corrected within five minutes; a technician is called by switching a green light above their work area to red. In turn, if the technician cannot resolve the issue at the assembly station within five minutes, it is brought to a special section on the floor where...
they cannot fix the issue, a new production order is placed and the inoperable unit is sent to a special laboratory for detailed diagnostics.

The servers then move down the assembly line and are automatically stacked into carts holding four units each, which are transferred to the burn-in area and tested for six to eighteen hours depending on specifications. If there is specific customer software to be loaded, it is installed and tested in a special part of the burn-in area. Once a server has completed testing, it is placed mechanically in a shipping container to minimise any risk of damage. At the same time, the ‘collateral’ materials that are to be shipped with the server are assembled by an automated ‘pick’ system, which turns a light on in front of each item that is to be placed in the shipping container, again removed by a scanning of the bar code on the item to ensure everything is included. Then the box passes through a conveyor system, reaches a centralised shipping area and is delivered to the client. Though production occurs very quickly, each server is customised on a mass scale making Dell one of the leaders in the server market.

*Source:* www.itpna.com
After studying this chapter, you should be able to:
» Describe the Porter’s competitive strategies
» Explain the features of competitive advantage
» Know how to build or acquire competitive advantage
» Define core competence and low cost strategies
» Identify the differentiation strategies and focus strategies

8.1 INTRODUCTION

Business level strategy deals with how a particular business competes. The principal focus is on meeting competition, protecting market share and earning profit at the business unit level by performing activities differently, offering superior value to customers. A firm is able to deliver superior value to customers when it is in a position to perform an activity that is distinct or different from that of its competitors. This is popularly defined as competitive advantage. Competitive advantage implies a distinct and sustainable advantage over competitors. It is a kind of clear superiority or distinctive competence in some functions or area over the competitors. The areas may include finance, marketing, production, human resources, new product development, research etc. Firms usually build competitive advantage by initiating certain unique steps that help them gain an edge over their rivals in attracting customers. These steps would include offering best customer service, producing at the lowest cost or focusing efforts on a specific segment or niche of the industry. A useful approach to formulating business level strategies is based on Michael Porter’s ‘competitive analysis’ and three general alternative business strategies that are derived from it.

8.2 PORTER’S COMPETITIVE STRATEGIES

M E Porter studied a number of business organisations and proposed that business-level strategies are the result of five competitive forces in the company’s environment. According to him, competitiveness within an industry is determined by the following new entrants or new companies within the industry; products that might act as a substitute for goods or services that companies within the industry produce; the ability of suppliers to control issues like cost of materials that companies use to manufacture their products; the bargaining power that buyers possess within the industry; and the general level of rivalry or competition among firms within the industry. According to Porter, buyers, product substitutes, suppliers and potential new companies within the industry all contribute to the level of rivalry among industry firms. Understanding the forces that determine competitiveness within an industry should help managers develop strategies that will enable individual companies within the industry
to be more competitive. Porter suggested three generic strategies that managers might take up to make organisations more competitive.

- **Cost Leadership**: Cost leadership is a strategy that focuses on making an organisation more competitive by producing its products more cheaply than competitors can. The logic behind this strategy is that by producing products more cheaply than competitors, organisations can offer products to customers at lower prices than the competitors and thereby hope to increase market share. Nirma Chemicals was able to challenge the might of Hindustan Lever by pursuing this strategy aggressively, without, of course, sacrificing quality. For example, Wal-mart, a typical industry cost leader, enjoys a competitive advantage due to a unique satellite-based distribution system; it generally keeps store location costs to a minimum by placing stores on low-cost land outside small to medium-sized southern towns. Most software companies in India enjoy the cost advantage in terms of low labour and location costs when compared to their Western counterparts. It is small wonder the call centre business has shifted to India (especially to areas like Noida, Gurgaon) in recent times. A low-cost strategy is not without risks. To be effective, the company in question should be the cost leader, not just one of several players. Otherwise, two or more companies vying for cost leadership can push prices to unremunerative levels. HLL is facing ‘low-cost competition’ in oil business from desi brands such as Gemini Gold Winner etc. due to this reason only. These desi brands have exploited the ‘value for money’ idea to their advantage playing on the price factor constantly. The business, therefore, must have a cost advantage that cannot be easily imitated, and it must stay abreast of new technologies that can upset cost calculations completely. Further, managers must still carry out product or service innovations that are very important to customers, lest competitors, using a differentiation strategy, woo customers away using product or service improvements to good effect.

- **Differentiation Strategy**: It involves attempting to develop products and services that are viewed as unique in the industry. Successful differentiation allows the business to charge premium prices, leading to above average profits. Differentiation can take many forms – for example, design or brand image (Rolex Watches, Levi’s Jeans, Pepsi or Coca-Cola for brands); technology (Macintosh stereo components, Honda’s vehicles, Hyster in lift trucks); customer service (City Bank, HDFC), unique channels (Tupperware), unique features (Mercedes-Benz, Cross writing instruments) quality (Xerox in copiers, Rolls Royce). Differentiation works best when the differentiating factor is both important to customers and difficult for competitors to imitate. If buyers are loyal to a company’s brand, a differentiation strategy can reduce rivalry with competitors. Of course when costs are
too high, customers may choose less costly alternatives, even though they forego some desirable features. Also, customer tastes and needs can change, so businesses following a differentiation strategy must carefully evaluate customer’s shifting preferences from time to time.

- **Focus:** It is a strategy that emphasises making an organisation more competitive by targeting a specific regional market, product line or buyer group. The organisation can use either a differentiation or low cost approach, but only for a narrow target market. The logic of this approach is that an organisation that limits its attention to one or a few market segments can serve those segments better than organisations that seek to influence the entire market. For example, products such as Rolls-Royce automobiles, Titan jewellery watches, Cross pens are designed to appeal to a narrow segment of the market and serve the same well rather than trying to cover the whole ground. The important risks are possibilities that the costs for the focused firm will become too great relative to those of the less focused one, differentiation too will become less of an advantage as competitors serving broader markets embellish their products, and competitors will begin focusing on a group within the customer population being served by the firm with the focus strategy.

Porter found that many firms did not consciously pursue one of these three strategies and were therefore, struck in the middle of the pack with no strategic advantage. Without a strategic advantage, the businesses earned below-average profits and therefore, were not in a position to compete successfully.

**Competitive Advantage in Motor Vehicle Industry**

Porter argued that in the motor vehicle industry, Toyota became the overall cost leader. The company is successful in a number of segments with a full range of cars. Its mission is to remain a low cost producer (like Maruti). In contrast, General Motors also competes in most segments of the market but tries to differentiate each of its products with better styling and innovative features. Hyundai is successful around the world with four small and medium size cars which it produces at low cost and prices competitively. BMW and Mercedes offer exclusive cars for the price-insensitive, quality-conscious customer.

Porter argued that a company cannot achieve superior profitability if it is ‘struck in the middle’ with no clear strategy for competitive advantage. Thus, Chrysler came upon hard times because in its Can business it neither stood out as lowest in cost, highest in perceived value, or best in serving some market segment.

**Activity**

Cost leadership or differentiation – which one of these two strategies is Wal-Mart synonymous with? Discuss.
Fill in the blank:
1. Buyers, product substitutes, suppliers and potential new companies within the industry all contribute to the level of ______________ among industry firms.

## 8.3 COMPETITIVE ADVANTAGE

When a firm sustains profits that exceed the average for its industry, the firm is said to possess a competitive advantage over its rivals. The goal of much of business strategy is to achieve a sustainable competitive advantage.

Michael Porter identified two basic types of competitive advantage:
- Cost advantage
- Differentiation advantage

A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at a lower cost (cost advantage), or deliver benefits that exceed those of competing products (differentiation advantage). Thus, a competitive advantage enables the firm to create superior value for its customers and superior profits for itself.

**DEFINITION**

Cost and differentiation advantages are known as positional advantages since they describe the firm’s position in the industry as a leader in either cost or differentiation.

A resource-based view emphasises that a firm utilises its resources and capabilities to create a competitive advantage that ultimately results in superior value creation. The following diagram combines the resource-based and positioning views to illustrate the concept of competitive advantage:

![Figure 8.1: A Model of Competitive Advantage](image-url)
8.3.1 RESOURCES AND CAPABILITIES
According to the resource-based view, in order to develop a competitive advantage the firm must have resources and capabilities that are superior to those of its competitors. Without this superiority, the competitors simply could replicate what the firm was doing and any advantage quickly would disappear.

Resources are the firm-specific assets useful for creating a cost or differentiation advantage and that few competitors can acquire easily. The following are some examples of such resources:
- Patents and trademarks
- Proprietary know-how
- Installed customer base
- Reputation of the firm
- Brand equity

**DEFINITION**
Capabilities refer to the firm's ability to utilise its resources effectively.

An example of a capability is the ability to bring a product to market faster than competitors. Such capabilities are embedded in the routines of the organisation and are not easily documented as procedures and thus are difficult for competitors to replicate.

8.3.2 COST ADVANTAGE AND DIFFERENTIATION ADVANTAGE
Competitive advantage is created by using resources and capabilities to achieve either a lower cost structure or a differentiated product. A firm positions itself in its industry through its choice of low cost or differentiation. This decision is a central component of the firm's competitive strategy.

Another important decision is how broad or narrow a market segment to target. Porter formed a matrix using cost advantage, differentiation advantage, and a broad or narrow focus to identify a set of generic strategies that the firm can pursue to create and sustain a competitive advantage.

**Value Creation**
The firm creates value by performing a series of activities that Porter identified as the value chain. In addition to the firm's own value-creating activities, the firm operates in a value system of vertical activities including those of upstream suppliers and downstream channel members.

To achieve a competitive advantage, the firm must perform one or more value creating activities in a way that creates more overall value.
than do competitors. Superior value is created through lower costs or superior benefits to the consumer (differentiation).

8.3.3 FEATURES OF COMPETITIVE ADVANTAGES

- **Not Sustainable for Long:** It is not always possible for companies to sustain individual sources of competitive advantage for long (rivals copy and do everything possible to wipe out the edge through their own innovations). So, the best way to maintain leadership is to continually seek new forms of advantage through constant experimentation, innovative efforts and investments in the latest technology. According to Kotler, competitive advantages are not sustainable, but leverageable. A leverageable advantage is one that a company can use as a springboard to new advantages, much as Microsoft has leveraged its operating system to Microsoft Office and then to networking applications. Therefore, a company that hopes to endure must be in the business of continuously inventing new advantages.

- **Relevant Advantage:** In order to implement the chosen strategy, a firm must have the relevant competitive advantage. To become a global player, for example, a cement company can buy or take controlling stakes in competing firms (as in the case of Gujarat Ambuja Cements). However, unless the company has some relevant competitive edge over its rivals (in terms of pricing, transport costs, distribution network, location of units in cement-deficit states etc) the acquisition strategy may not pay off in the long run. In the rush to become a major player, a firm, therefore, should not throw caution to the wind and extend its arms over the market beyond a point (remember India Cements case in the Cement industry?).

- **Backbone of Strategy:** A successful strategy is always built around the competitive advantage. Without such a distinct advantage, it is not possible to achieve corporate objectives successfully. It becomes difficult to outwit competitors. The firm may not be in a position to price its products in a flexible way. Where there is a distinct edge, as in the case of Maruti Udyog Limited (for instance in terms of sales, price advantage, cost advantage owing to its massive scale of operations, monopoly status in the lower income segment etc.), the firm could breathe easily by playing on the price, cost, early bird status, monopoly position, brand image and a host of other factors. Likewise Bajaj Auto in scooters, Telco in the heavy vehicles segment have acquired competitive advantages by building strong entry barriers (scale of operations, lower costs, etc.).

**SELF ASSESSMENT QUESTIONS**

Fill in the blank:

2. Competitive advantage factors include marketing, finance, research and development, personnel and ....................
How Google has leveraged its competitive advantage in developing a better search engine as against its competitors? Discuss.

The firm’s resources and capabilities together form its distinctive competencies. These competencies enable innovation, efficiency, quality, and customer responsiveness, all of which can be leveraged to create a cost advantage or a differentiation advantage.

**8.4 COMPETITIVE ADVANTAGE FACTORS**

**Marketing**
- Innovations in Marketing (Birla 3M, LG Electronics credit card operations of Citi Bank).
- Customer Service (Washing machine segment where each player tries to extend the warranty period by a few months).
- New Product Development (Citi Bank, HDFC Bank, Ranbaxy, Dr Reddy Labs).
- Price (Maruti Udyog in small cars, Exide Industries in batteries, Moser Baer in data storage products, Archies in Greeting card segment, etc.).
- Distribution Channel (Hindustan Lever, Bata India, Britannia Industries, Asian Paints).
- Personnel Selling or Sales Force Effectiveness (Eureka Forbes Limited which has achieved unique success in vacuum cleaners and water purifiers through personnel selling).
- Product in terms of quality, design, technological strength, differentiation, brand image etc.

**Finance**
- Assets (asset rich companies like Reliance, TISCO, ONGC, IPCL, GAIL, IOC, etc.)
- Profitability (HDFC Bank, Britannia, Ranbaxy, Hindustan Inks and Resins etc. which have earned fat profits despite the slowdown).
- Gearing and leverage (Engineers India, NMDC, Castrol, HLL, Novartis).
Cost consciousness (ability to cut costs and adopt strategies that help companies improve their input-output ratio: Godrej Foods, Whirlpool, ITC Agrotech, ACC, Bharat Forge, MRF etc.).

**Research and Development**
- Research capabilities (Cipla, Dr Reddy Labs, Ranbaxy, Sun Pharma, Pfizer).
- Research personnel (Dr Reddy Labs, Ranbaxy).
- Number of patents generated (Dr Reddy Labs, Ranbaxy).
- Speed of research efforts, leading to new product launches etc.

**Personnel**
- Quality of personnel (in terms of latest knowledge, core skills, critical experience as can be found in people working in Wipro, Infosys, Satyam, Polaris, Cipla, Dr Reddy Labs etc.).
- Satisfaction of personnel (low attrition rates that characterise companies which have liberal stock option plans and exciting security and welfare schemes such as Infosys, Polaris, NIIT etc.).
- Labour costs (most software producers in India).
- Industrial relations (Sundaram Fasteners, Sundaram Clayton).

**Production**
- Scale of operations (Reliance, BHEL, ONGC, Ranbaxy).
- Capacity utilisation.
- Productivity (Foreign banks).
- Extent of automation (Maruti, Hero Honda).
- Locational benefits (ACC, Gujarat Ambuja).

**ACTIVITY**

Write a 200-words report on the competitive advantage factors behind the success of Domino’s in the QSR (quick service restaurant) segment.

**8.5 HOW TO BUILD OR ACQUIRE COMPETITIVE ADVANTAGE?**

Firms usually build competitive advantage using various strategic routes such as:

- **Innovation**: Innovation is a new idea applied to initiating or improving a product, process or service. Today’s successful organisations must foster innovations and master the art of change or they will become candidates for extinction. Victory
will go to those organisations that maintain their flexibility, continually improve their quality, and beat their competition in the marketplace through a constant stream of innovative products and services (S P Robbins).

- **Integration**: Integration could be horizontal (adding one or more businesses that are similar usually by purchasing such businesses) or vertical (called as backward integration; here a business grows by becoming its own supplier). Reliance Industries, Hindustan Lever Ltd., Nirma, Videocon, India Cements, etc., have followed this route in order to gain competitive advantage in their respective areas of business.

- **Alliances, Mergers, Acquisitions**: During the past 20 months, Indian software firms have made over 25 overseas acquisitions and the trend promises to snowball in the coming years.

- **Research and Development**: Research and development is responsible for producing unique ideas and methods that will lead to new and improved products and services. Indian pharma giants like Ranbaxy, Dr Reddy Laboratories, Aurobindo Pharma, Cipla are trying to gain significant cost advantages through the research and development push.

- **Entry Barriers**: The entry barriers created by Bajaj Auto in two-wheelers Maruti Udyog Limited in passenger cars, Asian paints in decorative paints, TELCO in heavy vehicles segment; Thermax in industrial boilers have helped them remain at the top for a painfully long time in India. Entry barriers include large size, low investment, substantial cost advantage, formidable distribution network, powerful brand etc.

- **Benchmarking**: It is a way of comparing your own products and processes against the very best (rivals) in the world. The basic purpose of benchmarking is to initiate or improve upon the best practices of other companies. Benchmarking is an important tool in building competitive advantage. Quite often, benchmarking could be used by a forward—thinking leader to improve internal practices and processes and build a sustainable competitive advantage.

- **Value Chain Approach**: According to Michael Porter the value chain approach also helps in identifying and building competitive advantage. Every firm is a collection of activities that are performed to design, produce, market, and deliver and support its product. The value chain identifies nine strategically relevant activities that create value and cost in a specific business. The nine value-adding activities consist of five primary activities and four support activities.

- **Strategic Business Unit (SBU) Structure**: Firms can also achieve competitive advantage by dividing their operations into separate strategic business units.
An SBU has three features:

- It is a single business or collection of related businesses that can be planned separately from the rest of the company.
- It has its own set of competitors.
- It has a manager who is responsible for strategic planning and performance and who controls most of the factors affecting profit.

The resources of a firm are allocated to various SBUs based on their market attractiveness and profit potential. SBUs carry out their own strategic business planning, remain close to their environment and profitably exploit new opportunities that come their way.

**Building Durable Competitive Advantage: Core Competence**

To be successful in the long run, every firm must possess some long-lasting, unique competitive advantage that can't be easily imitated by competitors. The enduring competitive superiority enables the firm to get ahead easily and emerge as a ‘winner’ on most occasions – at least till others catch up and bridge the gap in terms of cost leadership or product differentiation. C K Prahlad and Gary Hamel argued that it is not the product that is at the root of such a competitive advantage. Behind the product, there is the core competence, a fundamental, unique and far reaching strength of the firm.

Once the skills that offer competitive advantage are developed, they should be exploited. For example, Honda has exploited its skills at engine design and technology. Core competencies must, however, be flexible and responsive to changing customer needs. Canon has developed core competencies in fibre optics, precision mechanics and microelectronics and these are spread across a wide range of products such as cameras, calculators, photocopiers and printers. There is continuous product innovation, keeping pace with market requirements and customer expectations.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

3. ......................... is a way of comparing your own products and processes against the very best (rivals) in the world.

4. Value chain approach helps in identifying and building .....................

**ACTIVITY**

Corporate lawsuits against each other to protect respective product designs are essentially concentrated contests to defend core competencies. Discuss in light of the Apple-Samsung lawsuits in US courts.
SBUs usually benefit from separate planning efforts, face competitors with lot of advance preparation and are managed effectively as profit centres.

8.6 ACQUIRING CORE COMPETENCE

Firms can acquire core competence through heavy investments in technology, research and development followed by new product innovations. Hammel and Prahalad (“Corporate Imagination and Expeditionary Market”, HBR, July-August 91) argued that most profitable companies are those that create and dominate new markets, looking for opportunities to further explore key skills and competencies. New product innovations such as chilled prepared meals (Marks and Spencer), the compact disc (Philips) and the anti-lock breaking system for cars (Bosch) took place in companies which have excellent in-house R&D facilities. (In India, Ranbaxy, Dr Reddy Labs in pharma; TCs and Infosys in Software; HLL, Nestle, Cadbury in fast moving consumer goods have a good track record of exploiting their key research and development skills for achieving consistent growth. Employees play a key role in acquiring such capabilities. Leaders have to provide a positive work climate for employees to develop such crucial skills. The US company 3M is renowned for its ability to empower employees and produce innovative products (masking tape, post-it notes etc.); laboratory staff are free to devote 15% of their time on developing ideas. They are allowed to work as per their own convenience. Technicians are encouraged to talk with customers; internal networking is fostered.

Focus on One or Two Skills

To gain a fundamental, immutable strength in the long-run, a firm should focus on one or two core skills, which it should develop. Focus does not mean restricting the number of businesses the firm can operate. It only means concentrating on a particular group of customers, a specific geographic area, or a certain part of the product or service line. The rationale is that by specialising, the organisation can serve the market segment more effectively than competitors who try to cover the entire market. The focus strategy still relies on a low-cost or a differentiation approach, or perhaps both, to establish a strong position within the particular market segment or niche. The differentiation within a focus strategy can occur by tailoring products to the exclusive needs of the market segment. A cost advantage may be simultaneously possible because a firm may be able to offer better prices on custom orders even though another firm may have the cost leadership in serving the larger-volume requirements of the broader market. Building core competencies is not easy. It requires a conscious, determined long-range effort on the part of strategic leaders who seek to strike a happy balance between objectives, resources, skills and opportunities.
Core Competence Model

Core competences are often presented as arising from unique resources that give rise to distinct capabilities. An expanded version of this model is given in Figure 8.2. This version suggests that behind resources is something called attributes; that, as well as unique resources, core competences are influenced by unique weaknesses; and that combining intersectoral core competences give rise to a unique potential societal function.

Figure 8.2: Core Competence Strategic Model

The expanded model is the basis for understanding intersectoral collaborations as initiatives that aim not just to co-ordinate activities between different organisations with complementary resources but also to offset weaknesses and produce outcomes that are more than the sum of the parts. From the societal function point of view, these collaborations provide an important place for negotiating the social contract and improving cohesion between disparate parts of society.

Against this backdrop, let’s now examine the three generic strategies advocated by Porter to make organisations more competitive in a detailed manner.

Fill in the blank:
5. Firms can acquire core competence through heavy investments in technology, research and development followed by new ..................

Maruti Suzuki has launched a new automatic Gear shift car, Celerio this year. Is it the right strategy adopted by the company to acquire core competency in automobile sector? Discuss.

8.7 LOW COST STRATEGIES

Low cost leadership strategies are based on a firm’s ability to offer a product or service at a lower cost than its rivals. When a firm is able
to build a substantial cost advantage over other competitors, it can pass on the benefits to customers and gain a large market share. Low cost works because after a certain time all markets mature and the number of players and their offerings stagger to a very high level. Buyers in such a market are able to drive down prices to rock bottom levels where only the low cost producers survive. Low cost producers are also able to withstand sluggish demand conditions, weather out business cycles and get ahead of their rivals. Desi brands for example, in FMCG sector are growing at a respectable level even when other established players are finding it difficult to stay afloat (example look at Anchor’s Growth rate of 50 per cent, Gold winners 24%, Gemini’s 40%, Ghadi’s 20% growth rate against HLLs flat growth rate in many of its product categories during 2001-03).

Low cost strategies can be used effectively when (a) the market for the product or service is price sensitive (b) the product or service is standardised (c) the buyers are powerful enough to extract a concession from the manufacturer (d) the buyers are not brand-loyal and are willing to switch from one seller to another based on price differences and (e) where differentiation is not possible and even when there is such a possibility – customers do not value it.

A low cost strategy builds competitive advantage through economies of scale, experience curve effects and other factors to capture a substantial share of the market.

- **Economies of Scale:** Large established firms produce, sell and advertise in greater volume than smaller firms and late entrants. The substantial volumes that they are able to generate help them take advantage of economies of scale within many primary and supporting value-adding activities. More employees are required to carry out an activity. This, in turn, helps them specialise and achieve greater productivity. Fixed costs can be spread over a large volume. The firm can gain from quantity discounts available on components, inputs and other raw materials. Also, large, volume players are in a better position to vertically integrate and make their own inputs at a lower cost. High levels of vertical integration enable firms to control all of the inputs, supplies, and equipment required to convert raw material into the final end product. At the same time firms could also think of buying more than they make. They can focus effort on these few activities, which they are best equipped to carry on and get supplies from others – thereby avoiding large fixed-cost capital investments. They can also avoid investing in those technologies or production processes that could become obsolete in a short span of time. For example Dell Computer does not invest in making chips or designing software; it simply assembles and distributes personal computers by buying key components from outside suppliers. The savings obtained through tight inventory and production cost control are passed on to buyers.
Experience Curve Effects: The principal source of experience based cost reduction is learning by organisation members. As employees repeat activities, they learn how to carry them out more quickly and accurately. The net effect is continuing improvement in both productivity and quality as employees’ experience base expands. Again, as a firm’s engineers become more familiar with the way a product is manufactured, they can often redesign components that cause problems in later assembly, reduce the number of components needed to make the product and substitute better materials (Pitts and Lei). These changes help in reducing manufacturing costs and improving the product quality over time. Increasing experience also helps engineers to bring small but useful improvements in the way the product is manufactured by changing the workflow or altering the equipment design.

Vertical Integration: Extending control over sources of supply (upstream operations) is vertical integration. High levels of vertical integration which can be achieved by fairly large firms, help firms control all of the inputs, supplies and equipment required to convert raw materials and equipment into finished products. Firms pursue vertical integration in cases where their products and technologies tend to remain fairly stable over long periods. Vertical integration could be an important cost driver in cases when the firm manufactures components that directly feed into its final products.

Location of Activities: The actual location where a value-added activity is carried out could be an important factor in determining a firm’s cost advantage. Maruti, for example, works with key suppliers to build their component factories near its own assembly plant in Gurgaon. This way it gets the parts it needs without the costs of holding inventory.

Benefits and Risks of Low-cost Leadership Strategies

Numerous studies have proved that firms with a high market share enjoy above-average returns over extended periods of time. Customers are usually reluctant to switch their loyalty to a competing brand unless that brand has something unique to offer. Low-cost firms can bring about pricing discipline within the industry also (as other firms are aware that they cannot carry out a price war with the low cost leader). The price-cutting power acts as a powerful entry barrier for firms contemplating entry into industry. Low-cost firms are generally in a better position to absorb increase in prices of inputs from time to time and keep the prices of their products somewhat steady.

The cost leadership strategy is not risk free.

A cost leader has to lock up his resources in fixed assets and equipment. After investing in such inflexible production and distribution technologies, it becomes difficult for the firm to embrace a more innovative technological process. For example
when quartz and digital watches became popular during the late 1970, Timex was so committed to its mechanical watch and process technology that it could not adapt to technological change.

- Cost reduction methods can be easily copied by rival firms as cost advantages in standardised production processes are somewhat slippery.
- “Firms obsessed with low costs may find themselves ambushed by competitors talking a different strategy designed to outflank a dominant industry player.”
- When other firms also enter the industry to reap the benefits, competition increases to such a level, where they do not hesitate to take the prices to unremunerative level. Excess capacity build up coupled with depressing price levels would force many players to draw the shutters down in the end.

In actual practice many firms have succeeded in achieving dramatic reductions in operating costs by focusing on those activities in which the firm, has a cost advantage and outsourcing others, and by extensively reengineering manufacturing and administrative processes. Given multiple drivers of relative cost, the cost leadership strategy requires multiple initiatives at different organisational levels. Careful examination of existing operations relative to rivals can indicate cost reduction opportunities by lowering input cost, accessing scale economies and better utilising capacity. At the same time the firm must actively seek opportunities for innovation and process design with a view to exploit new sources of dynamic efficiency (Grant).

**Self Assessment Questions**

Fill in the blank:

6. Low cost leadership strategies are based on a firm’s ability to offer a product or service at a ………………………… than its rivals.

**Activity**

A low pricing point offered by companies to customers self-destroys the industry and makes the customer price sensitive. Discuss.

**8.8 Differentiation Strategies**

The attraction of differentiation over low cost as a basis for competitive advantage is its potential for sustainability. It is susceptible to being overturned by changes in the external environment, and it is more difficult to copy. Differentiation strategies are based on offering buyers something unique or different that makes the firm’s products or services distinct from that of its rivals. According to Michael Porter
“strategy is about selling yourself apart from the competition. It’s not just a matter of being better at what you do – it’s a matter of being different at what you do”.

Differentiation strategies can be pursued by firms when:

- The market is too large to be served by a few firms offering standardised products/services.
- The customer needs and preferences are too diversified to be met through standardised products/services.
- The firm is able to charge a premium for an advantage that is valued by customers.
- The product is such that customer loyalty can be obtained and sustained (e.g. Chicory blended coffee, Darjeeling tea).

The potential for differentiation in any business is vast. It may involve physical differentiation of the product, it may be through complementary services, or it may even be intangible. Differentiation extends beyond technology, design and marketing to include all aspects of a firm’s interactions with its customers. Thus, McDonald’s differentiation advantage within the fast food business depends not just on the characteristics of the food (physical) it serves or the associated services (speed of service, cleanliness etc.), but also the values it projects (intangible) such as happiness and interest in children. In the end, differentiation is all about a firm’s responsiveness to customer requirements where every corporate activity is to be examined through the customer’s eyes. Will this make it easier for the customer? Faster? Better? Less Expensive?

Thus, products can be differentiated along any dimension that is valued by some group of customers. Any competitive advantage must be seen by customers as a customer advantage (Kotler). For example, if a company delivers faster than its competitors, this will not be a customer advantage, if customers do not value speed. Companies, therefore, must focus attention on building and sustaining customer advantages through differentiation. Then, they will move closer to the hearts of customers – who do not hesitate to buy the product again and again. Firms using this strategy seek to differentiate their products from rivals goods or services along as many dimensions as possible. The less the similarity with rivals’ products, the more buffered a firm is from competition with its rivals.

**Benefits and Risks of Differentiation Strategies**

Differentiation builds competitive advantage by making customers more loyal, less price sensitive and less willing to consider other product alternatives. The firm pursuing a high differentiation strategy along some key product’s attribute (e.g. fuel efficiency of Hero Honda Motor Cycles) or buyer need can earmark its own strategic group within the industry. In such a scenario, destructive price wars can be avoided. The perceived, superior quantity special appeal enables
the firm to hold its ground as far as the pricing strategy is concerned. Product quality helps the firm build its own reputation and demand that often gets translated into higher market share as well. Risks associated with the differentiation strategy include:

- A customer group’s decision that the differences between the differentiated products and the cost leader’s good or service (remember the Surf vs. Nirma battle?) is no longer worth a premium price. As a product becomes more mature, customers become smarter about what they want, what genuine value is, and what they are willing to pay. Price premiums become difficult to justify as customers gain more knowledge about the product” (See opening case).

- Unless differentiation is based on some unique proprietary knowledge, skill, expertise or patent, a firm faces the threat of being outmanoeuvred by rivals, who can stuff the product or service offering with similar features at a lesser lost.

- Excessive differentiation can seriously affect the competitive advantage and profitability of firms as “rising operating costs eat into price premiums that customers are willing to pay”.

### SELF ASSESSMENT QUESTIONS

Fill in the blanks:

7. The attraction of differentiation over low cost as a basis for competitive advantage is its potential for ……………………………..

8. Differentiation builds competitive advantage by making ……………………… more loyal, less price sensitive and less willing to consider other product alternatives.

9. ………………… builds competitive advantage by making customers more loyal, less price sensitive and less willing to consider other product alternatives.

### ACTIVITY

Which of the two is more prudential for a two-wheeler manufacturing company that operates globally: one product in all markets or many products in one market? Discuss in light of differentiation strategy.

### NOTE

The important assumption behind differentiation strategies is that customers are ready to pay a premium price for a product that is distinct (or at least perceived as such) in some important way like superior quality special appeal, better service, etc.
8.9 **FOCUS STRATEGIES**

Focus strategies aim to sell goods or services to narrow or specific target market, niche or segment. The essence of the focus strategy is the exploitation of a narrow target’s differences from the balance of the industry. Focus builds competitive advantage through high specialisation and concentration of resources in a given niche. If a niche or segment has distinctive and lasting features, then a firm can develop its own set of entry barriers in much the same way that large established firms do in broader markets. Nowadays, Internet is playing a great role in identifying market segments marked with greater and greater specificity in terms of unique customer needs. Firms can build focus in one of two ways. Focused cost leadership and focused differentiation. Through the cost leadership and the differentiated focus strategies firms serve the needs of a narrow competitive segment (a buyer group, products segment or geographic location). This strategy works when firms have the core competencies required to offer value to a narrow competitive segment that exceeds the value available from firms serving customers on an industry-wide basis.

A focused firm can serve the needs of a niche segment through a low cost or differentiation strategy (a) by identifying gaps not covered by existing players and (b) by developing superior skills or achieving superior efficiency while serving such narrow segments. A number of Indian companies have adopted the focus strategies either on the basis of lower cost or differentiation quite successfully in recent times:

- **Ayur Herbal Brand**: The Delhi based D S Narang has carefully positioned the ‘Ayur’ brand herbal shampoo at the lower end of the market by pricing it at less than half the price charged by other players. The 10-year-old Ayur brand is worth more than ₹ 100 crore now.

- **Anchor Toothpaste**: Atul Shah found the gap in the predominantly vegetarian Gujarat and Rajasthan markets (as far as toothpastes are concerned) and positioned his ‘Anchor’ brand as a vegetarian product (differentiation) and priced it ₹ 35 (200 gms packet) as against Colgate’s ₹ 62 (250 gm). Anchor is a ₹ 150 crore brand now and has grabbed nearly 10% market share (behind Colgate and HLL) now.

- **Ayurvedic Brand**: ‘No Marks’: S C Sehgal found that there is great demand for ayurvedic products in the global markets (after making a trip to New York, London and Paris in early 90s). He launched the ‘No marks’ ayurvedic product and began advertising through Aaj Tak Hindi channel, highlighting the superiority of ayurvedic product(s). The brand is raking in nearly ₹ 5 crores in sales every month.

- **‘T’ Series Cassettes**: In early 1980s Gulshan Kumar brought a revolution in the music cassettes industry by launching the
‘T’ series brand at the lower-end of the market. Priced at less than half the price charged by the market leader HMV, the brand proved to be a mega-hit with the masses (low cost strategy).

As the above examples clearly show, smaller firms normally avoid competing with larger firms by targeting small markets of little or no interest to the larger firms (say the ₹ 1 sachet market in shampoos ignored by other players). Of course, it is not always easy to find such gaps in the broader market, unless one is blessed with creativity, and ingenuity. Before exploiting such gaps, one should pay attention to the following:

- **Uniqueness**: Is the segment, to be created and exploited, unique in terms of certain key attributes such as age, religion, region, lifestyle etc?
- **Size**: Is the segment big enough to offer profitable growth for a reasonable length of time?
- **Ignored by the Big**: Is the segment to be pursued ignored by large firms? Or does not impact their success in any way?
- **Resources**: Is the firm well equipped (in terms of skills, expertise, resources) to serve the niche market?
- **Superiority**: Is it possible for the firm to guard its territory from rival firms on the strength of its superior service, better customer relations? Has it got a clear edge over others in building and sustaining customer loyalty for some time?

The key to nichemanship is specialisation, superior, differentiated service at a price liked by the customer (the value for money proposition). In course of time, rival firms may try every trick in the book to break the hold of the focused firm in a ‘niche’ segment. As a result, niches can weaken. To survive and flourish in a competitive market, the firm must continually create new ones. For example after tasting success through Dandi Salt (₹ 125 crores brand), Kunvar Ajay Industries, Suresh Agarwal has gone one step further and entered the detergent business through another winning brand – Friendly wash (₹ 40 crores brand). Next on the cards: Atta and Shampoo brands. The firm should “stick to its niching”, but not necessarily to its niche. That is why multiple niching is preferable to single niching. By developing strength in two or more niches, the firm increases its chances for survival.

**Benefits and Risks of Focus Strategies**

The biggest benefit of a focus strategy is that the firm is able to find a market niche against a larger, broader-line competitor. Through specialisation and high concentration of its resources in a given area, the firm is able to serve the requirements of a niche segment better than others, and insulate itself from the attention of bigger players in the field. Over time, it is able to improve other sources of value-adding activities that contribute to cost or differentiation.
The biggest risk associated with a focus strategy lies in that the distinctive tastes and product characteristics may blur over time. This, in turn, reduces the defensibility of the niche. When the tastes and preferences of a particular segment are widely known, competitors may initiate and bring out their own product offerings to capture the market, (e.g. HLL bringing out the ₹ 1 Shampoo sachet). The bigger players may use their technological strength while redefining the preferences of the niche in a better way.

To survive in a competitive market, firms will need to offer a variety of value ‘bundles’ or solutions to customers. Exclusive reliance on any single generic strategy (low cost or differentiation) is quite risky because it does not endow the firm with a sustained capability to innovate new sources of value more quickly and more efficiently over time.

Current research evidence supports moderate diversification in place of exclusive focus on a narrow segment. According to Harper and Vugierie, “Companies must branch out into new businesses to compensate for the declining prospect of creating value in older ones”. To generate superior shareholder returns firms must strike a happy balance between focus and diversification.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

10. ________________ means concentrating on a particular group of customers, a specific geographic area, or a certain part of the product or service line.

11. The biggest benefit of a focus strategy is that the firm is able to find a ________________ against a larger, broader-line competitor.

12. Through .......... and high concentration of its resources in a given area, the firm is able to serve the requirements of a niche segment better than others.

13. Exclusive reliance on any single .......... strategy does not endow the firm with a sustained capability to innovate new sources of value more quickly.

**ACTIVITY**

Focus strategy helps a company build walls around its niche, but may find itself restricted by the same walls. Discuss.

**8.10 SUMMARY**

- According to Porter, buyers, product substitutes, suppliers and potential new companies within the industry all contribute to the level of rivalry among industry firms. Understanding the
forces that determine competitiveness within an industry should help managers develop strategies that will enable individual companies within the industry to be more competitive.

- Porter suggested three generic strategies that managers might take up to make organisations more competitive. These are – Cost leadership, differentiation strategy and focus strategy.

- Business level strategy is an integrated and coordinated set of commitments and actions the firm uses to gain a competitive advantage by exploiting core competencies in specific product markets.

- In selecting business level strategy, the firm determines: (a) Who it will serve, (b) What needs those target customers have that it will satisfy, (c) How those needs will be satisfied.

- Customer relationships are strengthened by offering them superior value: (a) Help customers to develop a new competitive advantage, (b) Enhance the value of existing competitive advantages.

- When a firm sustains profits that exceed the average for its industry, the firm is said to possess a competitive advantage over its rivals. The goal of much of business strategy is to achieve a sustainable competitive advantage.

### KEY WORDS

- **Barriers to Entry**: Obstacles to entering an industry. The major barriers include economies of scale, product differentiation, capital needs, access to distribution channels, cost leadership, government policy etc.

- **Benchmarking**: The process of finding the best available product features, processes and services and using them as a standard (benchmark) for improving a company’s own products, processes and services.

- **Competitive Advantage**: A superior or distinctive competence in some function or area relative to the competition.

- **Core Competence**: It is a unique strength that gives a firm access to important market segments, offers significant benefits to customers in the end products and is difficult to copy.

- **Culture**: A system of shared values and beliefs that produce norms of behaviour.

- **Differentiation Strategy**: A competitive strategy based on providing buyers with something special or unique that makes the firm’s product or service distinctive.

Contd...
**Focus Strategy:** It is a strategy that emphasises making an organisation more competitive by targeting a specific regional market, product line or buyer group.

**Innovation:** It is a new idea applied to initiating or improving a process, product or service.

**Leadership:** The capacity to secure the cooperation of others in accomplishing a goal.

**Lower Cost Leadership Strategy:** A competitive strategy based on the firm's ability to provide products or services at lower cost than its rivals.

**Niche Marketing:** Focusing on sub segments or niches with distinctive traits that may seek a special combination of benefits.

**Power:** The ability, apart from functional authority or control over resources or rewards, to influence the behaviour of others.

**Pragmatism:** The ability to make things happen and achieve positive results.

**Product Innovations:** A firm's activities that enhance the differentiation of its products or services.

### 8.11 DESCRIPTIVE QUESTIONS

1. What is the relationship between a firm's customers and its business-level strategy? Why is this relationship important?

2. How is competitive advantage achieved through successful implementation of the cost leadership strategy?

3. How is competitive advantage achieved through successful implementation of the differentiation strategy?

4. How is competitive advantage achieved through successful implementation of the focused cost leadership strategy?

5. How competitive advantage is created by a firm? Explain the factors associated with it.

6. Explain the model of competitive advantage as proposed by M.E. Porter. Describe its features.

7. How core competency can be built by durable competitive advantage?

8. White short notes on:
   - (a) Benchmarking
   - (b) Core Competence

9. Define ‘Competitive Advantage’. Explain how firms build or acquire competitive advantage over time. Use examples in support of your answer.
10. What do you mean by differentiation strategy? Explain the benefits and risks associated with it.

**8.12 ANSWERS AND HINTS**

**ANSWERS FOR SELF-ASSESSMENT QUESTIONS**

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**HINTS FOR DESCRIPTIVE QUESTIONS**

1. Refer to 8.1 & 8.2

Business level strategy deals with how a particular business competes. The principal focus is on meeting competition, protecting market share and earning profit at the business unit level by performing activities differently, offering superior value to customers. A firm is able to deliver superior value to customers when it is in a position to perform an activity that is distinct or different from that of its competitors. This is popularly defined as competitive advantage. Competitive advantage implies a distinct and sustainable advantage over competitors. It is a kind of clear superiority or distinctive competence in some functions or area over the competitors. M E Porter studied a number of business organisations and proposed that business-level strategies are the result of five competitive forces in the company’s environment. According to him, competitiveness within an industry is determined by the following new entrants or new companies within the industry; products that might act as a substitute for
goods or services that companies within the industry produce; the ability of suppliers to control issues like cost of materials that companies use to manufacture their products; the bargaining power that buyers possess within the industry; and the general level of rivalry or competition among firms within the industry.

2. Refer to 8.3

Cost leadership is a strategy that focuses on making an organisation more competitive by producing its products more cheaply than competitors can. The logic behind this strategy is that by producing products more cheaply than competitors, organisations can offer products to customers at lower prices than the competitors and thereby hope to increase market share.

3. Refer to 8.3

Differentiation Strategy involves attempting to develop products and services that are viewed as unique in the industry. Successful differentiation allows the business to charge premium prices, leading to above average profits.

4. Refer to 8.3

Focus is a strategy that emphasises making an organisation more competitive by targeting a specific regional market, product line or buyer group. The organisation can use either a differentiation or low cost approach, but only for a narrow target market. The logic of this approach is that an organisation that limits its attention to one or a few market segments can serve those segments better than organisations that seek to influence the entire market.

5. Refer to 8.3.2 & 8.4

Competitive advantage is created by using resources and capabilities to achieve either a lower cost structure or a differentiated product. A firm positions itself in its industry through its choice of low cost or differentiation. This decision is a central component of the firm’s competitive strategy. Marketing, Finance, Research & Development, Personnel and Production are some of the factors of competitive advantage.

6. Refer to 8.3, 8.3.1 & 8.3.3

When a firm sustains profits that exceed the average for its industry, the firm is said to possess a competitive advantage over its rivals. The goal of much of business strategy is to achieve a sustainable competitive advantage. A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at a lower cost (cost advantage), or deliver benefits that exceed those of competing products (differentiation advantage). Thus, a competitive advantage enables the firm to create superior value for its customers and superior profits for itself. According to the resource-based view, in order to develop
a competitive advantage the firm must have resources and capabilities that are superior to those of its competitors. Features of Competitive Advantages are inability to sustain for long, relevant advantage and backbone of strategy are the features of competitive advantage.

7. Refer to 8.5

To be successful in the long run, every firm must possess some long-lasting, unique competitive advantage that can’t be easily imitated by competitors. The enduring competitive superiority enables the firm to get ahead easily and emerge as a ‘winner’ on most occasions – at least till others catch up and bridge the gap in terms of cost leadership or product differentiation.

8. Refer to 8.5 & 8.6

Benchmarking is the process of finding the best available product features, processes and services and using them as a standard (benchmark) for improving a company’s own products, processes and services. Core Competence is a unique strength that gives a firm access to important market segments, offers significant benefits to customers in the end products and is difficult to copy.

9. Refer to 8.3 & 8.5

A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at a lower cost (cost advantage), or deliver benefits that exceed those of competing products (differentiation advantage). Firms usually build competitive advantage using various strategic routes such as: innovation, integration, alliances, mergers, acquisitions, research & development, entry barriers, benchmarking, value chain approach and strategic business unit (SBU) structure.

10. Refer to 8.8

The attraction of differentiation over low cost as a basis for competitive advantage is its potential for sustainability. It is susceptible to being overturned by changes in the external environment, and it is more difficult to copy. Differentiation strategies are based on offering buyers something unique or different that makes the firm’s products or services distinct from that of its rivals. Differentiation builds competitive advantage by making customers more loyal, less price sensitive and less willing to consider other product alternatives. The firm pursuing a high differentiation strategy along some key product’s attribute (e.g. fuel efficiency of Hero Honda Motor Cycles) or buyer need can earmark its own strategic group within the industry.
8.13 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS


E-REFERENCES

9

ANALYSING RESOURCES AND CAPABILITIES

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9.1 Introduction
9.2 Factor Affecting the Internal Environment
9.3 Resources and Capabilities as Sources of Profit
9.4 Resources of the Firm
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  9.5.2 Architecture of Capability
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9.7 Placing Resource and Capability Analysis to Work
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  9.8.1 Relationship between Resources and Capabilities
  9.8.2 Replicating Capabilities
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  9.8.4 Approaches to Capability Development
9.9 Summary
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9.12 Suggested Readings for Reference
COMPETITIVE STRATEGIES OF ZARA IS INEVITABLE

Zara – the Spanish clothing and accessories retailer founded in 1975, is one of the hottest fashion chains of 21st century, offering men’s clothing, women’s clothing, cosmetics, complements and children’s clothing. Since its initial public offering in 2001, Zara’s parent, Inditex tripled its sales and profits and doubled the number of stores for its flagship brands. Headquartered in Spain, Zara is known for its innovations and its stores operate in choicest locations in Europe, Asia and North America. Described by many as the most devastating retailer in the world, the company has rewritten a number of rules in the fashion retailing industry so far through its novel strategies. Any Zara store typically carries only a small batch of merchandise, compelling shoppers to visit the stores frequently. For example, in London, shoppers visit the average store four times a year, but frequent Zara 17 times annually. Zara makes about 20,000 items a year which are being released in phases. The small batch size helps the company catch the changes in fashion quickly and introduce new models at amazing speed – thanks to its grip over the supply chain. Every store places orders twice a week and shipments reach most European stores in about 24 hours’ time. Customers (as well as store employees) thus, are pretty sure about when shipments will arrive and visit the store frequently making enquiries. Zara has so far resisted the industry-wide trend towards transferring fast fashion production to low-cost countries. By concentrating its production in-house and in Spain, Zara has developed a super-responsive supply chain. It designs, produces and delivers a new garment to its stores in a mere 15 days, something very unusual in the fashion industry, compared to 6 month industry average. The company also does not believe in offering its products on discount and when it happens occasionally, it averages only 15%. Amazing to relate, Zara follows a zero advertising policy and prefers to invest a percentage of revenues to opening new stores – 1285 stores all over the world currently with annual sales of over $10 billion instead. Zara is able to push competitors to the wall so far due to its ability to design, produce and deliver fashion garments efficiently and effectively, leveraging on its unique resource strengths and capabilities.
After studying this chapter, you should be able to:

- Appreciate the role of a firm’s resources and capabilities as a basis for formulating strategy
- Identify and appraise the resources and capabilities of a firm
- Evaluate the potential for a firm’s resources and capabilities to confer sustainable competitive advantage
- Use the results of resource and capability analysis to formulate strategies that exploit internal strengths while defending against internal weaknesses
- Identify the means through which a firm can develop its resources and capabilities

9.1 INTRODUCTION

Strategy is concerned with matching a firm’s resources and capabilities to the opportunities that arise in the external environment. So far, the emphasis of the book has been the identification of profit opportunities in the external environment of the firm. With this chapter, our emphasis shifts from the interface between strategy and the external environment towards the interface between strategy and the internal environment of the firm – more specifically, with the resources and capabilities of the firm. Increasing emphasis on the role of resources and capabilities as the basis for strategy is the result of two factors. First, as firms’ industry environments have become more unstable, so internal resources and capabilities rather than external market focus has been viewed as a securer base for formulating strategy. Second, it has become increasingly apparent that competitive advantage rather than industry attractiveness is the primary source of superior profitability.

9.2 FACTOR AFFECTING THE INTERNAL ENVIRONMENT

Basing Strategy on Resources and Capabilities

During the 1990s, ideas concerning the role of resources and capabilities as the principal basis for firm strategy and the primary source of profitability coalesced into what has become known as the resource-based view of the firm. To understand why the resource-based view has had a major impact on strategy thinking, let us go back to the starting point for strategy formulation: typically some statement of the firm’s identity and purpose (often expressed in a mission statement). Conventionally, firms have answered the question “what is our business?” in terms of the market they serve: “who are our customers?” and “which of their needs are we seeking to serve?” However, in a world where customer preferences are volatile and
the identity of customers and the technologies for serving them are changing, a market-focused strategy may not provide the stability and constancy of direction needed to guide strategy over the long term.

**DEFINITION**

When the external environment is in a state of flux, the firm itself, in terms of its bundle of resources and capabilities, may be a much more stable basis on which to define its identity.

In general, the greater the rate of change in a firm’s external environment, the more likely it is that internal resources and capabilities will provide a secure foundation for long-term strategy. In fast-moving, technology-based industries, new companies are built around specific technological capabilities. Motorola, the Texas-based supplier of wireless telecommunications equipment, semiconductors, and direct satellite communications, has undergone many transformations, from being a leading provider of TVs and car radios to its current focus on telecom equipment. Yet, underlying these transformations has been a consistent focus on wireless electronics.

**Figure 9.1: Analysing Resources and Capabilities: The Interface between Strategy and the Firm**

The difficulties experienced by established firms in adjusting to technological change within their own markets are well documented—in typesetting and in disk drive manufacturing, successive technological waves have caused market leaders to falter and allowed new entrants to prosper.

### SELF ASSESSMENT QUESTIONS

Fill in the blanks:

1. When the external environment is in a state of flux, the firm itself, in terms of its bundle of resources and capabilities, may be a much more .............. basis on which to define its identity.

2. In fast-moving, technology-based industries, new companies are built around specific ......................... capabilities.
In a volatile industry marked by disruptive technologies, companies should focus on building competencies, not just products. Discuss with example.

9.3 RESOURCES AND CAPABILITIES AS SOURCES OF PROFIT

Among the two major sources of superior profitability: industry attractiveness and competitive advantage. Of these, competitive advantage is the more important. Internationalisation and deregulation have increased competitive pressure within most sectors; as a result, few industries (or segments) offer cosy refuges from vigorous competition. The industry factors account for only a small proportion of interfirm profit differentials.

Establishing competitive advantage through the development and deployment of resources and capabilities, rather than seeking shelter from the storm of competition, has become the primary goal for strategy.

The distinction between industry attractiveness and competitive advantage (based on superior resources) as sources of a firm’s profitability corresponds to economists’ distinction between different types of profit (or rent). The profits arising from market power are referred to as monopoly rents; those arising from superior resources are Ricardian rents, after the 19th-century British economist David Ricardo. Ricardo showed that, even when the market for wheat was competitive, fertile land would yield high returns. Ricardian rent is the return earned by a scarce resource over and above the cost of bringing it into production.

In practice, distinguishing between profit arising from market power and profit arising from resource superiority is less clear in practice than in principle. A closer look at Porter’s five forces framework suggests that industry attractiveness derives ultimately from the ownership of resources. Barriers to entry, for example, are the result of patents, brands, distribution channels, learning, or some other resource possessed by incumbent firms. Similarly, the lack of rivalry resulting from the dominance of a single firm (monopoly) or a few firms (oligopoly) is usually based on the concentrated ownership of key resources such as technology, manufacturing facilities, or distribution facilities.

The resource-based approach has profound implications for companies’ strategy formulation. When the primary concern of strategy was industry selection and positioning, companies tended to adopt similar strategies. The resource-based view, by contrast,
emphasises the uniqueness of each company and suggests that the key to profitability is not through doing the same as other firms, but rather through exploiting differences.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

3. Distinguishing between profit arising from market power and profit arising from ... is less clear in practice than in principle.

4. The resource-based approach has profound implications for companies’ ... 

**ACTIVITY**

Write a 200-words report on the attractiveness of the multi-brand retail industry in India. Justify the entry of Trent into the industry based on resources.

**NOTE**

Establishing competitive advantage involves formulating and implementing a strategy that exploits the uniqueness of a firm’s portfolio of resources and capabilities.

**9.4 RESOURCES OF THE FIRM**

It is important to distinguish between the resources and the capabilities of the firm: resources are the productive assets owned by the firm; capabilities are what the firm can do. Individual resources do not confer competitive advantage, they must work together to create organisational capability. It is capability that is the essence of superior performance. Figure 9.2 shows the relationship among resources, capabilities, and competitive advantage.

Drawing up an inventory of a firm’s resources can be surprisingly difficult. No such document exists within the accounting or management information systems of most corporations. The corporate balance sheet provides a limited view of a firm’s resources – it comprises mainly financial and physical resources. To take a wider view of a firm’s resources it is helpful to identify three principal types of resource: tangible, intangible and human resources.
9.4.1 TANGIBLE RESOURCES

Tangible resources are the easiest to identify and evaluate: financial resources and physical assets are identified and valued in the firm’s financial statements. Yet, balance sheets are renowned for their propensity to obscure strategically relevant information, and to under- or overvalue assets. Historic cost valuation can provide little indication of an asset’s market value. Disney’s movie library had a balance sheet value of $4.6 billion in 2005, based on production cost less amortisation. Its land assets (including its 28,000 acres in Florida) were valued at a paltry $1.1 billion.

However, the primary goal of resource analysis is not to value a company’s assets, but to understand their potential for creating competitive advantage. Information that British Airways possesses tangible fixed assets with a book value of £8.2 billion is of little use in assessing their strategic value. To assess British Airways’ ability to compete effectively in the world airline industry we need to know about the composition of these assets, the location of land and buildings, the types of plane and their age, and so on.

Once we have fuller information on a company’s tangible resources we explore how we can create additional value from them. This requires that we address two key questions:

- What opportunities exist for economising on their use? It may be possible to use fewer resources to support the same level of business, or to use the existing resources to support a larger volume of business.

- What are the possibilities for employing existing assets more profitably?
9.4.2 INTANGIBLE RESOURCES

For most companies, intangible resources are more valuable than tangible resources. Yet, in company financial statements, intangible resources remain largely invisible – particularly in the US where R&D is expensed. The exclusion or undervaluation of intangible resources is a major reason for the large and growing divergence between companies’ balance sheet valuations (“book values”) and their stock market valuations (see Table 9.1).

**TABLE 9.1: MAJOR COMPANIES WITH THE HIGHEST MARKET-TO-BOOK RATIOS, DECEMBER 2005**

<table>
<thead>
<tr>
<th>Company</th>
<th>Ratio</th>
<th>Country</th>
<th>Company</th>
<th>Ratio</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yahoo! Japan</td>
<td>72.0</td>
<td>Japan</td>
<td>Coca-Cola</td>
<td>7.8</td>
<td>US</td>
</tr>
<tr>
<td>Colgate-Palmolive</td>
<td>20.8</td>
<td>US</td>
<td>Diageo</td>
<td>7.4</td>
<td>UK</td>
</tr>
<tr>
<td>GlaxoSmithKline</td>
<td>13.4</td>
<td>UK</td>
<td>3M</td>
<td>7.3</td>
<td>US</td>
</tr>
<tr>
<td>Anheuser-Busch</td>
<td>12.6</td>
<td>US</td>
<td>Nokia</td>
<td>6.7</td>
<td>Finland</td>
</tr>
<tr>
<td>eBay</td>
<td>11.2</td>
<td>US</td>
<td>Sanofi-Aventis</td>
<td>6.3</td>
<td>France</td>
</tr>
<tr>
<td>SAP</td>
<td>10.8</td>
<td>Germany</td>
<td>AstraZeneca</td>
<td>5.9</td>
<td>UK</td>
</tr>
<tr>
<td>Yahoo!</td>
<td>10.7</td>
<td>US</td>
<td>Johnson &amp; Johnson</td>
<td>5.7</td>
<td>US</td>
</tr>
<tr>
<td>Dell Computer</td>
<td>10.0</td>
<td>US</td>
<td>Boeing</td>
<td>5.7</td>
<td>US</td>
</tr>
<tr>
<td>Sumitomo Mitsui Financial</td>
<td>8.8</td>
<td>Japan</td>
<td>Eli Lily</td>
<td>5.6</td>
<td>US</td>
</tr>
<tr>
<td>Procter &amp; Gamble</td>
<td>8.4</td>
<td>US</td>
<td>Cisco Systems</td>
<td>5.5</td>
<td>US</td>
</tr>
<tr>
<td>Qualcomm</td>
<td>8.3</td>
<td>US</td>
<td>Roche Holding</td>
<td>5.5</td>
<td>Switz.</td>
</tr>
<tr>
<td>Schlumberger</td>
<td>8.2</td>
<td>US</td>
<td>L’Oreal</td>
<td>5.3</td>
<td>France</td>
</tr>
<tr>
<td>Unilever</td>
<td>8.1</td>
<td>Neth./UK Altria</td>
<td>5.2</td>
<td>US</td>
<td></td>
</tr>
<tr>
<td>PepsiCo</td>
<td>8.0</td>
<td>US</td>
<td>Novartis</td>
<td>5.1</td>
<td>Switz.</td>
</tr>
</tbody>
</table>

Note: The table includes companies with the highest market capitalisation as a proportion of balance sheet net asset value among the top 200 companies of the world with the largest market capitalisation at the end of 2005.

Among the most important of these undervalued or unvalued intangible resources are brand names. Table 9.2 shows companies owning brands valued at $15 billion or more. Brand names and other trademarks are a form of reputational asset: their value is in the confidence they instil in customers. This value is reflected in the price premium that customers are willing to pay for the branded product over that for an unbranded or unknown brand. Brand value
(or “brand equity”) can be estimated by taking the price premium attributable to a brand, multiplying it by the brand’s annual sales volume, then calculating the present value of this revenue stream. The brand valuations in Table 9.2 involve estimating the operating profits for each brand (after taxation and a capital charge), estimating the proportion of net operating income attributable to the brand, and then capitalising these returns. The value of a company’s brands can be increased by extending the product/market scope over which the company markets those brands. Philip Morris is an expert at internationalising its brand franchises.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Brand</th>
<th>Brand value in 2006, $ billion</th>
<th>Change from 2004</th>
<th>Country of origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Coca-Cola</td>
<td>67.5</td>
<td>0%</td>
<td>USA</td>
</tr>
<tr>
<td>2</td>
<td>Microsoft</td>
<td>59.9</td>
<td>−2%</td>
<td>USA</td>
</tr>
<tr>
<td>3</td>
<td>IBM</td>
<td>53.4</td>
<td>−1%</td>
<td>USA</td>
</tr>
<tr>
<td>4</td>
<td>GE</td>
<td>47.0</td>
<td>+7%</td>
<td>USA</td>
</tr>
<tr>
<td>5</td>
<td>Intel</td>
<td>35.6</td>
<td>+6%</td>
<td>USA</td>
</tr>
<tr>
<td>6</td>
<td>Nokia</td>
<td>26.5</td>
<td>+10%</td>
<td>Finland</td>
</tr>
<tr>
<td>7</td>
<td>Disney</td>
<td>26.4</td>
<td>−2%</td>
<td>USA</td>
</tr>
<tr>
<td>8</td>
<td>McDonald’s</td>
<td>26.0</td>
<td>+4%</td>
<td>USA</td>
</tr>
<tr>
<td>9</td>
<td>Toyota</td>
<td>24.8</td>
<td>+10%</td>
<td>Japan</td>
</tr>
<tr>
<td>10</td>
<td>Marlboro</td>
<td>21.2</td>
<td>−4%</td>
<td>USA</td>
</tr>
<tr>
<td>11</td>
<td>Mercedes Benz</td>
<td>20.0</td>
<td>−6%</td>
<td>Germany</td>
</tr>
<tr>
<td>12</td>
<td>Citi</td>
<td>20.0</td>
<td>0%</td>
<td>USA</td>
</tr>
<tr>
<td>13</td>
<td>Hewlett-Packard</td>
<td>18.9</td>
<td>−10%</td>
<td>USA</td>
</tr>
<tr>
<td>14</td>
<td>American Express</td>
<td>18.6</td>
<td>+5%</td>
<td>USA</td>
</tr>
<tr>
<td>15</td>
<td>Gillette</td>
<td>17.5</td>
<td>+5%</td>
<td>USA</td>
</tr>
<tr>
<td>16</td>
<td>BMW</td>
<td>17.1</td>
<td>+8%</td>
<td>Germany</td>
</tr>
<tr>
<td>17</td>
<td>Cisco</td>
<td>16.6</td>
<td>+4%</td>
<td>USA</td>
</tr>
<tr>
<td>18</td>
<td>Louis Vuitton</td>
<td>16.1</td>
<td>n.a.</td>
<td>France</td>
</tr>
<tr>
<td>19</td>
<td>Honda</td>
<td>15.8</td>
<td>+6%</td>
<td>Japan</td>
</tr>
<tr>
<td>20</td>
<td>Samsung</td>
<td>15.0</td>
<td>19%</td>
<td>S. Korea</td>
</tr>
</tbody>
</table>

Note: Brand values are calculated as the net present value of future earnings generated by the brand.

Harley-Davidson’s brand strength has not only permitted the company to obtain a price premium of about 40% above that of comparable motorcycles, but also to license its name to the manufacturers of clothing, coffee mugs, cigarettes, and restaurants. Reputation may be attached to a company as well as to its brands. Companies depend on the support from employees, customers, investors, and governments.
Harris Interactive shows Johnson & Johnson followed by Coca-Cola, Google, UPS, and 3M to have the highest “reputation quotients.”

Like reputation, technology is an intangible asset whose value is not evident from most companies’ balance sheets. Intellectual property – patents, copyrights, trade secrets, and trademarks – comprise technological and artistic resources where ownership is defined in law. Over the past 20 years, companies have become more attentive to the value of their intellectual property. Texas Instruments was one of the first companies to begin managing its patent portfolio in order to maximise its licensing revenues. For some companies, their ownership of intellectual property is a key source of their market value.

9.4.3 HUMAN RESOURCES

The human resources of the firm are the expertise and effort offered by its employees. Human resources do not appear on corporate balance sheets for the simple reason that people are not owned: they offer their services under employment contracts. Identifying and appraising the stock of human resources within a firm is complex and difficult. Human resources are appraised at the time of recruitment and throughout the period of employment, e.g. through annual performance reviews. Companies are continually seeking more effective methods to assess the performance and potential of their employees. Over the past decade, human resource appraisal has become far more systematic and sophisticated. Organisations are relying less on formal qualifications and years of experience and more on attitude, motivation, learning capacity, and potential for collaboration. Competency modelling involves identifying the set of skills, content knowledge, attitudes, and values associated with superior performers within a particular job category, then assessing each employee against that profile. The results of such competency assessments can then be used to identify training needs, make selections for hiring or promotion, and determine compensation. A key outcome of systematic assessment has been recognition of the importance of psychological and social aptitudes in linking technical and professional abilities to overall job performance. Recent interest in emotional intelligence reflects growing recognition of the importance of social and emotional skills and values.

This organisational context as it affects internal collaboration is determined by a key intangible resource: the culture of the organisation. The term organisational culture is notoriously ill defined. It relates to an organisation’s values, traditions, and social norms.

Industry insiders have raised eyebrows in the acquisition of Patni Computers by Igate Solutions for disharmony in organisational culture. Do you feel the same? Discuss.
Self Assessment Questions

Fill in the blanks:

5. Like reputation, technology is an ______________ asset whose value is not evident from most companies’ balance sheets.

6. The human resources of the firm are the expertise and effort offered by its ______________

Note

The ability of employees to harmonise their efforts and integrate their separate skills depends not only on their interpersonal skills but also the organisational context.

9.5 Organisational Capabilities

Resources are not productive on their own. A brain surgeon is close to useless without a radiologist, anaesthetist, nurses, surgical instruments, imaging equipment, and a host of other resources. To perform a task, a team of resources must work together. An organisational capability is a “firm's capacity to deploy resources for a desired end result.” Just as an individual may be capable of playing the violin, ice skating, and speaking Mandarin, so an organisation may possess the capabilities needed to manufacture widgets, distribute them throughout Latin America, and hedge the resulting foreign exchange exposure. We use the terms capability and competence interchangeably.

Our primary interest is in those capabilities that can provide a basis for competitive advantage. Selznick used distinctive competence to describe those things that an organisation does particularly well relative to its competitors. Prahalad and Hamel coined the term core competences to distinguish those capabilities fundamental to a firm’s strategy and performance. Core competences, according to Hamel and Prahalad, are those that:

- Make a disproportionate contribution to ultimate customer value, or to the efficiency with which that value is delivered, and
- Provide a basis for entering new markets.

Prahalad and Hamel criticise US companies for emphasising product management over competence management. They compare the strategic development of Sony and RCA in consumer electronics. Both companies were failures in the home video market. RCA introduced its videodisk system, Sony its Betamax videotape system. For RCA, the failure of its first product marked the end of its venture into home video systems and heralded a progressive retreat from the consumer electronics industry. RCA was acquired by GE, which then sold off the combined consumer electronics division to Thomson of France. Sony, on the other hand, acknowledged the failure of Betamax, but continued to develop its capabilities in video technology. This
continuous development and upgrading of its video capabilities resulted in a string of successful video products from camcorders and digital cameras to the PlayStation game console.

9.5.1 CLASSIFYING CAPABILITIES

To identify a firm’s capabilities, we need to have some basis for classifying and disaggregating its activities. Two approaches are commonly used:

- A functional analysis identifies organisational capabilities in relation to each of the principal functional areas of the firm. Table 9.3 classifies the principal functions of the firm and identifies organisational capabilities pertaining to each function.

- A value chain analysis separates the activities of the firm into a sequential chain. Michael Porter’s representation of the value chain distinguishes between primary activities (those involved with the transformation of inputs and interface with the customer) and support activities (see Figure 9.3). Porter’s generic value chain identifies a few broadly defined activities that can be disaggregated to provide a more detailed identification of the firm’s activities (and the capabilities that correspond to each activity). Thus, marketing might include market research, test marketing, advertising, promotion, pricing, and dealer relations.

<table>
<thead>
<tr>
<th>Functional area</th>
<th>Capability</th>
<th>Exemplars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Functions</td>
<td>Financial control</td>
<td>Exxon Mobil, PepsiCo</td>
</tr>
<tr>
<td></td>
<td>Strategic management of multiple businesses</td>
<td>General Electric, Procter &amp; Gamble</td>
</tr>
<tr>
<td></td>
<td>Strategic innovation</td>
<td>BP, Google</td>
</tr>
<tr>
<td></td>
<td>Multi-divisional coordination</td>
<td>Unilever, Shell</td>
</tr>
<tr>
<td></td>
<td>Acquisition management</td>
<td>Cisco, Bank of America</td>
</tr>
<tr>
<td></td>
<td>International management</td>
<td>Shell, Citigroup</td>
</tr>
<tr>
<td>Management Information</td>
<td>Comprehensive, integrated MIS network</td>
<td>Wal-Mart, Capital One, Dell Computer</td>
</tr>
<tr>
<td></td>
<td>linked to managerial decision making</td>
<td></td>
</tr>
<tr>
<td>Research &amp; Development</td>
<td>Research</td>
<td>IBM, Merck</td>
</tr>
<tr>
<td></td>
<td>Innovative new product development</td>
<td>3M, Apple</td>
</tr>
<tr>
<td></td>
<td>Fast-cycle new product development</td>
<td>Canon, Inditex (Zara)</td>
</tr>
</tbody>
</table>

Contd...
ANALYSING RESOURCES AND CAPABILITIES

<table>
<thead>
<tr>
<th>Operations</th>
<th>Efficiency in volume manufacturing</th>
<th>Briggs &amp; Stratton, YKK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Continuous improvements in operations</td>
<td>Toyota, Harley-Davidson</td>
</tr>
<tr>
<td></td>
<td>Flexibility and speed or response</td>
<td>Four Season Hotels</td>
</tr>
<tr>
<td>Product Design</td>
<td>Design capability</td>
<td>Nokia, Apple Computer</td>
</tr>
<tr>
<td>Marketing</td>
<td>Brand management</td>
<td>P&amp;G, Altria</td>
</tr>
<tr>
<td></td>
<td>Promoting reputation for quality</td>
<td>Johnson &amp; Johnson</td>
</tr>
<tr>
<td></td>
<td>Responsiveness to market trends</td>
<td>MTV, L'Oreal</td>
</tr>
<tr>
<td>Sales and Distribution</td>
<td>Effective sales promotion and execution</td>
<td>PepsiCo, Pfizer</td>
</tr>
<tr>
<td></td>
<td>Efficiency and speed of order processing</td>
<td>L.L. Bean, Dell Computer</td>
</tr>
<tr>
<td></td>
<td>Speed of Distribution</td>
<td>Amazon.com</td>
</tr>
<tr>
<td></td>
<td>Quality and effectiveness of customer service</td>
<td>Singapore Airlines, Caterpillar</td>
</tr>
</tbody>
</table>

Figure 9.3: Porter’s Value Chain

9.5.2 ARCHITECTURE OF CAPABILITY

Why is 3M so good at developing new products for a variety of home, office, and medical needs? How is Wal-Mart able to combine relentless cost focus and high levels of flexibility and adaptability? Why is Toyota so superior to either Ford or GM in developing new models of car and launching them globally? We can guess, but the fact remains: we don’t really know how organisational capabilities are created or why one company performs a capability more effectively than another. To begin to understand organisational capabilities, let us look at their structure.
NOTES

Capability as Routine

Organisational capability requires the expertise of various individuals to be integrated with capital equipment, technology, and other resources. But how does this integration occur? Virtually all productive activities involve teams of people undertaking closely coordinated actions – typically without detailed direction. Richard Nelson and Sidney Winter have used the term organisational routines to refer to these regular and predictable patterns of activity made up of a sequence of coordinated actions by individuals. Such routines form the basis of most organisational capabilities. At the manufacturing level, a series of routines governs the passage of raw materials and components through the production process to the factory gate. Sales, ordering, distribution, and customer service activities are similarly organised through a number of standardised, complementary routines. Even top management functions comprise routines for monitoring business unit performance, capital budgeting, and strategic planning.

Like individual skills, organisational routines develop through learning-by-doing. Just as individual skills become rusty when not exercised, so it is difficult for organisations to retain coordinated responses to contingencies that arise only rarely. Hence, there may be a trade-off between efficiency and flexibility. A limited repertoire of routines can be performed highly efficiently with near-perfect coordination. The same organisation may find it extremely difficult to respond to novel situations.

Routinisation is an essential step in translating directions and operating practices into capabilities. In every McDonald's hamburger restaurant, operating manuals provide precise directions for the conduct of every activity undertaken, from the placing of the pickle on the burger to the maintenance of the milk-shake machine. In practice, the operating manuals are seldom referred to in the course of day-to-day operations – through continuous repetition, tasks become routinised.

Hierarchy of Capabilities

Whether we examine capabilities from a functional or value chain approach, it is evident that broad functions or value chain activities can be disaggregated into more specialist capabilities performed by smaller teams of resources. What we observe is a hierarchy of capabilities where more general, broadly defined capabilities are formed from the integration of more specialised capabilities. For example:

- A hospital’s capability in treating heart disease depends on its integration of capabilities pertaining to a patient’s diagnosis, physical medicine, cardiovascular surgery, pre- and post-operative care, as well as capabilities relating to various administrative and support functions.
Toyota’s manufacturing capability – its system of “lean production” – integrates capabilities relating to the manufacture of components and subassemblies, supply-chain management, production scheduling, assembly, quality control procedures, systems for managing innovation and continuous improvement, and inventory control.

Figure 9.4 offers a partial view of the hierarchy of capabilities of a telecom equipment maker. At the highest level of integration are those capabilities which integrate across multiple functions. New product development draws upon a broad range of functional capabilities – which is why it is so difficult to manage. One solution to the problems of integrating functional know-how into new product development is the creation of cross-functional product development teams. The use of such product development teams (led by a “heavyweight” team leader) by Toyota, Nissan, and Honda has been a key reason for these firms’ fast-cycle new product development compared with US and European car companies.

Figure 9.4: Hierarchical Nature of Capabilities: A Manufacturer of PBXs

Self Assessment Questions

Fill in the blank:

7. ................. is an essential step in translating directions and operating practices into capabilities.
Great companies build competencies using the Great Repetitive Model. Cite an example of a company that has developed capability as a routine and write a 200-words report on the same.

### 9.6 APPRAISING RESOURCES AND CAPABILITIES

So far, we have established what resources and capabilities are, how they can provide a long-term focus for a company’s strategy, and how we can go about identifying them. However, if the focus of this book is the pursuit of profit, we also need to appraise the potential for resources and capabilities to earn profits for the company. The profits that a firm obtains from its resources and capabilities depend on three factors: their abilities to establish a competitive advantage, to sustain that competitive advantage, and to appropriate the returns to that competitive advantage. Each of these depends on a number of resource characteristics. Figure 9.5 shows the key relationships.

![Figure 9.5: Appraising the Strategic Importance of Resources and Capabilities](image)

**9.6.1 ESTABLISHING COMPETITIVE ADVANTAGE**

For a resource or capability to establish a competitive advantage, two conditions must be present:

**Scarcity:** If a resource or capability is widely available within the industry, then it may be essential to compete, but it will not be a
sufficient basis for competitive advantage. In oil and gas exploration, new technologies such as directional drilling and 3-D seismic analysis are critical to reducing the costs of finding new reserves. However, these technologies are widely available from oilfield service and IT companies. As a result, such technologies are “needed to play,” but they are not sufficient to win.

**Relevance:** A resource or capability must be relevant to the key success factors in the market. British coal mines produced some wonderful brass bands. Unfortunately, musical capabilities did little to assist the mines in meeting competition from cheap imported coal and North Sea gas. As retail banking shifts toward automated teller machines and online transactions, so the retail branch networks of the banks have become less relevant for customer service.

### 9.6.2 SUSTAINING COMPETITIVE ADVANTAGE

The profits earned from resources and capabilities depend not just on their ability to establish competitive advantage, but also on how long that advantage can be sustained. This depends on whether resources and capabilities are durable and whether rivals can imitate the competitive advantage they offer. Resources and capabilities are imitable if they are transferable or replicable.

**Durability:** Some resources are more durable than others and, hence, are a more secure basis for competitive advantage. The increasing pace of technological change is shortening the useful life span of most resources including capital equipment and proprietary technologies. Brands, on the other hand, can show remarkable resilience to time. Heinz sauces, Kellogg’s’ cereals, Campbell’s soup, Hoover vacuum cleaners, and Coca-Cola have been market leaders for over a century.

**Transferability:** The simplest means of acquiring the resources and capabilities necessary for imitating another firm’s strategy is to buy them. The ability to buy a resource or capability depends on its transferability – the extent to which it is mobile between companies. Some resources, such as finance, raw materials, components, machines produced by equipment suppliers, and employees with standardised skills (such as short-order cooks and auditors), are transferable and can be bought and sold with little difficulty. Some resources are not easily transferred – either they are entirely firm specific, or their value depreciates on transfer.

Sources of immobility include:

- Geographical immobility of natural resources, large items of capital equipment, and some types of employees may make it difficult for firms to acquire these resources without relocating themselves.

- Imperfect information regarding the quality and productivity of resources creates risks for buyers. Such imperfections are especially important in relation to human resources – hiring
decisions are typically based on very little knowledge of how the new employee will perform. Sellers of resources have better information about the characteristics of the resources on offer than potential buyers – this creates a “lemons problem” for firms seeking to acquire resources. Jay Barney has shown that different valuations of resources by firms can result in their either being underpriced or overpriced, giving rise to differences in profitability between firms.

- Complementarity between resources means that the detachment of a resource from its “home team” causes it to lose productivity and value. Thus, if brand reputation is associated with the company that created it, a change in ownership of the brand erodes its value. The transfer of the Thinkpad brand of notebook computers from IBM to Lenovo almost certainly eroded its value.

- Organisational capabilities, because they are based on teams of resources, are less mobile than individual resources. Even if the whole team can be transferred (in investment banking it has been commonplace for whole teams of analysts or M&A specialists to defect from one bank to another), the dependence of the team on a wider network of relationships and corporate culture may pose difficulties for recreating the capability in the new company.

**Replicability**: If a firm cannot buy a resource or capability, it must build it. In financial services, most innovations in new derivative products can be imitated easily by competitors. In retailing too, competitive advantages that derive from store layout, point-of-sale technology, charge cards, and extended opening hours can also be copied easily by competitors.

Less easily replicable are capabilities based on complex organisational routines. Some capabilities appear simple but prove difficult to replicate. Just-in-time scheduling and quality circles are relatively simple techniques used effectively by Japanese companies. Although neither require advanced manufacturing technologies or sophisticated information systems, their dependence on high levels of collaboration through communication and trust meant that many American and European firms had difficulty implementing them. Even where replication is possible, incumbent firms may benefit from the fact that resources and capabilities that have been accumulated over a long period can only be replicated at disproportionate cost by would-be imitators. Dierickx and Cool identify two major sources of incumbency advantage:

- Asset mass efficiencies occur where a strong initial position in technology, distribution channels, or reputation facilitates the subsequent accumulation of these resources.

- Time compression diseconomies are the additional costs incurred by imitators when attempting to accumulate rapidly a resource or capability. Thus, “crash programs” of R&D and
“blitz” advertising campaigns tend to be less productive than similar expenditures made over a longer period.

9.6.3 **APPROPRIATING THE RETURNS TO COMPETITIVE ADVANTAGE**

Who gains the returns generated by superior capabilities? We should normally expect that such returns accrue to the owner of that capability. However, ownership is not always clear-cut: capabilities depend heavily on the skills and efforts of employees – who are not owned by the firm. For companies dependent on human ingenuity and know-how, the mobility of key employees represents a constant threat to their competitive advantage. In investment banks and other human capital-intensive firms, the struggle between employees and shareholders to appropriate rents is reminiscent of the war for surplus value between labour and capital that Marx analysed. The prevalence of partnerships (rather than joint-stock companies) in professional service industries (lawyers, accountants, and management consultants) reflects the desire to avoid conflict between owners and its human resources.

The less clearly defined are property rights in resources and capabilities, the greater the importance of relative bargaining power in determining the division of returns between the firm and its individual members. In the case of team-based organisational capabilities, this balance of power between the firm and an individual employee depends crucially on the relationship between individuals’ skills and organisational routines. The more deeply embedded are individual skills and knowledge within organisational routines, and the more they depend on corporate systems and reputation, the weaker the employee is relative to the firm.

Conversely, the closer an organisational capability is identified with the expertise of individual employees, and the more effective those employees are at deploying their bargaining power, the better able employees are to appropriate rents. If the individual employee’s contribution to productivity is clearly identifiable, if the employee is mobile, and if the employee’s skills offer similar productivity to other firms, the employee is in a strong position to appropriate most of his or her contribution to the firm’s value added. In recent years investment banks and consulting companies have emphasised the team-based nature of their capabilities. In downplaying the role of individual expertise, they can improve their firm’s potential for appropriating the returns to their capabilities.

### Activity

If its rival imitates a company’s capability, should the company continue to treat it as a basis for competitive advantage? Discuss.
We have covered the principal concepts and frameworks for analysing resources and capabilities. How do we put this analysis into practice? Let us discuss the simple, step-by-step approach to how a company can appraise its resources and capabilities and then use the appraisal to guide strategy formulation.

Step 1 – Identify the Key Resources and Capabilities

To draw up a list of the firm’s resources and capabilities, we can begin from outside or inside the firm. From an external focus, we begin with key success factors. What factors determine why some firms in an industry are more successful than others and on what resources and capabilities are these success factors based?

Suppose we are evaluating the resources and capabilities of Volkswagen AG, the German-based automobile manufacturer. We can start with key success factors in the world automobile industry: low-cost production, attractively designed new models embodying the latest technologies, and the financial strength to weather the cyclical and heavy investment requirements of the industry. What capabilities and resources do these key success factors imply? They would include manufacturing capabilities, new product development capability, effective supply chain management, global distribution, brand strength, scale-efficient plants with up-to-date capital equipment, a strong balance sheet, and so on. To organise and categorise these various resources and capabilities, it is helpful to switch to the inside of VW and look at the company’s value chain, identifying the sequence of activities from new product development to purchasing, to supply chain management, to component manufacture, assembly, and right the way through to dealership support and after-sales service. We can then look at the resources that underpin the capabilities at each stage of the value chain.

Step 2 – Appraising Resources and Capabilities

Resources and capabilities need to be appraised against two key criteria. First is their importance: which resources and capabilities are most important in conferring sustainable competitive advantage? Second, where are our strengths and weaknesses as compared with competitors?

- **Assessing Importance**: The temptation in assessing which resources and capabilities are most important is to concentrate on customer choice criteria. What we must bear in mind, however, is that our ultimate objective is not to attract customers, but to make superior profit through establishing a sustainable competitive advantage. For this purpose we need to look beyond customer choice to the underlying strategic characteristics of resources and capabilities. To do this we need to look at the set of appraisal
criteria outlined in the previous section “Appraising Resources and Capabilities.” In the case of VW, many resources and capabilities are essential to compete in the business, but several of them are not scarce (for example, total quality management capability and technologically advanced assembly plants have become widely diffused within the industry), while others (such as IT capability and design capability) are outsourced to external providers – either way, they are “needed to play” but not “needed to win.” On the other hand, resources such as brand strength and a global distribution network, and capabilities such as fast-cycle new product development and global logistics capability, cannot be easily acquired or internally developed – they are critical to establishing and sustaining advantage.

- **Assessing Relative Strengths:** Objectively appraising the comparative strengths and weaknesses of a company’s resources and capabilities relative to competitors is difficult. In assessing their own competencies, organisations frequently fall victim to past glories, hopes for the future, and their own wishful thinking. The tendency toward hubris among companies – and their senior managers – means that business success often sows the seeds of its own destruction. Among the failed industrial companies in America and Europe are many whose former success blinded them to their stagnating capabilities and declining competitiveness: examples include the cutlery producers of Sheffield, England and the integrated steel giants of the United States. To identify and appraise a company’s capabilities, managers must look both inside and outside. Internal discussion can be valuable in sharing insights and evidence and building consensus regarding the organisation’s resource and capability profile. The evidence of history can be particularly revealing in reviewing instances where the company has performed well and those where it has performed poorly: do any patterns appear? Finally, to move the analysis from the subjective to the objective level, benchmarking is a powerful tool for quantitative assessment of performance relative to that of competitors. Benchmarking is “the process of identifying, understanding, and adapting outstanding practices from organisations anywhere in the world to help your organisation improve its performance.” Benchmarking offers a systematic framework and methodology for identifying particular functions and processes and then for comparing their performance with other companies.

Ultimately, appraising resources and capabilities is not about data, it’s about insight and understanding.

Every organisation has some activity where it excels or has the potential to excel. For Federal Express, it is a system that guarantees next-day delivery anywhere within the United States. For BMW it is the ability to integrate world-class engineering with design excellence and highly effective marketing. For
McDonald’s, it is the ability to supply millions of hamburgers from thousands of outlets throughout the world, with remarkable uniformity of quality, customer service, and hygiene. For General Electric, it is a system of corporate management that reconciles coordination, innovation, flexibility, and financial discipline in one of the world’s largest and most diversified corporations. All these companies are examples of highly successful enterprises. One reason why they are successful is that they have recognised what they can do well and have based their strategies on their strengths. For poor-performing companies, the problem is not necessarily an absence of distinctive capabilities, but a failure to recognise what they are and to deploy them effectively.

**Bringing Together Importance and Relative Strength:** Putting together the two criteria – importance and relative strength – allows us to highlight a company’s key strengths and key weaknesses. Consider, for example, Volkswagen AG. Dividing this display into four quadrants allows us to identify those resources and capabilities that we may regard as key strengths and those that we may identify as key weaknesses. For example, our assessment suggests that plant and equipment, engineering capability, and supply chain management are key strengths of VW, while distribution (a relatively weak presence in the US and Japan), new product development (no consistent record of fast-cycle development of market-winning new models), and financial management are key weaknesses.

**Step 3 – Developing Strategy Implications**

How do we exploit our key strengths most effectively? What do we do about our key weaknesses in terms of both upgrading them and reducing our vulnerability to them? Finally, what about our “inconsequential” strengths? Are these really superfluous, or are there ways in which we can deploy them to greater effect?

**Exploiting Key Strengths:** Having identified resources and capabilities that are important and where our company is strong relative to competitors, the key task is to formulate our strategy to ensure that these resources are deployed to the greatest effect. If engineering is a key strength of VW, then it may wish to seek differentiation advantage through technical sophistication and safety features. If VW is effective in managing government relations and is well positioned in the potential growth markets of China, Eastern Europe, and Latin America, exploiting this strength may require developing models that will appeal to these markets. To the extent that different companies within an industry have different capability profiles, this implies differentiation of strategies within the industry. Thus, Toyota’s outstanding manufacturing capabilities and fast-cycle new product development, Hyundai’s low-cost manufacturing capability that derives from its South Korean location and Peugeot’s design flair...
suggest that each company should be pursuing a distinctively different strategy.

- **Managing Key Weaknesses**: What does a company do about its key weaknesses? It is tempting to think of how companies can upgrade existing resources and capabilities to correct such weaknesses. However, converting weakness into strength is likely to be a long-term task for most companies. In the short to medium term, a company is likely to be stuck with the resources and capabilities that it inherits from the previous period. The most decisive – and often most successful – solution to weaknesses in key functions is to outsource. Thus, in the automobile industry, companies have become increasingly selective in the activities they perform internally. Through clever strategy formulation a firm may be able to negate the impact of its key weaknesses.

- **What about Superfluous Strengths?**: What about those resources and capabilities where a company has particular strengths, but these don't appear to be important sources of sustainable competitive advantage? One response may be to lower the level of investment from these resources and capabilities. If a retail bank has a strong, but increasingly underutilised, branch network, this may be an opportunity to prune its real estate assets and invest in IT approaches to customer services.

However, in the same way that companies can turn apparent weaknesses into competitive strengths, so it is possible to develop innovative strategies that turn apparently inconsequential strengths into valuable resources and capabilities.

### SELF ASSESSMENT QUESTIONS

Fill in the blank:

8. Organisational capability requires the expertise of various individuals to be integrated with ................. equipment, technology, and other resources.

### 9.8 DEVELOPING RESOURCES AND CAPABILITIES

Conventional approaches to developing resources and capabilities have emphasised gap analysis – identifying discrepancies between the current position and the desired future position, then adopting policies to fill those gaps. Such approaches are of limited value. In the case of resources, investing in areas of weakness – whether it is proprietary technology or manufacturing facilities – can be very expensive and, because of the complex complementarities between different resources, such investments may deliver limited returns. In the case of capabilities, because we know little about their structure or operation, developing them is a hazardous endeavour.
9.8.1 RELATIONSHIP BETWEEN RESOURCES AND CAPABILITIES

Possibly the most difficult problem in developing capabilities is that we know little about the linkage between resources and capabilities. In most sports, the relationship between the skills of the individual players and team performance is weak. In European football (soccer), teams built with modest expenditures often outplay star-studded, big-budget teams. In international competitions – the soccer world cup, Olympic games, and ice hockey world cup – small, resource-poor countries often humiliate the preeminent national teams.

Among business firms, we observe the same phenomenon. The firms that demonstrate the most outstanding capabilities are not necessarily those with the greatest resource endowments:

- In automobiles, General Motors has four times the output of Honda and four times the R&D expenditure, yet it is Honda, not General Motors, that is world leader in power train technology.
- In animated movies, the most successful productions in recent years were by newcomers Pixar (Toy Story, The Incredibles) and Aardman Animations (Wallace and Gromit) rather than by industry giant, Walt Disney.
- In telecom equipment it was the upstart Aircel rather than industry leaders Vodafone, Airtel, Idea Cellular and Reliance that established leadership in the new world of package switching.

According to Hamel and Prahalad, it is not the size of a firm’s resource base that is the primary determinant of capability, but the firm’s ability to leverage its resources. Resources can be leveraged in the following ways:

- **Concentrating resources** through the processes of converging resources on a few clearly defined and consistent goals; focusing the efforts of each group, department, and business unit on individual priorities in a sequential fashion; and targeting those activities that have the biggest impact on customers’ perceived value.

- **Accumulating resources** through mining experience in order to achieve faster learning, and borrowing from other firms – accessing their resources and capabilities through alliances, outsourcing arrangements, and the like.

- **Complementing resources** involves increasing their effectiveness through linking them with complementary resources and capabilities. This may involve blending product design capabilities with the marketing capabilities needed to communicate these to the market, and balancing to ensure that limited resources and capabilities in one area do not hold back the effectiveness of resources and capabilities in another.
Conserving resources involves utilising resources and capabilities to the fullest by recycling them through different products, markets, and product generations; and co-opting resources through collaborative arrangements with other companies.

9.8.2 REPLICATING CAPABILITIES

Growing capabilities requires that the firm replicates them internally. Some of the world’s most successful corporations are those that have been able to replicate their capabilities in different product and geographical markets. Ray Kroc’s genius was to take the original McDonald’s formula and replicate it thousands of times over in building a global chain of hamburger restaurants. Other leading service companies – Nike, Reebok, Levis – have built global presence on the principle that once a capability has been developed, its replication in another location can be achieved at a low cost.

If routines develop learning-by-doing, and the knowledge that underpins them is tacit, replication is far from easy. Replication requires systematisation of the knowledge that underlies the capability – typically through the formulation of standard operating procedures. Thus, McDonald’s has distilled its business system into operating procedures and training manuals that govern the operation and maintenance of every aspect of its restaurants. This systematisation presumes that the firm can more fully articulate the processes that underlie its capabilities. In the case of semiconductor fabrication, these processes are so complex and the know-how involved so deeply embedded that the only way that Intel can replicate its production capabilities is by replicating its lead plant in every detail – a process called “Copy Exactly.”

9.8.3 DEVELOPING NEW CAPABILITIES

Creating certain resources – a brand or an overseas distribution network – may be difficult, costly, and time consuming, but at least the challenge can be comprehended and planned. Creating organisational capability poses a much higher level of difficulty. If capabilities are based on routines that develop through practice and learning, what can the firm do to establish such routines within a limited time period? We know that capabilities involve teams of resources working together, but, even with the tools of business process mapping, we typically have sketchy understanding of how people, machines, technology, and organisational culture fit together to achieve a particular level of performance. In the same way that we can only speculate about what makes Tiger Woods the greatest golfer of our time, we are unable fully to diagnose how Dell achieves its brilliance at logistics management or how Electronic Arts has been able to develop video games that continue to set new standards in complexity, sophistication, and player involvement.
NOTES

- **Capability as a Result of Early Experiences**: Organisational capability is path dependent – a company’s capabilities today are the result of its history. More importantly, this history will constrain what capabilities the company can perform in the future. To understand the origin of a company’s capabilities, a useful starting point is to study the circumstances that existed and events that occurred at the time of the company’s founding and early development. How did Wal-Mart develop its super efficient system of warehousing and distribution? This system was not the result of careful planning and design, but of initial conditions: because of its rural locations, the company was unable to get reliable distribution from its suppliers, and so it established its own distribution system. How does one explain Wal-Mart’s amazing commitment to cost efficiency? Its management systems are undoubtedly important, but ultimately it is Wal-Mart’s origins in small-town Arkansas and the values and personality of its founder, Sam Walton, that sustains its obsession with efficiency and cost cutting.

- **Organisational Capability: Rigid or Dynamic?**: These long periods over which capabilities develop have important implications for firms’ capacity for change. The more highly developed a firm’s organisational capabilities are, the narrower its repertoire and the more difficult it is for the firm to adapt them to new circumstances. Dorothy Leonard argues that core capabilities are simultaneously core rigidities – they inhibit firms’ ability to access and develop new capabilities. Nevertheless, some companies appear to have the capacity to continually upgrade, extend, and reconfigure their organisational capabilities. David Teece and his colleagues have referred to dynamic capabilities as the “firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments.” There is little consensus in the literature as to what dynamic capabilities are Eisenhardt and Martin identify dynamic capabilities as routines that enable a firm to reconfigure its resources – these include R&D, new product development and acquisition capabilities. Zollo and Winter define dynamic capabilities as higher level processes through which the firm modifies its operating routines.

What is agreed is that dynamic capabilities are far from common. For most companies highly developed capabilities in existing products and technologies create barriers to developing capabilities in new products and new technologies. When adapting to radical change within an industry, or in exploiting entirely new business opportunities, are new firms at an advantage or disadvantage to established firms? It depends on whether the change or the innovation is competence enhancing or competence destroying. In TV manufacturing, the most successful new entrants were existing producers of radios – the new
technology was compatible with their capabilities. However, in most new industries, the most successful firms tend to be start-ups rather than established firms. In personal computers, it was newcomers such as Dell, Acer and Compaq that emerged as most successful during the 1990s. Among established firms, relatively few (IBM, Hewlett-Packard, and Toshiba) went on to significant success. Many others (e.g., Xerox, GE, Texas Instruments, AT&T, and Olivetti) exited. In wireless telephony, too, it was start-ups – Vodafone, Idea Cellular, Reliance – that were more successful than established telephone companies.

9.8.4 APPROACHES TO CAPABILITY DEVELOPMENT

So, how do companies go about developing new capabilities? Let us review few approaches commonly utilised.

- **Acquiring Capabilities:** Mergers and Acquisitions: If new capabilities can only be developed over long periods, then acquiring a company that has already developed the desired capability can short-circuit the tortuous process of capability development. In technologically fast-moving environments, established firms typically use acquisitions as a means of acquiring specific technical capabilities – Cisco Systems and Microsoft have each benefited substantially from such acquisitions. Microsoft’s adaptation to the internet and its entry into video games was achieved through multiple acquisitions. Each year, Microsoft hosts its VC Summit, where venture capitalists from all over the world are invited to market their companies. However, using acquisitions as a means of extending a company’s capability base involves major risks. On its own, acquisition does not achieve the intended goal. Once the acquisition has been made, the acquiring company must find a way to integrate the acquiree’s capabilities with its own. All too often, culture clashes, personality of management systems can result in the degradation or destruction of the very capabilities that the acquiring company was seeking.

- **Accessing Capabilities:** Strategic Alliances: Given the high cost of acquiring companies, alliances offer a more targeted and cost effective means to access another company’s capabilities. A strategic alliance is a cooperative relationship between firms involving the sharing of resources in pursuit of common goals. Long-running technical collaboration between HP and Canon has allowed both firms to enhance their printer technology. Strategic alliances comprise a wide variety of collaborative relationships, which include joint research, technology-sharing arrangements, shared manufacturing, joint marketing and/or distribution arrangements, and vertical partnerships, to mention but a few. Alliances may involve formal agreements or they may be entirely informal; they may or may not involve ownership links. Alliances may also be for the purpose of acquiring the partner’s capabilities through organisational learning.
Creating Capabilities: Creating organisational capability requires, first, acquiring the necessary resources and, second, integrating these resources. With regard to resource acquisition, particular attention must be given to organisational culture – values and behavioural norms are critically important influences on motivation and collaboration. In general, however, it is integration that presents the greatest challenge. We know that capabilities are based on routines – coordinated patterns of activity – but we know little about how routines are established. The assumption has been that they “emerge” as a result of learning-by-doing. Recent research, however, has emphasised on the role of management in developing organisational capability through motivation and deliberate learning. Organisational structure and management systems are of particular importance:

- Capabilities need to be housed within dedicated organisational units if organisational members are to achieve high levels of coordination. Thus, product development is facilitated when undertaken within product development units rather than through a sequence of “over-the-wall” transfers from one functional department to another. Similarly, capabilities in quality management, change management, corporate social responsibility, and customer are all best developed when organisational units are dedicated to such activities. Inevitably, aligning organisational structure with the multiple capabilities creates organisational complexity.

- Organisations need to take systematic approaches to capability development – the need to create, develop, and maintain organisational capabilities must be built into the design of management systems. The literature emphasises the roles of search, experimentation, and problem solving in capability development. Systematic approaches to capability development – including the creation of organisational routines for defensive and offensive manoeuvres – are central to the management and coaching of sports teams, but in most business organisations the heavy emphasis on maintaining current operations means that limited attention is devoted to explicit capability development. The management of motivation and incentives in one area that is relatively well developed. The literature places heavy emphasis on the role of strategic intent and performance aspirations in driving capability development. This has implications for both leadership and the design of incentives.

Organisations often discover that the organisational structure, management systems, and culture that support existing capabilities may be unsuitable for new capabilities. To resolve this problem, companies may find it easier to develop new capabilities in new organisational units that are geographically separated from the main company.
Given the complexity and uncertainty of programs to develop new organisational capabilities, an indirect approach may be preferable. If we cannot design new capabilities from scratch, but if we know what types of capabilities are required for different products, then by pushing the development of particular products we can pull the development of the capabilities that those products require. For such an approach to be successful it must be systematic and incremental.

Ultimately, developing organisational capabilities is about building the know-how of the company, which requires integrating the knowledge of multiple organisational members. One of the most powerful tools for managing such process is knowledge management.

Fill in the blanks:

9. Possibly the most difficult problem in developing capabilities is that we know little about the linkage between ......................... and capabilities.

10. Growing capabilities requires that the firm ......................... them internally.

Developing complex capabilities over a significant period of time requires a sequencing of products, where each stage of the sequence has specific capability development goals.

9.9 SUMMARY

- Internal environment comprises many features of the firm, but for the purposes of strategy analysis, the key issue is what the firm can do. This means looking at the resources of the firm and the way resources combine to create organisational capabilities.

- Our interest is the potential for resources and capabilities to establish sustainable competitive advantage. Systematic appraisal of a company’s resources and capabilities provides the basis for formulating (or reformulating) strategy. How can the firm deploy its strengths to maximum advantage? How can it minimise its vulnerability to its weaknesses? How can it develop and extend its capabilities to meet the challenges of the future?

- Despite the progress that has been made in the last ten years in our understanding of resources and capabilities, there is much that remains unresolved.

- The management systems of most firms devote meticulous attention to the physical and financial assets that are valued on their balance sheets; much less attention has been paid to the critical intangible and human resources of the firm, and even less to the identification and appraisal of organisational capability.
Most senior managers are now aware of the importance of their resources and capabilities, but the techniques of identifying, assessing, and developing them are woefully underdeveloped.

**Key Words**

- **Competitive Advantage**: Superiority gained by a firm when it can provide the same value as its competitors but at a lower price, or can charge higher prices by providing greater value through differentiation. Competitive advantage results from matching core competencies to the opportunities.

- **Internal Environment**: Conditions, entities, events, and factors within an organisation which influence its activities and choices, particularly the behaviour of the employees.

- **Mission Statement**: Written declaration of a firm’s core purpose and focus which normally remain unchanged, whereas business strategies and practices may frequently be altered to adapt to the changing circumstances.

- **Organisational Capability**: Ability and capacity of an organisation expressed in terms of its (1) Human resources: their number, quality, skills, and experience, (2) Physical and material resources: machines, land, buildings, (3) Financial resources: money and credit, (4) Information resources: pool of knowledge, databases, and (5) Intellectual resources: copyrights, designs, patents, etc.

- **Replication**: Replication requires systematisation of the knowledge that underlies the capability – typically through the formulation of standard operating procedures.

**9.10 Descriptive Questions**

1. In recent years Google has expanded from internet search across a broad range of internet services, including email, photo management, satellite maps, digital book libraries, blogger services, and telephony. To what extent has Google’s strategy focused on its resources and capabilities rather specific customer needs? What are Google’s principal resources and capabilities?

2. Microsoft’s main capabilities relate to the development and marketing of complex computer software and its greatest resource is its huge installed base of its Windows operating system. Does Microsoft’s entry into video game consoles indicate that its strategy is becoming divorced from its principal resources and capabilities?

3. Many companies announce in their corporate communications: “Our people are our most important resource.” In terms of Intangible Resources, can employees be considered to be of the utmost strategic importance?
4. Apply the approach outlined in the section “Putting Resource and Capability Analysis to Work” to your own business school. Begin by identifying the resources and capabilities relevant to success in the market for business education, appraise the resources and capabilities of your school, then make strategy recommendations regarding such matters as the programs to be offered and the overall positioning and differentiation of the school and its offerings.

5. Describe with examples the various types of resources in a firm.

6. How resources and capabilities can be stated as a source of profit? Explain.

7. How strategy can be based on resource and capabilities? Explain with a suitable diagram.

8. How organizational capabilities are classified? Discuss.

9. Describe the architecture of organizational capabilities.

10. What do you mean by replicating capabilities? Explain approaches to capability development.

### 9.11 ANSWERS AND HINTS

**ANSWERS FOR SELF-ASSESSMENT QUESTIONS**

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**HINTS FOR DESCRIPTIVE QUESTIONS**

1. Refer to 9.7

To identify the key resources and capabilities, appraising resources and capabilities and developing strategy implications.
NOTES

2. Refer to 9.8.1
   Possibly the most difficult problem in developing capabilities is that we know little about the linkage between resources and capabilities. According to Hamel and Prahalad, it is not the size of a firm’s resource base that is the primary determinant of capability, but the firm’s ability to leverage its resources. Resources can be leveraged in the following ways: concentrating resources, accumulating resources, complementing resources and conserving resources.

3. Refer to 9.6.1 & 9.6.2
   Yes, employees can be considered as a competitive advantage. For a resource or capability to establish a competitive advantage, two conditions must be present: scarcity and relevance. The profits earned from resources and capabilities depend not just on their ability to establish competitive advantage, but also on how long that advantage can be sustained. This depends on whether resources and capabilities are durable and whether rivals can imitate the competitive advantage they offer.

4. Refer to 9.7
   To identify the key resources and capabilities; appraising resources and capabilities including assessing importance, relative strength and bringing together importance and relative strength; developing strategy implications; developing strategy implications including exploiting key strengths, managing key weaknesses and superfluous strengths.

5. Refer to 9.4
   Tangible Resources, Intangible resources and Human resources are examples of various types of resources in a firm.

6. Refer to 9.3
   Among the two major sources of superior profitability: industry attractiveness and competitive advantage. Of these, competitive advantage is the more important. Internationalisation and deregulation have increased competitive pressure within most sectors; as a result, few industries (or segments) offer cosy refuges from vigorous competition. The industry factors account for only a small proportion of interfirm profit differentials. The distinction between industry attractiveness and competitive advantage (based on superior resources) as sources of a firm’s profitability corresponds to economists’ distinction between different types of profit (or rent).

7. Refer to 9.2
   Strategies can be based when the firms seeks to answer the question “what is our business?” in terms of the market they serve: “who are our customers?” and “which of their needs are we seeking to serve?”
When the external environment is in a state of flux, the firm itself, in terms of its bundle of resources and capabilities, may be a much more stable basis on which to define its identity. In general, the greater the rate of change in a firm’s external environment, the more likely it is that internal resources and capabilities will provide a secure foundation for long-term strategy. In fast-moving, technology-based industries, new companies are built around specific technological capabilities.

8. Refer to 9.5.1

On the basis of functional analysis and value chain organizational capabilities are classified.

9. Refer to 9.5.2

The architecture of organizational capabilities are classified as: Capability as Routine and Hierarchy of capabilities.

10. Refer to 9.8.2 & 9.8.4

Growing capabilities requires that the firm replicates them internally. Some of the world’s most successful corporations are those that have been able to replicate their capabilities in different product and geographical markets. Ray Kroc’s genius was to take the original McDonald’s formula and replicate it thousands of times over in building a global chain of hamburger restaurants. Acquiring capabilities, accessing capabilities and creating capabilities are some of the approaches to capability development.

### 9.12 SUGGESTED READINGS FOR REFERENCE

**SUGGESTED READINGS**

NOTES

E-REFERENCES

- http://www.makeitbusiness.com/keep-sustain-competitive-advantage/
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INTRODUCTORY CASELET

EXP STRATEGIC IMPLEMENTATION OF PANASONIC SYSTEMS

Does your bike fit you to a “t”? Would you like one that does? If you are willing to pay 20 to 30 percent more than you would pay for a mass-produced bike, you can get a Panasonic bike manufactured to exactly match your size, weight and colour preference. You can even get your bike within three weeks of your order (only two weeks if you visit Japan). This is accomplished by a process called the Panasonic Individual Customer System (PICS), which skilfully employs computers, robots and a small factory workforce to make one-of-a-kind models at the National Bicycle Industrial Company factory in Kokubu, Japan. The National Bicycle Industrial Company (NBIC), a subsidiary of electronics giant Matsushita, began making the bikes under the Panasonic brand in 1987. With the introduction of its Personalised Order System (POS) for the Japanese market (PICS was developed for overseas sales), the firm gained international attention as a classic example of mass customisation – producing products to order in lot sizes of one. The factory itself has 21 employees and a Computer-aided Design (CAD) system, and is capable of producing any of 8 million variations on 18 models of racing, road and mountain bikes in 199 colour patterns for virtually any sized person. The PIC system works in the following way. A customer visits a local Panasonic bicycle store and is measured on a special frame. The store-owner then faxes the specifications to the master control room at the factory. There an operator punches the specifications into a minicomputer, which automatically creates a unique blueprint and produces a bar code (The CAD blueprint takes about three minutes as opposed to three hours required by company drafts people prior to computerisation). The barcode is then attached to metal tubes and gears that ultimately become the customer’s personal bike. At various stages in the process, line workers access the customer’s requirement using the barcode label and a scanner. This information, displayed on a CRT terminal or computer terminal (CRT is defined as an electronic or electromechanical hardware device applicable for entering data into and displaying data from a computer or a computing system) at each station, is fed directly to the computer-controlled machines that are part of a local area computer network. At each step of production, a computer reading the code knows that each part belongs to a specific bike, and tells a robot where to weld or tells a painter which pattern to follow. Despite the use of computers and robots, the process is not highly automated. Gears are hand-wired, assembly is manual, and the customer’s name is silk-screened by hand with the touch of an artisan. The entire manufacturing and assembly time required to complete a single bike is 150 minutes, and the factory can make about 60 a day. NBIC’s mass-production factory (which makes

Contd...
90 percent of its annual production) can make a standard model in 90 minutes. One might ask why a customer must wait two to three weeks given that it takes less than three hours to make a custom model. According to the General Manager (Sales), “We could have made the time shorter, but we want people to feel excited about waiting for something special.” To provide a more personal touch to mass customisation, the factory is given the responsibility to communicate directly with the customer. Immediately after the factory receives the customer’s order, a personalised computer-generated drawing of the bicycle is mailed with a note thanking the customer for choosing the bike. This is followed up with a second personal note, three months later, inquiring about the customer’s satisfaction with the bicycle. Finally, a “bicycle birthday card” is sent to commemorate the first anniversary of the bicycle. NBIC is now contemplating extending the Panasonic system to all of its bicycle production, while Matsushita is considering applying the concept to industrial machinery.
After studying this chapter, you should be able to:

- Explain the meaning, definition and significance of functional level strategy
- Know how to transform strategies into actions
- Describe the role of leaders in functional level strategic management
- Appreciate the significance of a good structural design in functional level management
- Analyse the significance of channelising and utilising the information and control system
- Enumerate the human resource management in formulating functional level strategies
- Evaluate the implementing global strategies and related issues

10.1 INTRODUCTION

The functional level of the organisation is the level of the operating divisions and departments. The strategic issues at the functional level are related to business processes and the value chain. Functional level strategies in marketing, finance, operations, human resources, and Research and Development involve the development and coordination of resources through which business unit level strategies can be executed efficiently and effectively. Functional units of an organisation are involved in higher level strategies by providing input into the business unit level and corporate level strategy, such as providing information on resources and capabilities on which the higher level strategies can be based. Once the higher-level strategy is developed, the functional units translate it into discrete action-plans that each department or division must accomplish for the strategy to succeed. These all precautions will help to avoid failures in strategies put forward by me in the company and will lead to the success of the company.

10.2 CONVERTING STRATEGY INTO ACTION

Functional strategies deals with a relatively restricted plan designed to achieve objectives in a specific functional area, allocation of resources among different operations within that functional area and coordination among different functional areas for optimal contribution to the achievement of business and corporate level objectives.

**DEFINITION**

Functional strategies are concerned with “dealing the right things.”
The need for the functional strategy may arise out of a benchmarking strategy of an organisation where it wants to improve its functional structure efficient enough to compete with the leader or best performers in the similar field. If an organisation fails to implement a good functional strategy, then it would not be able to compete with its rivals/competitors in the long-run in terms of cost, quality and performance.

To plan and implement a functional strategy it is pertinent to have a proper review of the functional structure of an organisation. It is the functional structure which has to be modernised, updated, renovated with acquisition of technology, enhancement of core competence and other requisite factors necessary to remain competitive in efficient production of products and services, especially bringing credit and performance to the organisation in time of its excellent quality, better performance, competitive costs and good benefits.

The business world is facing a crisis in strategy. This is not because the majority of managers cannot produce a good strategy; most organisations develop their strategic plans well. The crisis has occurred because many businesses fail to execute their strategies effectively. Fortune magazine has repeatedly claimed that 70% of strategic failures are due to poor execution, not because of a lack of vision, and that only 10% of well formulated strategies are properly executed.

In 2006, the Balanced Scorecard Collaborative issued the following statistics on its website:

- 95% of a typical workforce does not understand its organisation’s strategy
- 90% of organisations do not execute their strategy effectively
- 86% of executive teams spend less than one hour per month discussing strategy
- 70% of organisations do not link middle management incentives to strategy
- 60% of organisations do not link strategy to budgeting.

To achieve its objectives, an organisation must be able to turn its vision, mission and core strategies into action. In many organisations, there is a major disconnect between forming the strategy and executing it. An ill-executed strategy not only leads to shareholder and board frustration, but can also cause high executive turnover. Strategy mapping is a recent development aimed at improving strategy implementation and execution.

Good functional strategy describes how an organisation plans to use employee, technological and business processes to meet customer expectations and shareholder demands. In short, strategy maps allow organisations to describe and communicate their strategies clearly.
Literature on strategic management has tended to concentrate on what is functional strategy and why companies should adopt it.

**Specify an Overriding Objective**

The first step is about linking the strategy map to the creation or reaffirmation of the organisation’s mission, core values and vision. It must distinguish between the organisation’s overriding objective and its strategies. Business leaders often confuse objective and strategy, and believe that satisfied customers, excellent service or being a low-cost provider form the overriding objective.

However, for profit making organisations, the overriding objective must be the bottom line. Here are some examples of an overriding objective:

- Increase the return on capital employed by 6% within three years
- Increase profit margin from 8% to 12% and net cash flow from five crore rupees to eight crore rupees within five years
- Increase the target share price by 20% by the next reporting date
- Increase total shareholder return relative to benchmark by 10% within two years.

**Value Proposition**

If an organisation wants to be a market leader, it must know what its customers value. Once it has this information, the organisation can re-focus its efforts to provide value drivers better than its rivals. The organisation then chooses the value proposition to help it win market share. It should refer to the three value propositions for competing in the market:

- Operational excellence (also known as best total cost)
- Product leadership
- Customer intimacy (also referred to as customer solutions).

The purpose of the value proposition stage is to choose one dominant value proposition and provide breakthrough customer value in it.

**Financial Strategies**

Organisations need to determine their plans and strategies around revenues and costs. Financial strategies fall into three main areas:

- Revenue growth
- Productivity
- Asset utilisation.

Every organisation must pay attention to each financial strategy area. However, the choice of value proposition in step 2 will decide which one will predominate in step 3.
Customer Strategies
Once the financial strategy has been determined, the organisation needs to make formal plans and strategies. The organisation must determine and articulate its customer strategies, which can be split into three main areas:

- Retaining and adding customers
- Increasing revenue per customer
- Reducing cost per customer

Execute through the Internal Perspective Strategies
The organisation must establish the actions that will realise its plans and strategies to win market share. The organisation must draft a plan to execute the ‘story’ that has been developed so far.

Plan the Learning and Growth Strategies
Once the financial and customer strategies are established and an execution plan devised, the organisation will almost certainly find some gaps in the knowledge, skills and abilities it needs. Companies develop appropriate learning and growth strategies to fill the gaps. After it has produced a strategy map at a basic corporate level following the six steps, organisations can ‘cascade’ it into several lower level divisional or geographic maps. Functional level strategy could play a big part in budgetary decision making because each budgetary measure can be seen in terms of its impact in achieving the strategic goals of the organisation.

SELF ASSESSMENT QUESTIONS
Fill in the blanks:
1. Functional strategies are concerned with dealing the ............
2. To plan and implement a functional strategy it is pertinent to have a proper review of the ....................... of an organisation.
3. Good functional strategy describes how an organisation plans to use employee, technological and business processes to meet customer ....................... and shareholder ..................

ACTIVITY
The success of a corporate strategy is based on the execution of the functional strategy. Discuss.

NOTE
Linking functional level strategy to budgeting can send an effective signal to employees as to where initiatives can be best deployed.
### 10.3 Role of Leaders in Functional Level Strategic Management

With the global economic downturn and tighter market competition, business leaders must develop innovative strategies that will keep their organisations profitable and in some cases survive.

#### Definition

Today’s leaders must create and execute their strategies with a clear vision, precise communication, short- and long-term goals and a step-by-step marketing plan to attract the kind of organisational buy-in that will turn their ideas into profits.

In order to successfully implement their strategies, CEOs and high-level executives must gain the support of their organisations.

When leaders and their executive teams take an active role in implementing strategies, this is a commitment to ensure the ideas or strategies become part of the organisation. Insightful leaders realise that for strategies to be successfully integrated into their organisations, they must align, measure, market and package the strategy to their business, customers and investment community as they would with any marketing campaign.

It is vital that communication is consistent and that leaders are involved in every aspect of the execution phases when putting innovative plans into action. Goal setting is another important element of the execution process. Several studies on why CEOs fail indicate that a main reason is not because of their strategies, but in their failure to successfully execute them. Below are the steps leaders must take to effectively align and develop an innovative marketing campaign that will allow them to successfully execute what they want to achieve.

#### 10.3.1 Looping Strategies with Tactical Tools

Before executing a plan of action, leaders must know how they can be most effective and creditable within their organisation, how they personally function as leaders and how they can best influence others to gain support and commit to their strategies. Leaders must clearly define and communicate their roles in the implementation process. For example, if a CEO’s strength lies in dealing face to face with people, she will not spend time speaking in the form of large groups. “Strategies must communicate to the organisation where it is heading and what tactical tools will get them to where they need to go.”

In addition, they must have an awareness of the strengths and weaknesses of their executive and management teams. This knowledge will help leaders to establish and appropriately determine what role each member of the executive and management team must play in the execution process. A leader must also know the role every
department must play, what will be expected, who will be accountable and what is to be gained. Leaders must align their own talents and skills with those of their executive and management teams for the implementation process to be as efficient as possible.

It is also essential to prepare for and examine all the possibilities for success and failure and what skills, talents and actions will be needed in any given situation. Leaders, executives and managers must constantly monitor, evaluate and perform progress checks to determine if their strategies are on track and to deal with negative surprises before they turn into critical set backs or derail the strategy. They must make sure that they are using their talent in the most effective and productive way possible. Strategies must communicate to the organisation where it is heading and what tactical tools will get them to where they need to go.

### 10.3.2 GATHERING AND SHARING INFORMATION

With the economy and markets changing at warp speed, leaders must know how to generate a steady flow of reliable information to help keep track of industry trends, changing customer needs and product cycles. It is imperative that CEOs and executives take a hands-on approach to develop sources that will provide a steady flow of trustworthy information. These sources of information can come from outside vendors, customers, industry experts and sales people.

When leaders, along with their management teams, have a steady flow of meaningful information, this will create insights into any changes that might need to be made to their strategies or execution plans. Also, by effectively managing information, leaders will be in a stronger position to identify potential problems or opportunities before the competition does. They will also be in a better position to know how to react and take advantage of the situation by creating the right kind of strategies and execution plans.

### 10.3.3 GOALS

When leaders only establish one goal of increasing sales or profits, they are setting themselves up for execution failure. Goal setting needs to be done by using a step-by-step process that creates clear, understandable and obtainable short- and long-term objectives that will produce the best strategy execution results. Leaders who use their management teams in the goal setting process have a higher probability that the goals are realistic and obtainable.

By setting short- and long-term execution goals for each division, leaders will help create ownership between the execution process and what needs to be accomplished. Also, leaders who incorporate timetables into their goals will achieve the best results. Each manager needs to conduct meetings with their teams to obtain feedback and evaluate the progress being made in reaching their customised goals.
NOTES

Setting the right short- and long-term goals should not be taken lightly if leaders want to succeed at executing their strategies.

10.3.4 COMMUNICATION

The flow and type of information communicated will play a significant role in how successful leaders will be in implementing their ideas throughout their organisations. It is imperative that the person delivering the messages is well respected and trusted throughout the company. A mistake that many leaders make is not keeping their people well informed about issues surrounding what they want to be accomplished. This is particularly true if the strategy is far reaching.

If workers are not kept informed, they will make up their own messages and stories in an attempt to fill in the blanks. This can cause the rumour mill to become the main source of information, causing leaders to lose control over the facts. Once leaders lose control over what messages are being communicated, this will have a negative impact on their ability to execute their strategies. “Leaders must align their own talents and skills with those of their executive and management teams for the implementation process to be as efficient as possible.”

When directing communicating to individual departments, leaders must personalise their messages so that everyone involved understands how strategies relate to them and what role they play in accomplishing the desired results. It is imperative to visualise the final goal. The first step is to establish a message that will not only communicate what the strategy is meant to accomplish, but will get others to come together in support of the changes that will be taking place.

A good example of how important communication is in the execution process is McDonalds’ strategy message: ‘Plan to Win’. To complement this message, McDonald’s created five easy-to-understand drivers that directly related to the main message. These drivers clearly communicate what steps McDonald’s needed to take for the ‘Plan to Win’ strategy to be successful. Next, it set a growth strategy, creating a message of ‘being better and not just bigger’.

The company communicated its strategy message through its annual report, website, company newsletters, corporate speeches and by its actions. Today, its customer satisfaction scores are on the rise; in 2008, McDonald’s achieved its sixth consecutive year of comparable same-store sales growth. Remember, even if a company has the greatest ideas, best products and brilliant concepts, without the right messages and communication plan it will be hard to get the kind of organisational buy-in needed to successfully execute the strategy.

To get maximum performance from department heads and line and project managers, leaders must put aside any personal agendas—real or perceived—and monitor how key employees are interpreting and communicating the goals and objectives to those who report to them. It is important that everyone is on the same page in the way they are
communicating what is expected from their subordinates. In other words, the organisation must be moving in the same direction and doing what is necessary to produce the desired results.

10.3.5 ACCOUNTABILITY AND MEASURING PROCESSES
Leaders must put in place systems for how managers will be evaluated and held accountable for their execution performance. The systems should include a reward structure and what management practices are required to obtain such rewards. This information will help managers and their teams understand what actions will need to be taken, what will remain the same and what kind of changes will be required to successfully implement the strategies.

A well-defined plan outlining how success will be measured can provide clarification to both the organisation and managers on what direction they need to be headed in. It is important that the process by which managers will be measured is well defined and easy to interrupt. Measurement systems can be a tactical tool to create the right kind of actions, behaviours and focus that will help implement the strategy. Successful measurements that focus on what is important, what practices are needed, the strategy itself and how an organisation’s culture must work will have the best opportunity to succeed. Without complete clarity, measurements can become counterproductive and produce results that were not intended.

10.3.6 ORGANISATIONAL DESIGN
“[To gain the necessary insights, leaders must conduct in-depth research within their organisations to find out what has worked in the past and why.”](#) To gain the necessary insights, leaders must conduct in-depth research within their organisations to find out what has worked in the past and why. If an organisation has a global presence, special care must be taken to ensure the research identifies differences that might exist from one culture to the next.

Leaders must recognise that making large-scale changes to an organisation and its culture is not an easy task. This is why leaders and their teams need to debate and examine what changes are truly necessary and if they can be done. A number of factors will influence an organisation’s ability to change and accept new ideas. Such factors include maturity stage, openness to change, the relationship between management and workers, the overall design of the organisation, and its leaders’ skills at implementing change.

10.3.7 STRATEGY ALIGNMENT
It is important that when leaders develop their strategy that it is aligned to the culture of the company. An example is an organisation that has a long history of producing high-end, quality products but in a difficult economy needs to reduce expenses. The culture of the company is based on pride in the quality of their products. If the leader
has a strategy of reducing the cost of their product by 20% and takes the focus off quality, this might be disruptive to the organisation’s heritage and culture. It could result in the loss of good employees. On the other hand, if a leader approaches the same situation by challenging the organisation to produce the highest quality product possible at the needed price, this might produce the desired results without changing the deep history and culture of the organisation.

10.3.8 MAKING IT WORK

Strategy execution is a complex process that cannot be taken lightly. Every strategy is different and will require a unique execution plan of action that will align the strategy to the organisation’s culture, processes and structures. Leaders need to know the depth of their management teams and align what can be done with what needs to be done. Leaders who take a hands-on approach exert a higher level of influence over the execution process and can generate the kind of organisational buy-in needed to make the strategy take hold.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

4. If workers are not kept .........................., they will make up their own messages and stories in an attempt to fill in the blanks.

5. Leaders must put in place systems for how managers will be evaluated and held accountable for their ......................

6. Strategy execution is a complex process that cannot be taken ......................

**ACTIVITY**

Empowerment of functional level employees enhances the success of functional strategy. Discuss.

**NOTE**

It is the responsibility of leaders and their executive teams to set change priorities and to develop plans to help their organisations accept and adjust to the desired changes. Also, leaders must know how every department will be affected and who will be responsible for getting the right things done.

10.4 STRUCTURAL DESIGN

Functional structure in the Functional level strategy formulation is most often called structural design. In a functional structure, teams or groups are created based on common functions in a bottom-up manner. The result is a set of functional units such as engineering, marketing,
finance, human resource etc. that are controlled and coordinated from the top level management. Functional structure are the most common type of structural design and have evolved from the concept of high specialisation, high control framework of manufacturing organisations tuned towards high efficiency. Functional management is more technical oriented and less product or business oriented, while they are skilled in taking decisions in their functional areas, they are weak in the areas of product business plans, market study and product release management. If the organisation does have multiple product lines, then the functional hierarchy at lowest level does get divided along product lines, thereby creating deeper hierarchies.

![Functional Structure Diagram](image)

**Figure 10.1: Structural Design for Functional Level Strategy**

### 10.4.1 FUNCTIONAL STRUCTURE

Functional structures are typically highly hierarchical; hence they inherit the properties of hierarchical structure.

- **Maximises Functional Performance:** All the human knowledge, skills and infrastructure required for a particular functional activity are consolidated in a single sub-organisation, this facilitates sharing of valuable expertise by superiors with their subordinates. The functional units are managed by leaders who have in-depth knowledge and experience; they are able to control the unit very effectively. Hence it harvests the potential of the unit without duplication of scarce resources, maximising their utilisation.

- **Cultivates Specialists:** This type of structure promotes career development of individuals aspiring to be technical specialists of their field in large organisations. If the organisation has properly crafted performance management that promotes the visibility of individual skills, functional structure makes it easier to coach other and climb the hierarchical ladder.

### Weaknesses of Functional Structure

- **Restrictive Organisational View:** Each functional unit has expertise in its own field, but lacks broader awareness about the organisations objectives or even the products. The responsibility of successfully integrating the organisation lies with few top
level executives, at the same time, the organisational structure limits the capabilities of the functional managers to occupy top management positions. Thus, even though such organisations might be effective initially, being controlled by few founding members, its long term efficiency is doubtful.

- **Slow Response**: Functional units cannot respond to fast changes in customer demands or the product since only the top level management has broad knowledge and the decision making authority. The management also performs the role of coordinating tasks across functional units, thus unless a complete plan of action is not formulated by the managements, little progress can be made in individual functional units.

- **Poor Accountability**: Due to weak link between product and functional units, it is hard to correlate profits of individual products to the budget and spending of individual units. The units that offer support to other functional units, like human resource or IT department, do not contribute directly to the revenue, yet they are essential components that helps in running the organisation smoothly.

### Most Effective Conditions

- **Small/medium size or few products**: Functional units are effective when the organisation has only few products or is small in size; the drawback of limited view of the entire organisation gets negligible. One way to test it is to try to restructure the organisation from a hierarchical to horizontal, if the resulting structure is not too different, it implies that organisation is inherently lacking a horizontal dimension.

- **Stable external environment**: Functional units are effective when the organisation has routine technologies and there is less probability of emergence of competitive technology that is radically different.

### 10.4.2 PRODUCT DIVISIONAL STRUCTURE

In a divisional structure, the teams are organised in set of divisions, where each division corresponds to the end product or services provided by the organisation. Each division has its own set of functional units like research, manufacturing, marketing etc and is completely self-contained. A divisional structure is less hierarchical than functional; it is formed by decomposing the functional structure along the product lines. Unlike functional management, the divisional management is more skilled along product business and lesser in core technical competencies.

### Strengths of Divisional Structure

- **Clear Accountability**: Structuring along the product lines provides clear correlation between the expense and profit of
the individual divisions. The business objectives of the division can be formulated more objectively and the expectations can be better agreed.

- **Departmental Coordination**: An objective accountability leads to better cohesion within the boundaries of the department; it creates a win-win situation where teams have mutual benefit in collaborating with each other.

- **Broader Skills Development**: Active collaborations between different specialisations provide employees with opportunities for learning new skills beyond their own area of expertise. It is easier to comprehend the dynamics of a product and therefore is best suited for nurturing general managers in an organisation.

- **Unstable Environment**: Since each division is product based and self-reliant, it can respond much quickly to changes in the external environment.

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**Weaknesses of Divisional Structure**

- **Resource Duplication**: In order to make each division independent, some of the resources which could have been shared are rather duplicated. Specialists with particular domain knowledge cannot be shared across divisional boundaries.

- **Inhibits Career Growth of Specialists**: While divisional structures are good for nurturing top level managers, they are bad for technical specialists. Technical people feel alienated from their peers in other divisions and have poor exposure to the developments across the organisations.
NOTES

- **Divisional Affiliations**: The employees feel more affiliated towards their own department and would still lack the sense of being part of a larger organisation, they might know their own purpose but might not understand how they might related to organisation’s objectives.

- **Difficult Product Integration**: When an organisation produces multiple products which might be used together or are part of a larger product, the integration task becomes challenging since there is little coordination between the divisions. The product management task across different division requires regular sync-ups but the structure inherently provides little motivation for the product managers to seek this larger goal. Each divisional manager is more concerned about delivering his product and would view the integration as not part of his job or the problem.

**Most Effective Conditions**

- **Very Large Corporations**: The divisional structure is most effective for large corporations that have indeed multiple products that are poorly interrelated.

- **Competitive Environment**: The ability to respond rapidly to the external changes makes divisional structure best suited for highly competitive external environment.

### 10.5 INFORMATION AND CONTROL SYSTEM

Information and controls are to be an integral part of any organisation’s functional level strategies. The information system of the organisation should be up to date as it should have complete knowledge about the market trends and its close competitors. With a strong and efficient information system an organisation and formulate its strategies or can alter the strategies if any time its need arises. A bad information system (internal or external) can be a great hurdle in achieving success or the target of the organisation. Controls consist of all the measures taken by the organisation for the purposes of:

- Protecting its resources against waste, fraud, and inefficiency;
- Ensuring accuracy and reliability in accounting and operating data;
- Securing compliance with the policies of the organisation; and
- Evaluating the level of performance in all organisational units of the organisation.

Controls are simply good business practices.

### 10.5.1 RESPONSIBILITY

Everyone within the organisation has some role in controls. The roles vary depending upon the level of responsibility and the nature of involvement by the individual. The Board of President and senior
executives establish the presence of integrity, ethics, competence and a positive control environment. The department heads have oversight responsibility for controls within their units. Managers and supervisory personnel are responsible for executing control policies and procedures at the detail level within their specific unit. Each individual within a unit is to be cognizant of proper internal control procedures associated with their specific job responsibilities.

The internal audit role is to examine the adequacy and effectiveness of the company internal controls and make recommendations where control improvements are needed. Since internal auditing is to remain independent and objective, the internal audit office does not have the primary responsibility for establishing or maintaining internal controls.

### 10.5.2 ELEMENTS OF INTERNAL CONTROL

Internal control systems operate at different levels of effectiveness. Determining whether a particular internal control system is effective is a judgement resulting from an assessment of whether the five components – Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring – are present and functioning. Effective controls provide reasonable assurance regarding the accomplishment of established objectives.

**Control Environment**: The control environment, as established by the organisation's administration, sets the tone of the organisation and influences the control consciousness of its people. Managers of each department, area or activity establish a local control environment. This is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include:

- Integrity and ethical values;
- The commitment to competence;
- Leadership philosophy and operating style;
- The way management assigns authority and responsibility, and organises and develops its people;
- Policies and procedures.

**Risk Assessment**: Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economics, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Objectives must be established before Managers can identify and take necessary steps to manage risks. Operations objectives relate to
effectiveness and efficiency of the operations, including performance and financial goals and safeguarding resources against loss. Financial reporting objectives pertain to the preparation of reliable published financial statements, including prevention of fraudulent financial reporting. Compliance objectives pertain to laws and regulations which establish minimum standards of behaviour.

The process of identifying and analysing risk is an ongoing process and is a critical component of an effective internal control system. Attention must be focused on risks at all levels and necessary actions must be taken to manage. Risks can pertain to internal and external factors. After risks have been identified they must be evaluated.

Managing change requires a constant assessment of risk and the impact on internal controls. Economic, industry and regulatory environments change and entities’ activities evolve. Mechanisms are needed to identify and react to changing conditions.

Control Activities: Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity’s objectives. Control activities occur throughout the organisation, at all levels, and in all functions. They include a range of activities as diverse as approvals, authorisations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties. Control activities usually involve two elements: a policy establishing what should be done and procedures to effect the policy. All policies must be implemented thoughtfully, conscientiously and consistently.

Information and Communication: Pertinent information must be identified, captured and communicated in a form and time frame that enables people to carry out their responsibilities. Effective communication must occur in a broad sense, flowing down, across and up the organisation. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream.

Monitoring: Control systems need to be monitored – a process that assesses the quality of the system’s performance over time. Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities, and other actions personnel take in performing their duties that assess the quality of internal control system performance.

The scope and frequency of separate evaluations depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported immediately to top administration and governing boards.
Control systems change over time. The way controls are applied may evolve. Once effective procedures can become less effective due to the arrival of new personnel, varying effectiveness of training and supervision, time and resources constraints, or additional pressures. Furthermore, circumstances for which the internal control system was originally designed also may change. Because of changing conditions, management needs to determine whether the internal control system continues to be relevant and able to address new risks.

10.5.3 COMPONENTS OF THE CONTROL ACTIVITY

- Internal controls rely on the principle of checks and balances in the workplace.
- Personnel need to be competent and trustworthy, with clearly established lines of authority and responsibility documented in written job descriptions and procedures manuals. Organisational charts provide a visual presentation of lines of authority and periodic updates of job descriptions ensure that employees are aware of the duties they are expected to perform.
- Authorisation procedures need to include a thorough review of supporting information to verify the propriety and validity of transactions. Approval authority is to be commensurate with the nature and significance of the transactions and in compliance with organisation’s policy.
- Segregation of duties reduce the likelihood of errors and irregularities. An individual is not to have responsibility for more than one of the three transaction components: authorisation, custody, and record keeping. When the work of one employee is checked by another, and when the responsibility for custody for assets is separate from the responsibility for maintaining the records relating to those assets, there is appropriate segregation of duties. This helps detect errors in a timely manner and deter improper activities; and at the same time, it should be devised to prompt operational efficiency and allow for effective communications.
- Physical restrictions are the most important type of protective measures for safeguarding company assets, processes and data.
- Documentation and record retention is to provide reasonable assurance that all information and transactions of value are accurately recorded and retained. Records are to be maintained and controlled in accordance with the established retention period and properly disposed of in accordance with established procedures.
- Monitoring operations is essential to verify that controls are operating properly. Reconciliations, confirmations, and exception reports can provide this type of information.
NOTES

7. Information and ................. are an integral part of any organisation’s functional level strategies.
8. Internal control systems operate at different levels of ..............
9. Objectives must be established before Managers can identify and take necessary steps to .........................

ACTIVITY

Enlightened democracy in the organisation on need to know basis strengthens the control system. Discuss.

NOTE

The effectiveness of the internal controls are enhanced through the reviews performed and recommendations made by internal auditing.

10.6 HUMAN RESOURCES

Human resource management strategies, as with the other functional areas, occur at the corporate, business, and functional levels. Human resource activities are primarily executed at the functional level because that is where the workers are.

At the functional level, human resource management includes translating corporate and business unit strategies into specific functional activities. These include setting functional goals, analysing strengths and weaknesses, determining distinctive competencies and competitive advantages, and developing, evaluating, and communicating functional plans within the organisation. Major activities of human resources include planning for future human resource needs, recruiting personnel, placing people in new jobs, compensating them, evaluating their performance, training them, developing them into more efficient employees, and enhancing their work environment.

The most effective strategy for any organisation, and particularly large organisations and their business units, is to develop commitment among employees to the organisation and to the job. Many organisations consider human resources to be their most important asset and competitive strategic advantage.

In today’s global marketplace, to attract and retain competent employees, human resource managers must consider a variety of progressive working conditions and benefits, including customised fringe benefits, child day care and flexible work hours (four-day
weeks). Also, high performance requires appropriate reward systems to encourage and promote team-work.

In the past, during growth periods, companies were often able to retain employees through temporary downturns, a paternalistic strategy which created a loyal workforce that worked hard with little turnover. Today’s strategies of downsizing, restructuring, outsourcing, and so on have resulted in a reduction of corporate loyalty.

Human resource systems provide support to top management for implementing the organisational strategy by providing the people, skills, and systems to facilitate and reinforce the behaviour required. Matching the organisation’s human assets with its strategy can require changing the individuals assigned to a job or changing the behaviour of the individuals in their positions. It is the task of human resource management to provide the means to do either. This is done through systems for planning, staffing, appraisal, compensation and rewards.

Human resource planning integrates functional plans and activities into strategic plans in a manner consistent with the organisation’s business plans. Human resource planning includes resource planning and forecasting, career management, work scheduling and job design.

The contributions of human resource management to strategic planning include knowledge of the corporate culture in assessing the feasibility of the strategy. Knowledge of the organisation’s available skills as well as skills obtainable in outside labour markets facilitates assessing the costs of the alternatives. Human resource planning greatly enhances environmental scanning by providing external information on education trends, labour markets, laws, and regulations, as well as internal information on productivity, absenteeism, turnover, and other people’s problems. Assessing future needs involves both quantitative forecasting and qualitative forecasting.

Staffing consists of recruiting, selection, and placement of persons with the appropriate competencies. Staffing involves matching the position with the best functional background depending on the strategic direction desired, and identifying individuals that fit the job requirements. Among the factors to be considered are the overall framework of the organisation’s global philosophy, including ethnocentrism, polycentricism, regiocentrism and geocentricism.

Because the optimum source of talent for the future of any organisation is found in its present employees, the staffing aspect of human resource management includes training and development to develop new skills and behaviours that will be needed in the future for strategic implementation. Such activities range from managerial training in cultural values to teaching employees new skills based on new technologies, and include cultivating cultural sensitivity for international assignments. In addition to training, employee development must include individual career path planning aimed at aligning employee aspirations and capabilities with the organisation’s goals.
Appraisal and reward systems tell the organisation’s members what is important, therefore providing reinforcement for the proper behaviour. It is essential that the relevant behaviour is well defined and accurately measured, and the criteria used to appraise performance must reflect strategic goals and plans. Executive compensation must be in sync with strategic direction. Accordingly, a compensation plan should define proper performance behaviour, measure results, and tie compensation to performance. The focus of compensation plans should be on organisational strategy; accordingly, multi-year evaluations encourage a long term perspective.

Compensation arrangements are becoming more complex and include not only pay, but other benefits as well. These benefits can often attract and retain qualified individuals to fill key positions. The appraisal and reward system also involves performance management and control aspects, including: employee outplacement assistance, personnel policy, and program evaluation. Human resource management also includes handling labour relations, collective bargaining process, and labour-management cooperation.

**Self Assessment Questions**

Fill in the blank:

10. At the functional level, human resource management includes translating corporate and business unit strategies into specific ________________

**Activity**

Decisions should be taken at the point where the company meets the customer. Discuss.

**10.7 Implementing Global Strategies**

The main role of a CEO’s is to communicate a vision and to guide strategic planning. Clarity and consistent communication, from mapping desired outcomes to designing performance measures, seem to be essential to success. Successful leaders have often engaged their teams by simply telling the story of their shared vision, and publicly celebrating large and small wins, such as the achievement of milestones. To ensure that the vision is shared, teams need to know that they can test the theory, voice opinions, challenge premises, and suggest alternatives without fear of reprimand.

Implementing strategic plans may require leaders who lead through inspiration and coaching rather than command and control. Recognising and rewarding success, inspiring, and modelling behaviours is more likely to result in true commitment than use of authority, which can lead to passive resistance and hidden rebellion.
10.7.1 IMPLEMENTING STRATEGIC PLANS

Once strategies have been agreed on, the next step is implementation; this is where most failures occur. It is not uncommon for strategic plans to be drawn up annually, and to have no impact on the organisation as a whole. A common method of implementation is hoopla—a total communication effort. This can involve slogans, posters, events, memos, videos, Web sites, etc. A critical success factor is whether the entire senior team appears to buy into the strategy, and models appropriate behaviours. Success appears to be more likely if the CEO, or a very visible leader, is also a champion of the strategy.

Strategic measurement can help in implementing the strategic plan. Appropriate measures show the strategy is important to the leaders, provide motivation, and allow for follow-through and sustained attention. By acting as operational definitions of the plan, measures can increase the focus of the strategy, aligning the workforce around specific issues. The results can include faster changes (both in strategic implementation, and in everyday work); greater accountability (since responsibilities are clarified by strategic measurement, people are naturally more accountable); and better communication of responsibilities (because the measures show what each group’s primary responsibility is), which may reduce duplication of effort.

Creating a strategic map (or causal business model) helps identify focal points; it shows the theory of the business in easily understood terms, showing the cause and effect linkages between key components. It can be a focal point for communicating the vision and mission, and the plan for achieving desired goals. If tested through statistical-linkage analysis, the map also allows the organisation to leverage resources on the primary drivers of success.

The senior team can create a strategic map (or theory of the business) by identifying and mapping the critical few ingredients that will drive overall performance. This can be tested (sometimes immediately, with existing data) through a variety of statistical techniques; regression analysis is frequently used, because it is fairly robust and requires relatively small data sets.

This map can lead to an instrument panel covering a few areas that are of critical importance. The panel does not include all of the areas an organisation measures, rather the few that the top team can use to guide decisions, knowing that greater detail is available if they need to drill down for more intense examination. These critical few are typically within six strategic performance areas: financial, customer/market, operations, environment (which includes key stakeholders), people, and partners/suppliers. Each area may have three or four focal points; for example, the people category may include leadership, common values, and innovation.

Once the strategic map is defined, organisations must create measures for each focal point. The first step is to create these measures at an organisational level. Once these are defined, each functional area should identify how they contribute to the overall measures, and then
define measures of their own. Ideally, this process cascades downward through the organisation until each individual is linked with the strategy and understands the goals and outcomes they are responsible for and how their individual success will be measured and rewarded.

Good performance measures identify the critical focus points for an organisation, and reward their successful achievement. When used to guide an organisation, performance measures can be a competitive advantage because they drive alignment and common purpose across an organisation, focusing everyone’s best efforts at the desired goal. But defining measures can be tricky. Teams must continue to ask themselves, “If we were to measure performance this way, what behaviour would that motivate?” For example, if the desired outcome is world-class customer service, measuring the volume of calls handled by representatives could drive the opposite behaviour.

10.7.2 CASCADING THE PLAN

In larger organisations, cascading the strategic plan and associated measures can be essential to everyday implementation. To a degree, hoopla, celebrations, events, and so on can drive down the message, but in many organisations, particularly those without extremely charismatic leaders, this is not sufficient.

Cascading is often where the implementation breaks down. For example, only sixteen percent of the respondents in a 1999 Metrus Group survey believed that associates at all levels of their company could describe the strategy. In a 1998 national survey of Quality Progress readers, cascading was often noted as being a serious problem in implementing strategic measurement systems.

Organisations have found it to be helpful to ask each functional area to identify how they contribute to achieving the overall strategic plan (“functional area” designating whatever natural units exist in the organisation-functions, geographies, business units, etc.). Armed with the strategic map, operational definitions and the overall organisational strategic performance measures, each functional area creates their own map of success and defines their own specific performance measures. They can follow the model outlined above starting with their own SWOT analysis.

Example: In the 1990s, Sears cascaded its strategic plan to all of its stores through local store strategy sessions involving all employees. The plan was shown graphically by a strategy map, and reinforced through actions such as the sale of financial businesses such as Allstate. Online performance measures helped store managers to gain feedback on their own performance, and also let them share best practices with other managers.

Functional area leaders may be more successful using a cascade team to add input and take the message forward to others in the area. Developing ambassadors or process champions throughout the organisation to support and promote the plan and its implementation can also enhance the chances of success. These champions may be
candidates for participation on the design or cascade teams, and should be involved in the stakeholder review process.

10.7.3 STRATEGY IMPLEMENTATION ISSUES

Strategy implementation almost always involves the introduction of change to an organisation. Managers may spend months, even years, evaluating alternatives and selecting a strategy. Frequently this strategy is then announced to the organisation with the expectation that organisation members will automatically see why the alternative is the best one and will begin immediate implementation. When a strategic change is poorly introduced, managers may actually spend more time implementing changes resulting from the new strategy than was spent in selecting it. Strategy implementation involves both macro-organisational issues (e.g., technology, reward systems, decision processes, and structure), and micro-organisational issues (e.g., organisation culture and resistance to change).

Macro-organisational Issues of Strategy Implementation

Macro-organisational issues are large-scale, system-wide issues that affect many people within the organisation. Galbraith and Kazanjian argue that there are several major internal subsystems of the organisation that must be coordinated to successfully implement a new organisation strategy. These subsystems include technology, reward systems, decision processes, and structure. As with any system, the subsystems are interrelated, and changing one may impact others.

Technology can be defined as the knowledge, tools, equipment, and work methods used by an organisation in providing its goods and services. The technology employed must fit the selected strategy for it to be successfully implemented. Companies planning to differentiate their product on the basis of quality must take steps to assure that the technology is in place to produce superior quality products or services. This may entail tighter quality control or state-of-the-art equipment. Firms pursuing a low-cost strategy may take steps to automate as a means of reducing labour costs. Similarly, they might use older equipment to minimise the immediate expenditure of funds for new equipment.

Reward systems or incentive plans include bonuses and other financial incentives, recognition, and other intangible rewards such as feelings of accomplishment and challenge. Reward systems can be effective tools for motivating individuals to support strategy implementation efforts. Commonly used reward systems include stock options, salary raises, promotions, praise, recognition, increased job autonomy, and awards based on successful strategy implementation. These rewards can be made available only to managers or spread among employees throughout the organisation. Profit sharing and gain sharing are sometimes used at divisional or departmental levels to more closely link the rewards to performance.
Questions and problems will undoubtedly occur as part of implementation. Decisions pertaining to resource allocations, job responsibilities, and priorities are just some of the decisions that cannot be completely planned until implementation begins. Decision processes help the organisation make mid-course adjustments to keep the implementation on target.

Organisational structure is the formal pattern of interactions and coordination developed to link individuals to their jobs and jobs to departments. It also involves the interactions between individuals and departments within the organisation. Current research supports the idea that strategies may be more successful when supported with structure consistent with the new strategic direction. For example, departmentalisations on the basis of customers will likely help implement the development and marketing of new products that appeal to a specific customer segment and could be particularly useful in implementing a strategy of differentiation or focus. A functional organisational structure tends to have lower overhead and allows for more efficient utilisation of specialists, and might be more consistent with a low-cost strategy.

Micro-organisational Issues of Strategy Implementation

Micro-organisational issues pertain to the behaviour of individuals within the organisation and how individual actors in the larger organisation will view strategy implementation. Implementation can be studied by looking at the impact organisation culture and resistance to change has on employee acceptance and motivation to implement the new strategy.

Peters and Waterman focused attention on the role of culture in strategic management. Organisational culture is more than emotional rhetoric; the culture of an organisation develops over a period of time is influenced by the values, actions and, beliefs of individuals at all levels of the organisation.

Persons involved in choosing a strategy often have access to volumes of information and research reports about the need for change in strategies. They also have time to analyse and evaluate this information. What many managers fail to realise is that the information that may make one strategic alternative an obvious choice is not readily available to the individual employees who will be involved in the day-to-day implementation of the chosen strategy. These employees are often comfortable with the old way of doing things and see no need to change. The result is that management sees the employee as resisting change.

Employees generally do not regard their response to change as either positive or negative. An employee’s response to change is simply behaviour that makes sense from the employee’s perspective. Managers need to look beyond what they see as resistance and attempt to understand the employee’s frame of reference and why they may see the change as undesirable.
10.7.4 FORCE FIELD ANALYSIS

One technique for evaluating forces operating in a change situation is force field analysis. This technique uses a concept from physics to examine the forces for and against change. The length of each arrow as shown in Table 10.1 represents the relative strength of each force for and against change. An equilibrium point is reached when the sum of each set of forces is equal. Movement requires that forces for the change exceed forces resisting the change. Reducing resisting forces is usually seen as preferable to increasing supporting forces, as the former will likely reduce tension and the degree of conflict.

This model is useful for identifying and evaluating the relative power of forces for and against change. It is a useful way of visualising salient forces and may allow management to better assess the probable direction and speed of movement in implementing new strategies. Forces for change can come from outside the organisation or from within. External forces for change may result from socio-cultural factors, government regulations, international developments, technological changes, and entry or exit of competitors. Internal forces for change come from within the organisation and may include changes in market share, rising production costs, changing financial conditions, new product development, and so on.

Similarly, forces resisting change may result from external or internal sources. Common external pressures opposing change are contractual commitments to other businesses (suppliers, union), obligations to customers and investors, and government regulations of the firm or industry. Internal forces resisting change are usually abundant; limited organisational resources (money, equipment, personnel) is usually one of the first reasons offered as to why change cannot be implemented. Labour agreements limit the ability of management to transfer and, sometimes, terminate employees. Organisation culture may also limit the ability of a firm to change strategy.

The total elimination of resistance to change is unlikely because there will almost always remain some uncertainty associated with a change. Techniques that have the potential to reduce resistance to change when implementing new strategies include participation, education, group pressure, management support, negotiation, co-optation and coercion.

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<thead>
<tr>
<th>TABLE 10.1: FORCES OPERATING IN STRATEGY CHANGE</th>
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<tbody>
<tr>
<td><strong>Forces for Change</strong></td>
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<tr>
<td>External</td>
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<tr>
<td>Socio cultural changes</td>
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<td>Government regulations</td>
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Contd...
### Competitive Pressures
- Government regulations

### Internal
- Changes in market share
- Limited resources
- Changing rates of return
- Production economies
- Organisation culture

Participation is probably the most universally recommended technique for reducing resistance to change. Allowing affected employees to participate in both the planning and implementation of change can contribute to greater identification with the need for and understanding of the goals of the new strategy. Participation in implementation also helps to counteract the disruption in communication flows, which often accompanies implementation of a change. But participation has sometimes been overused. Participation does not guarantee acceptance of the new strategy, and employees do not always want to participate. Furthermore, participation is often time consuming and can take too long when rapid change is needed.

Another way to overcome resistance to implementing a new strategy is to educate employees about the strategy both before and during implementation. Education involves supplying people with information required to understand the need for change. Education can also be used to make the organisation more receptive to the need for the change. Furthermore, information provided during the implementation of a change can be used to build support for a strategy that is succeeding or to redirect efforts in implementing a strategy that is not meeting expectations.

Group pressure is based on the assumption that individual attitudes are the result of a social matrix of co-workers, friends, family, and other reference groups. Thus, a group may be able to persuade reluctant individuals to support a new strategy. Group members also may serve as a support system aiding others when problems are encountered during implementation. However, the use of a group to introduce change requires that the group be supportive of the change. A cohesive group that is opposed to the change limits the ability of management to persuade employees that a new strategy is desirable.

Management can take steps employees will view as being supportive during the implementation of a change. Management may extend the employees time to gradually accept the idea of change, alter behaviour patterns, and learn new skills. Support might also take the form of new training programs, or simply providing an outlet for discussing employee concerns.

Negotiation is useful if a few important resistors can be identified, perhaps through force field analysis. It may be possible to offer incentives to resistors to gain their support. Early retirement is frequently used to speed implementation when resistance is coming from employees nearing retirement age.
Co-optation is similar to negotiation in that a leader or key resistor is given an important role in the implementation in exchange for supporting a change. Manipulation involves the selective use of information or events to influence others. Such techniques may be relatively quick and inexpensive; however, employees who feel they were tricked into not resisting, not treated equitably, or misled may be highly resistant to subsequent change efforts. Distrust of management is often the result of previous manipulation.

Coercion is often used to overcome resistance. It may be explicit (resistance may be met with termination) or implicit (resistance may influence a promotion decision). Coercion may also result in the removal of resistors through either transfer or termination. Coercion often leads to resentment and increased conflict. However, when quick implementation of a change is needed or when a change will be unpopular regardless of how it is implemented, some managers feel coercion may be as good as most alternatives and faster than many others.

10.7.5 ROLE OF TOP MANAGEMENT

Top management is essential to the effective implementation of strategic change. Top management provides a role model for other managers to use in assessing the salient environmental variables, their relationship to the organisation, and the appropriateness of the organisation’s response to these variables. Top management also shapes the perceived relationships among organisation components.

Top management is largely responsible for the determination of organisation structure (e.g., information flow, decision-making processes, and job assignments). Management must also recognise the existing organisation culture and learn to work within or change its parameters. Top management is also responsible for the design and control of the organisation’s reward and incentive systems.

Finally, top management is involved in the design of information systems for the organisation. In this role, managers influence the environmental variables most likely to receive attention in the organisation. They must also make certain that information concerning these key variables is available to affected managers. Top-level managers must also provide accurate and timely feedback concerning the organisation’s performance and the performance of individual business units within the organisation. Organisation members need information to maintain a realistic view of their performance, the performance of the organisation, and the organisation’s relationship to the environment.

ACTIVITY

The top management is responsible for clearing any “mist on the screen”. Discuss.
Functional-level strategies are concerned with coordinating the functional areas of the organisation (marketing, finance, human resources, production, research and development, etc.) so that each functional area upholds and contributes to individual business-level strategies and the overall corporate-level strategy.

Functional strategies are primarily concerned with:
(a) Efficiently utilising specialists within the functional area.
(b) Integrating activities within the functional area (e.g., coordinating advertising, promotion, and marketing research in marketing; or purchasing, inventory control, and shipping in production/operations).
(c) Assuring that functional strategies mesh with business-level strategies and the overall corporate-level strategy.

Functional strategies are frequently concerned with appropriate timing. For example, advertising for a new product could be expected to begin sixty days prior to shipment of the first product. Production could then start thirty days before shipping begins. Raw materials, for instance, may require that orders are placed at least two weeks before production is to start. Thus, functional strategies have a shorter time orientation than either business-level or corporate-level strategies.

Accountability is also easiest to establish with functional strategies because results of actions occur sooner and are more easily attributed to the function than is possible at other levels of strategy. Lower-level managers are most directly involved with the implementation of functional strategies.

Strategies for an organisation may be categorised by the level of the organisation addressed by the strategy.

Corporate-level strategies involve top management and address issues of concern to the entire organisation.

Business-level strategies deal with major business units or divisions of the corporate portfolio. Business-level strategies are generally developed by upper and middle-level managers and are intended to help the organisation achieve its corporate strategies.

Functional strategies address problems commonly faced by lower-level managers and deal with strategies for the major organisational functions (e.g., marketing, finance, production) considered relevant for achieving the business strategies and supporting the corporate-level strategy.

Market definition is thus the domain of corporate-level strategy, market navigation the domain of business-level strategy, and support of business and corporate-level strategy by individual, but integrated, functional level strategies.
1. Explain the importance of formulating functional level strategy.

2. What is the role of leaders in formulating functional level strategy?

3. What is the significance of a good structural design?

4. What is the significance of information and control system in functional level strategy formulation?

5. How human resources are crucial in formulating the functional level strategy?

6. What precautions should be taken while implementing the global strategies?

7. How cascading the strategic plan gets implemented?

8. How strategic plans are implemented?

9. Explain the elements of internal control.

10. What is the role of top management in implementing global strategies?

### 10.10 ANSWERS AND HINTS

#### ANSWERS FOR SELF-ASSESSMENT QUESTIONS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Q. No.</th>
<th>Answers</th>
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<tbody>
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<td>Converting Strategy into</td>
<td>1.</td>
<td>right things</td>
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<td>Action</td>
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<td>2.</td>
<td>functional structure</td>
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<td>3.</td>
<td>expectations, demands</td>
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Contd...
Role of Leaders in Functional Level Strategic Management

4. informed
5. execution performance
6. Lightly
7. controls
8. effectiveness
9. manage risks

HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 10.4.1

Maximises Functional Performance: All the human knowledge, skills & infrastructure required for a particular functional activity are consolidated in a single sub-organisation, this facilitates sharing of valuable expertise by superiors with their subordinates. The functional units are managed by leaders who have in-depth knowledge and experience; they are able to control the unit very effectively. Hence it harvests the potential of the unit without duplication of scarce resources, maximising their utilisation. Cultivates Specialists: This type of structure promotes career development of individuals aspiring to be technical specialists of their field in large organisations. If the organisation has properly crafted performance management that promotes the visibility of individual skills, functional structure makes it easier to coach other and climb the hierarchical ladder.

2. Refer to 10.3, 10.3.1, 10.3.2, 10.3.3, 10.3.4, 10.3.5, 10.3.6, 10.3.7 & 10.3.8

Role of Leaders in functional level of strategic management involves looping strategies with tactical tools, gathering and sharing information, goals, communication, accountability and measuring processes, organizational design, strategy alignment and making it work.

3. Refer to 10.4

Functional structure in the Functional level strategy formulation is most often called as structural design. In a functional structure, teams or groups are created based on common functions in a bottom-up manner. The result is a set of functional units such as engineering, marketing, finance, human resource etc. that are controlled and coordinated from the top level management.
4. Refer to 10.5

Information and controls are to be an integral part of any organisation’s functional level strategies. The information system of the organisation should be up to date as it should have complete knowledge about the market trends and its close competitors. With a strong and efficient information system an organisation can formulate its strategies or can alter the strategies if any time its need arises.

5. Refer to 10.6

Human resource activities are primarily executed at the functional level because that is where the workers are.

At the functional level, human resource management includes translating corporate and business unit strategies into specific functional activities. These include setting functional goals, analysing strengths and weaknesses, determining distinctive competencies and competitive advantages, and developing, evaluating, and communicating functional plans within the organisation. Major activities of human resources include planning for future human resource needs, recruiting personnel, placing people in new jobs, compensating them, evaluating their performance, training them, developing them into more efficient employees, and enhancing their work environment. The most effective strategy for any organisation, and particularly large organisations and their business units, is to develop commitment among employees to the organisation and to the job. Many organisations consider human resources to be their most important asset and competitive strategic advantage.

6. Refer to 10.7.3 & 10.7.4

In macro-organizational issues of strategy implementation, firms which pursue a low-cost strategy may take steps to automate as a means of reducing labour costs. Similarly, they might use older equipment to minimise the immediate expenditure of funds for new equipment. Reward systems or incentive plans include bonuses and other financial incentives, recognition, and other intangible rewards such as feelings of accomplishment and challenge. Reward systems can be effective tools for motivating individuals to support strategy implementation efforts. In micro-organizational issues of implementation of strategies, implementation can be studied by looking at the impact organisation culture and resistance to change has on employee acceptance and motivation to implement the new strategy. Managers need to look beyond what they see as resistance and attempt to understand the employee’s frame of reference and why they may see the change as undesirable. Techniques that have the potential to reduce resistance to change when implementing new strategies include participation,
education, group pressure, management support, negotiation, co-optation and coercion.

7. Refer to 10.7.2

Organisations have found it to be helpful to ask each functional area to identify how they contribute to achieving the overall strategic plan (“functional area” designating whatever natural units exist in the organisation—functions, geographies, business units, etc.). Armed with the strategic map, operational definitions and the overall organisational strategic performance measures, each functional area creates their own map of success and defines their own specific performance measures. They can follow the model outlined above starting with their own SWOT analysis. Functional area leaders may be more successful using a cascade team to add input and take the message forward to others in the area. Developing ambassadors or process champions throughout the organisation to support and promote the plan and its implementation can also enhance the chances of success. These champions may be candidates for participation on the design or cascade teams, and should be involved in the stakeholder review process.

8. Refer to 10.7.1

Strategic plans get implemented with a total communication effort, strategic measurement by creating a strategic map (or casual business model) which helps to identify focal points and by creating measures for each focal point.

9. Refer to 10.5.2

Internal control systems operate at different levels of effectiveness. Determining whether a particular internal control system is effective is a judgement resulting from an assessment of whether the five components—Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring—are present and functioning. Effective controls provide reasonable assurance regarding the accomplishment of established objectives.

10. Refer to 10.7.5

Top management is essential to the effective implementation of strategic change. Top management provides a role model for other managers to use in assessing the salient environmental variables, their relationship to the organisation, and the appropriateness of the organisation’s response to these variables. Top management also shapes the perceived relationships among organisation components.

Top management is largely responsible for the determination of organisation structure (e.g., information flow, decision-making processes, and job assignments).
SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS

- D F Harvey, Business Policy and Strategic Management, Charles E Merill, Columbus, 1982.

E-REFERENCES

# CORPORATE GOALS AND STRATEGIC GAP

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INTRODUCTORY CASELET

APPLE, ALIENWARE AND GATEWAY COMPUTER: SUBTLE DIFFERENCES BETWEEN CORPORATE GOALS AND CORPORATE STRATEGIES

In the following section, we look at three corporations of the computing device industry to observe subtle difference in corporate goals and corporate strategies of the three companies.

**Apple:** Apple has pursued a Differentiation strategy. They manufacture almost all the components themselves even if there is a cheaper alternative, which could be out-sourced. This includes the operating system called Mac OSX instead of Windows, which the other manufacturers use. They invest a lot of money in design, brand image (For example, placing retail stores on premium high streets) trying to differentiate themselves from the competition by creating a “Mac” experience or way of life. This allows them to charge high premiums for their product, meaning that even though they sell less volume, they are still extremely profitable. Apple is also great at innovating and adapting to its market, for example, it used to manufacture its own processors but eventually the cost became greater than the value placed on it by the customers, so it switched to Intel manufactured chips.

**Alienware** is a comparatively small company that sells performance gaming computers. It has successfully focused its strategy at a very small segment of the market with very high premiums. Alienware sells some laptops upwards of $5000; in contrast Dell laptops can be bought for $400, more than 10x cheaper. Alienware outsources top of the range components from chip manufacturers (in the same way, Dell do their outsourcing) and assembles them in their own distinctly designed cases. In fact, Dell’s and Alienware’s strategy are similar in many respects, no retail stores, customised production, online orders. The difference between them is that Alienware has decided to focus on the gaming niche, which is considerably smaller than Dell’s scope.

**Gateway Computer** Corporation was one of the first modern home computer manufacturers, founded in 1985. However, in the recent years it has failed to form a competitive advantage and would be classified by Porter as “Stuck in the Middle”. While the computer market was still in the early stages, there was room for Gateway to succeed, however as the market has matured Gateway have been unable to sustain their advantage. Therefore, it has been pushed out of the market by stronger competition and has performed badly in the recent years. In fact, in October 2007, Gateway declared bankruptcy and was bought by a rival computer manufacturer (Acer).
After studying this chapter, you should be able to:

- Identify the meaning and definition of corporate goals
- Explain the meaning of strategic gap and how it hinders the achievement of corporate goal
- Enumerate the significance of Porter’s generic strategies and its utilisation in achieving the corporate goal

11.1 INTRODUCTION

Strategic planning is a great start. But on paper it is just an idea; it needs to be put into action. The projects created because of the strategic planning phase need to be managed closely. Implementation planning assists individuals and organisations with creating plans, putting them into action, and getting results. In order to activate strategies and projects effectively, it is important to employ an implementation plan that maintains goals and achieves desired end results.

11.2 CORPORATE GOALS

Companies require strategies to guide how to achieve objectives and how to pursue the company’s mission. Strategy-making is all about how – how to reach performance targets, how to outcompete rivals, how to achieve sustainable competitive advantage, how to strengthen the enterprise’s long-term business position, how to make management’s strategic vision for the company a reality. A strategy is needed for the company as a whole, for each business the company is in, and for each functional piece of each business — Research and Development, purchasing, sales and marketing, finance, human resources and so on.

A corporate goal is an observable and measurable end result having one or more objectives to be achieved within a more or less fixed timeframe.

The strategy making spotlight however needs to be kept trained on the important facets of management’s game plan for running the enterprise – those actions that determine what market position the company is trying to stake out and that underpin whether the company will succeed. Strategy is inherently action oriented; it concerns what to do, when to do it and who should be involved. Unless there is action, unless something happens, unless somebody does something, strategy thinking and planning simply go to waste and, in the end, amount to nothing.
For most of the organisations, profitability is the main goal. Maximising shareholder value, risk, and other goals include high productivity, good organisational leadership, high morale, good organisational reputation, high organisational efficiency, profit maximisation, organisational stability, value to local community, and service to public.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:
1. Companies require .................. to guide how to achieve objectives and how to pursue the company’s mission.
2. Strategy is inherently .................. oriented; it concerns what to do, when to do it and who should be involved.
3. For most of the organisations, .................. is the main goal.

**ACTIVITY**

Goals of the company are the starting point of the journey in strategic management. Discuss.

**NOTE**

Strategies are plans, big plans, and important plans. They show the general direction in which the organisation would achieve its goals. Strategies emerge from goals.

### 11.3 STRATEGIC GAP

Long-term goals and detailed, short-term budgets, with nothing to link the two together. Does this organisation sound familiar? Whatever the answer, most business professionals understand that achieving a long-term goal requires a series of logical, achievable, sequential steps. Organisations cannot rely on chance or luck. Yet the steps that lead from where a business is today to where it wants to be – its objectives – often are missing. If an organisation is not getting its goals, it simply means that it has strategic gap and there might be some loop holes in framing or execution of the strategic plans. Following paragraphs will discuss about different types of strategic gaps.

**DEFINITION**

Strategic Gap depends upon forecasting technique in which the difference between the desired performance levels and the extrapolated results of the current performance levels is measured and examined. This measurement indicates what needs to be done and what resources are required to achieve the goals of an organisation’s strategy.
11.3.1 MANAGEMENT-INDUCED GAPS

Management can cause a gap between strategy and execution through both action and inaction. Four main ways management causes this gap include failure to secure support for the plan, failure to communicate the strategy, failure to adhere to the plan, and failure to adapt to significant changes.

Failure to Secure Plan Support

The senior management team must develop a strategic plan with objectives, goals, strategies, and tactics that everyone supports. If people do not accept and support the plan, they are unlikely to put in the right amount of effort to make it succeed. Their allocation of resources may be counterproductive to implementing strategic initiatives, while their management time is diverted into seeking out factors that will justify their position. This misplaced time and effort will lead to a gap, which could prevent the execution of the plan.

To achieve buy-in, management must create a corporate culture and a set of values that support the vision and guide employees’ decisions and behaviour. Employees must have the opportunity to provide feedback regarding their ability to implement strategy. Not listening to their views, not addressing – and resolving – conflicts and major differences of opinion, and not building learning culture – one that tracks and learns from its own successes, failures, and mistakes – will result in strategies that are unrealistic and cannot be implemented. This situation leads to the strategy gap.

Failure to Communicate the Strategy

Operational managers and their employees are typically the people within an organisation who implement strategy. They need to know how the strategy affects them. Yet according to research by Kaplan and Norton, creators of the Balanced Scorecard, “less than 5 per cent of the typical workforce understands their organisation’s strategy.” Without a clear idea of what the strategy, vision, and direction of the organisation are, they are unlikely to act in ways that will result in effective implementation of the corporate plan.

Communication of strategy is vital in all management processes. When budgeting, employees need to see the tactical plans and related targets that affect them so they can modify their behaviour accordingly. During the year, they need to assess how well they are carrying out those tactics and the progress they are making toward strategic goals. When forecasting, employees need to know when their activities are unlikely to achieve their KPIs and, hence, their strategic goals so they can act early to bring the tactical plan back on target. Technology clearly has a role to play in facilitating this communication. Failure to effectively communicate strategy and how well or poorly it is being implemented will result in the strategy gap.
Failure to Adhere to the Plan

As the year progresses, many organisations make decisions reactively rather than strategically. Often the cause is the reporting of results based on a purely financial view of the organisation, such as on the chart of accounts by cost centre, rather than by a strategic and tactical view. As a result, operational managers focus on financial variances that do not relate to the specific strategic initiatives outlined in the plan. To put things back on track, the accounts become the target of any decision rather than the agreed-on action plans, which may have long been forgotten.

Test this for yourself. In your current reporting pack, how many of the reports tie actual and forecast results back to the strategies outlined in the strategic plan? The reports may monitor the goals, but how many of them actually monitor KPIs by tactic? Without this link, organisations are likely to act and react in ways that are divorced from the strategic plan, which results in the strategy gap.

Failure to Adapt to Significant Changes

The reality of today’s business environment is that it continually changes. Strategic plans are built on a set of assumptions, such as market growth, production capability, and competitor actions. If these assumptions change, it is unlikely that the plan will still hold true. Following the attacks of September 11, 2001, for example, most organisations found themselves in an economy that was substantially different from the one that existed when they planned earlier in the year. Continuing to follow a plan when the basic assumptions on which it was founded have changed makes no sense. Unless plans are modified to reflect changes to these assumptions, the result will be the strategy gap.

Some of the biggest corporate scandals have occurred in companies that are over obsessed with financialisation. What are the demerits of linking corporate goals to financial results?

11.3.2 PROCESS-INDUCED GAPs

The traditional processes an organisation uses to implement and monitor strategy are the second set of strategy gap causes. Once a strategic plan has been researched and created, what happens next? How is the plan translated into action? How are the organisation’s assets allocated to the various strategic initiatives? How is progress monitored and the success or failure of tactics measured? For most organisations, the key tool used to implement strategy is the annual budget, while the processes of actual reporting and forecasting are used to monitor achievement. But the way in which these processes are approached can lead to the strategy gap.
Lack of Strategic Focus

The objective of any process will determine what gets measured, by whom, and how far in the future. It may seem obvious that the budget should support the implementation of strategy. After all, the purpose of this tool is to control how resources are allocated, which in turn affects what an organisation accomplishes. It also may seem obvious that one of the roles of reporting would be to monitor strategic progress. Unfortunately, there is very little evidence to support that these processes actually achieve this. Instead of being focused on long-term business health, traditional planning and budgeting are internally driven and focused on current-year profits.

In a survey conducted by Comshare, Incorporated, participants said that there is typically a gap between the strategic plan and the budget created to support it. The budget tends to be financially focused with emphasis on the chart of accounts by cost centre, while the strategic plan tends to be behaviourally focused on strategies and tactics. The result is that budget holders, operational managers, and senior executives are often unaware of how strategic initiatives affect the operating plan or whether resources have even been allocated. Without this linkage, the budget becomes a pure numbers exercise, allowing the strategy gap to emerge. As a result, the budgeting and planning processes actually become barriers to strategy deployment.

The same is also true when it comes to reporting actual results and forecasting future performance. For many organisations, reporting of actuals takes the form of a simple income and expense statement by department, based on the chart of accounts. The reason reporting takes this form is mainly because the general ledger holds income and expense items, and these systems are used to generate the reports. However, strategic plans, which are typically action based and measure activity, do not fit easily within the rigid account and cost centre structure of a general ledger, and so the focus is lost. As a result, there is no direction or logical connection in the budgeting and reporting processes for budget holders to adapt their behaviour to achieving strategic goals.

Calendar Based

For most organisations, budgeting is an annual process that follows the strategic plan, and it is a process that just takes too long. Hackett Best Practices reports that a typical organisation takes over four months to complete a budget cycle. Organisations with an annual budget must try to predict events that are 16 months away, which is unrealistic and leads to the strategy gap. According to Hackett, in today’s fast-paced business environment, planning should be treated as a continuous exercise in operational decision making, resource allocation, and performance management.

Yet nearly half of organisations treat planning and budgeting as a strictly fiscal and annual exercise that leaves them unprepared to
deal with sudden change. Similarly, Hackett found that 74 per cent of organisations wait until the end of the month to issue reports. Doing so delays the opportunity to deal with important emerging trends, which could be vital to the effective implementation of strategy. Interestingly, most organisations have the data; it is their processes and tools that let them down. What is required is a planning, budgeting, and reporting process that is triggered by change, not by the date on a calendar.

**Financially Focused**

An organisation’s financial results are the outcome of its strategy implementation or lack of strategy implementation. Although some financial measures, such as investments and expenses, will be used in implementing a tactical plan, many of the measures will be nonfinancial. Indeed, the long-term viability of an organisation may well rest on the success of nonfinancial measures such as product reliability, customer satisfaction, organisational learning, and the efficiency of the internal processes. The adoption of methodologies like the Balanced Scorecard can ensure that organisations achieve the correct balance of measures that will be needed to achieve corporate objectives. The general ledger by itself will not be able to supply all the data required. As already mentioned, the chart of accounts is a transactional view of an organisation. The reliance on this view cannot support the planning and monitoring of strategy and will lead to the strategy gap.

**Internally Focused**

Consider an organisation that sets and achieves a revenue budget that reflects a growth of 10 per cent year on year. Is this achievement a good result? Is it a good result if the general ledger confirms that the goal was achieved while staying within the cost budget? What if the goal was built on the assumption that the market was due to grow at 5 per cent, when, in fact, it grew at 15 per cent? In this case, market share was lost rather than gained.

In most organisations today, reports compare the performance of the organisation with the budget, not with competitors and the market.

Strategy is nearly always based on a combined internal and external view that includes market and competitor assumptions.

To ensure that strategy is being implemented, actual reporting needs to compare performance by strategic initiative and to check that any external assumptions made while planning still hold true. Without this strategic external view, decisions will be based on a view of performance that is too narrowly focused, and the strategy gap will develop.

**Lack of Realistic Forecasting**

Although business conditions can change rapidly, many surprises that affect organisational performance can be predicted using available
data and technologies. By predicting future performance from plans based on the current and perceived business environment, contingencies drawn up in advance can be selected or corrections to the existing plan can be made to avoid or exploit the impact of any variances. The ability to recognise and exploit changing business conditions is the driving force behind rolling forecasts—which also deliver the benefit of reducing or eliminating the annual budget process. According to Hackett Best Practices research, however, only 23 per cent of organisations make use of this proven best practice.

When forecasting, many organisations once again focus solely on financial results, such as how much revenue will be generated and what the associated costs will be. As with planning, effective forecasting requires modifying and developing plans to achieve strategic goals. In some circumstances, such as when assumptions have changed, strategic goals may have to be reset. Forecasting involves two steps:

- Predicting the likely future performance based on current knowledge.
- Evaluating or selecting alternative plans to change the predicted outcome.

To predict future performance, the natural life cycle of an organisation’s products and services should be taken into account. This consideration must take place bottom up; that is, each product and service must be analysed individually.

Once a forecast has been generated, it can be used as the basis for “what if” analysis, the process of evaluating alternative scenarios. The aim is to evaluate what changes are required to the tactical plan to achieve the strategic goals. As with budgeting, this evaluation needs to be done by strategic initiative. The result will be the predicted income statement.

**Other Factors**

Two other factors that can contribute to the strategy gap are more attributable to organisational behaviour than to the processes themselves; nevertheless, they need to be taken into account when designing a solution. The first factor is a lack of accountability and commitment to the budgeting process. Budgeting is often a game in which budget holders inflate costs and suppress revenues because they expect senior management to demand reduced costs and increased revenues during a second budget pass. In addition, when a budget is handed down to budget holders without giving them a chance for input, budget holders feel free to miss their targets. After all, it was not their budget. This game playing produces unrealistic budgets, an absence of accountability, and a lack of commitment to the final plan. The result will be the strategy gap.

The second factor is wrongly focused incentive plans. Budget holders and management often are paid on their ability to meet or
beat the budget. This fact will affect their decisions when it comes to planning and reporting their performance and does little to help with the implementation of strategy. In some cases, it will actively work against the implementation of strategy. Hackett found that when management motivation was linked to strategy rather than to the annual plan, budgeting cycles were reduced and managers were less afraid of taking risks.

**ACTIVITY**

How does forecasting help a company de-risk its business model? Discuss.

**NOTE**

Organisations that reduce the forecasting process to a simple extrapolation into the future will reap unrealistic and misleading predictions. They will be unable to modify behaviour effectively to achieve strategic goals, which will result in the strategy gap.

### 11.3.3 TECHNOLOGY SYSTEM-INDUCED GAPS

The third area that causes the strategy gap involves the traditional systems used to support the planning, budgeting, forecasting, and reporting processes. Issues include fragmented systems and misplaced dependence on Enterprise Resource Planning (ERP).

**Fragmented Systems**

In most organisations, planning, budgeting, forecasting, and reporting are treated as separate, disconnected processes and supported by different technology solutions. In fact, these processes are all part of the much larger process of strategy implementation. The following analogy illustrates why this separation does not make sense. The journey that a business takes over time is like traveling down a road. The road curves and changes direction, and its exact route often are hidden from view. In the same way, business direction continually varies because of changing customer requirements, competitors’ actions, or other occurrences in the business environment.

On this journey, the business objective rests on the horizon. This objective, based on current circumstances and assumptions, is the planned destination for the organisation. It serves as a beacon, guiding the organisation’s actions and decisions. The journey is divided into a number of shorter segments, each of which the organisation will arrive at over time, allowing the organisation to gauge its progress. To reach the point on the horizon, the traveller outlines a route. This plan identifies the main roads to be travelled and the major cities the traveller will pass through en route to the final destination. In the same way, strategic plans outline the route an organisation will travel to reach its objective. The journey may take months or years to
complete. The key roads are analogous to the strategic plan's tactics that must be performed to achieve the objective. Cities are analogous to key performance indicators that will tell the organisation if the tactics have been completed and if it is on target for success.

Continuing, the traveller may plan in greater detail the portions of the journey to be attempted in the near future. The plan may include the names of townships, descriptions of landmarks, and locations of road junctions. These are vital indicators. Without them, the traveller may go in the wrong direction without realising it until much later. The budget is like that detailed plan outlining the organisation's immediate route. It is very much linked to the strategic plan but contains far more detail. With the budget, the business assigns money, people, and assets to the initiatives that will keep the organisation on course to reach its objective. Monitoring progress relative to the detailed plan is a vital activity because it shows the organisation whether it is on target. Past performance is of interest, but it actually does little to help the business navigate the road ahead. On the journey, organisations will come up against unexpected diversions, such as construction (activities that are not yet implemented), accidents (activities that are having an adverse impact on performance), and heavy traffic (intense competition for the same customers). These diversions will cause delays and can even lead to dead ends unless the organisation can avoid them. Similarly, organisations may come across new roads (new business opportunities) that were not on the map when the journey started. They may discover that taking advantage of these roads can enable them to reach their destination sooner than anticipated. Finally, like directional signs and mile markers, the forecast tells an organisation whether it is heading in the intended direction and where it will end up unless it takes immediate action. The enterprise must monitor position and make adjustments constantly. Occasionally it may need to make a major detour – sometimes even heading in what seems to be the wrong direction – to achieve its final objective. By taking note of the signs – the projected forecasts – and using judgment based on experience, business leaders can make intelligent adjustments to the plan. These adjustments will not be just a once-a-year activity. They may become necessary at any time to keep on track toward the intended destination.

Strategic planning, budgeting, forecasting, and monitoring actual are all part of the same process—moving an organisation toward its objective. Together, they are essential components in the implementation and execution of strategy. When performed in isolation, however, they provide little value.

Quite often, managers are asked to budget using systems that do not allow them to see the strategic plan or latest forecast. It is like asking someone to drive down the road with only partial sight, no map, and no idea of the final destination. To drive performance, the company needs to see the whole travel plan: objective, strategic plan, forecast, actuals and budget. These elements are all part of the same process.
This journey, or performance management process, is continuous. Markets and competitors do not remain motionless to accommodate an organisation's annual planning process. Traveling down this road smoothly and staying on course, like driving a car, requires regular, small adjustments.

Unfortunately, the traditional systems that support planning, budgeting, forecasting, and reporting are inflexible. Each component is isolated from the others. In addition, often each piece of the process is supported by a different technology than the others, causing integration problems. For example, the strategic plan may be presented as a text document; the budget may be prepared in a spreadsheet; actual results may be reported in the general ledger; and analyses may be performed using an Online Analytical Processing (OLAP) tool. These systems are completely disjointed, manually intensive, and error-prone. As a result, they help create the strategy gap. In addition, these systems tend to suffer from other problems that also create gaps:

- **Difficult to change**: Most existing management systems do not allow changes to be made easily. Altering structures, accounts, and basic assumptions so that management can quickly see the impact of change is complex and time consuming. Sadly, most systems are nothing short of glorified adding machines – and they do not even do this very well.

- **Reporting problems**: Systems tend to report from one perspective – usually accounts down the page, and time and version across the page, with each page representing a cost centre. Viewing data by product, turnover, geography, or any other business perspective – such as strategy and tactic – is extremely difficult. In addition, many systems require a great deal of effort to disseminate actuals, the latest forecast, and strategy information throughout the organisation. These difficulties prevent the detailed analysis of budgets, forecasts, and actual results in context and can result in the approval of unrealistic plans.

- **File management issue**: Many organisations still rely on spreadsheets for preparing budgets and reporting results. While spreadsheets are great personal productivity tools, they are a nightmare when used as a corporate planning and reporting system. In addition to flexibility and reporting problems already discussed, spreadsheets and many other file-based systems also incur version control and other problems because multiple files have to be maintained, relinked, and then redistributed. Apart from the time and error-prone nature of this task, you can never be sure that users are now using the right version.

**Misplaced Dependence on Enterprise Resource Planning**

A second system-induced gap can be caused by the reliance some organisations have placed on their Enterprise Resource Planning (ERP)
systems to implement strategy. At first glance, such reliance seems logical. Before ERP, the processes that made up the supply chain – order entry, inventory management, billing, accounts receivable, and others – were separate functions supported by multiple stand-alone systems, often running on multiple technologies. Each part of the process could be owned by a different department or operating unit.

The problems these systems generated are similar to those encountered with today’s planning, budgeting and reporting systems:

- Expensive in terms of both time (maintenance) and money (hardware and software, personnel). Software had to be maintained on individual desktops. Information Technology (IT) staff had to learn multiple technologies. If the system had been created in-house by a person who then left the company, the organisation had a big problem.

- Data integrity and version control issues. Changes in one system were not automatically reflected in other systems, data often had to be rekeyed, and data were shared by transferring files. Many departments multiplied by many files equalled trouble. Organisations could never be certain that the information they were basing decisions on was accurate and up to date.

- Organisations could not easily see what was happening across the enterprise, making it difficult to implement corporate strategy, measure its success, and make informed decisions. Enterprise resource planning was hailed as the solution because it integrated the supply chain processes and supporting systems. The ERP systems increased the efficiency and speed of these operations.

Because ERP systems appear to hold most of the actual data in a centralised database, organisations today are looking to these systems to solve their planning, budgeting, and reporting problems. Many organisations are also trying to leverage their huge investments in ERP implementations to get a return. Given that, many ERP vendors are now offering “integrated” planning, budgeting, and reporting applications on top of ERP; this initially seems an attractive solution. The problem, however, is that ERP is the wrong vehicle for implementing strategic plans just as a farm tractor is the wrong vehicle for taking a family on vacation. Gartner, the Stamford, Connecticut-based research firm, reports that “[a]lthough ERP systems have largely addressed the needs of transactional users, they have not been able to address the needs of strategic and operational users.” The main reasons given are the complexity of these systems for users and their closed architectures, which make it difficult to integrate non-ERP data. All enterprise resource planning systems are focused on transactions, not on strategy. This very issue is the reason why today’s traditional planning, budgeting, forecasting, and reporting systems fail.

Implementing a strategic plan requires the dissemination of goals, objectives, strategies, and tactics. Planners must be able to evaluate
the impact of economic drivers, forecast trends, and predict the impact of competitors. Senior management needs the ability to analyse alternative operating structures, investments, and divestments. Implementing strategy is about management effectiveness. The two are different and require different tools and processes.

### Fill in the blanks:

4. Management can cause a gap between strategy and execution through both action and .................
5. Operational managers and their employees are the people within an organisation who ................. strategy.
6. Communication of strategy is vital in all management .................
7. Failure to effectively communicate strategy and how well or poorly it is being implemented will result in the .................
8. Budgeting is an annual process that follows the ................., and it is a process that just takes too long.
9. An organisation’s ................. results are the outcome of its strategy implementation or lack of strategy implementation.
10. The traditional systems that support planning, budgeting, forecasting, and reporting are .................

### Activity

Centralisation of information systems and databases enhance the ease of budgeting, reporting and planning. Discuss.

### Note

Enterprise resource planning was not designed to deliver these capabilities. It is focused on operational efficiency.

### 11.4 PORTER’S GENERIC STRATEGIES

This has been discussed in chapter 2 in detail.

**Choosing the Right Generic Strategy**

Your choice of which generic strategy to pursue underpins every other strategic decision you make, so it’s worth spending time to get it right. But you do need to make a decision: Porter specifically warns against trying to “hedge your bets” by following more than one strategy. One of the most important reasons why this is wise advice is that the things you need to do to make each type of strategy work appeal to different types of people. Cost Leadership requires a very detailed
internal focus on processes. Differentiation, on the other hand, demands an outward-facing, highly creative approach. So, when you come to choose which of the three generic strategies is for you, it’s vital that you take your organisation’s competencies and strengths into account. Use the following steps to help you choose.

**Step 1:** For each generic strategy, carry out a SWOT analysis of your strengths and weaknesses, and the opportunities and threats you would face, if you adopted that strategy. Having done this, it may be clear that your organisation is unlikely to be able to make a success of some of the generic strategies.

**Step 2:** Use Five Forces Analysis to understand the nature of the industry you are in.

**Step 3:** Compare the SWOT analyses of the viable strategic options with the results of your Five Forces analysis. For each strategic option, ask yourself how you could use that strategy to:

- Reduce or manage supplier power.
- Reduce or manage buyer/customer power.
- Come out on top of the competitive rivalry.
- Reduce or eliminate the threat of substitution.
- Reduce or eliminate the threat of new entry.

Select the generic strategy that gives you the strongest set of options.

Porter’s Generic Strategies offer a great starting point for strategic decision making. Once you’ve made your basic choice, though, there are still many strategic options available. Bowman’s Strategy Clock helps you think at the next level of details, in that it splits Porter’s options into eight sub-strategies.

**Key Points**

According to Porter’s Generic Strategies model, there are three basic strategic options available to organisations for gaining competitive advantage. These are: Cost Leadership, Differentiation and Focus. Organisations that achieve Cost Leadership can benefit either by gaining market share through lowering prices (whilst maintaining profitability,) or by maintaining average prices and therefore increasing profits. All of this is achieved by reducing costs to a level below those of the organisation’s competitors. Companies that pursue a Differentiation strategy win market share by offering unique features that are valued by their customers. Focus strategies involve achieving Cost Leadership or Differentiation within niche markets in ways that are not available to more broadly-focused players.

**Activity**

Differentiation offers a stronger base for sustainability than cost leadership. Discuss.
Fill in the blanks:

11. Cost Leadership requires a very ............ internal focus on processes.
12. Differentiation, on the other hand, demands an outward-facing, highly ............... approach.
13. Porter’s Generic Strategies offer a great starting point for ............... decision making.

11.5 SUMMARY

- Goals describe a future end-state – desired outcome that is supportive of the mission and vision.
  - Shapes the way ahead in actionable terms.
  - Best applied where there are clear choices about the future.
  - Puts strategic focus into the organisation – specific ownership of the goal should be assigned to someone within the organisation.
  - May not work well where things are changing fast – goals tend to be long-term for environments that have limited choices about the future.
  - Cascade from the top of the Strategic Plan – Mission, Vision, Guiding Principles.

- Broad participation in the development of goals: Consensus from above – buy-in at the execution level. Should drive higher levels of performance and close a critical performance gap.

- The world’s best Strategic Plan will fail if it is not adequately resourced through the budgeting process.

- Strategic Plans cannot succeed without people, time, money, and other key resources. Aligning resources validates that initiatives and action plans comprising the strategic plan support the strategic objectives.

KEY WORDS

- **Strategic Gap**: Forecasting technique in which the difference between the desired performance levels and the extrapolated results of the current performance levels is measured and examined. This measurement indicates what needs to be done and what resources are required to achieve the goals of an organisation’s strategy.

- **Corporate Goal**: A corporate goal is an observable and measurable end result having one or more objectives to be achieved within a more or less fixed timeframe.

Contd...
Management-Induced Gaps: Management can cause a gap between strategy and execution through both action and inaction. Four main ways management causes this gap include failure to secure support for the plan, failure to communicate the strategy, failure to adhere to the plan, and failure to adapt to significant changes.

Process-Induced Gaps: The traditional processes an organization uses to implement and monitor are the process-induced gaps. It involves lack of strategic focus, calendar based budget cycle, financially focused, internally focused, lack of realistic forecasting, other factors such as lack of accountability and commitment to the budgeting process; wrongly focused incentive plans.

Technology-Induced Gaps: The strategy gap which involves the traditional systems that are used to support the planning, budgeting, forecasting, and reporting processes. Issues include fragmented systems and misplaced dependence on Enterprise Resource Planning (ERP).

Focus Strategies: Focus strategies involve achieving Cost Leadership or Differentiation within niche markets in ways that are not available to more broadly-focused players.

11.6 DESCRIPTIVE QUESTIONS
1. What are corporate goals?
2. How do strategic gaps hinder the achievement of corporate goals?
3. How many types of strategic gaps are there in the organisation?
4. How the Porter’s generic strategies are significant in overcoming the strategic gap?
5. Differentiate between Cost Leadership and Differentiation.
6. Explain Management-Induced Gaps leading to Strategic Gap.
7. Explain Process-Induced Gaps leading to Strategic Gap.
8. Explain Technology System-Induced Gaps leading to Strategic Gap.
9. How to choose the right Generic Strategies?
10. What are the three basic strategic options available to organisations for gaining competitive advantage? Describe them briefly.
11.7 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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<thead>
<tr>
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<td>Porter’s Generic Strategies</td>
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HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 11.2

A corporate goal is an observable and measurable end result having one or more objectives to be achieved within a more or less fixed timeframe. Companies require strategies to guide how to achieve objectives and how to pursue the company’s mission. Strategy-making is all about how—how to reach performance targets, how to outcompete rivals, how to achieve sustainable competitive advantage, how to strengthen the enterprise’s long-term business position, how to make management’s strategic vision for the company a reality.

2. Refer to 11.3,11.3.1,11.3.2 & 11.3.3

Strategic gaps hinder the achievement of corporate goals through management induced gaps, process-induced gaps and technology system-induced gaps.

3. Refer to 11.3.1,11.3.2 & 11.3.3

Three strategic gaps – management induced gaps, process-induced gaps and technology system-induced gaps.

4. Refer to 11.4

Porter’s generic strategies are significant in overcoming the strategic gap by using SWOT Analysis and Use of Five Forces Model and their comparison of the results obtained helps to select the best generic option.
Organisations that achieve Cost Leadership can benefit either by gaining market share through lowering prices (whilst maintaining profitability) or by maintaining average prices and therefore increasing profits. All of this is achieved by reducing costs to a level below those of the organisation’s competitors. Companies that pursue a Differentiation strategy win market share by offering unique features that are valued by their customers.

Management can cause a gap between strategy and execution through both action and inaction. Four main ways management causes this gap include failure to secure support for the plan, failure to communicate the strategy, failure to adhere to the plan, and failure to adapt to significant changes.

The traditional processes an organisation uses to implement and monitor strategy are the second set of strategy gap causes. Once a strategic plan has been researched and created, what happens next? How is the plan translated into action? How are the organisation’s assets allocated to the various strategic initiatives? How is progress monitored and the success or failure of tactics measured? For most organisations, the key tool used to implement strategy is the annual budget, while the processes of actual reporting and forecasting are used to monitor achievement. But the way in which these processes are approached can lead to the strategy gap.

The third area that causes the strategy gap involves the traditional systems used to support the planning, budgeting, forecasting, and reporting processes. Issues include fragmented systems and misplaced dependence on Enterprise Resource Planning (ERP).

By performing SWOT analysis, Use Five Forces Analysis to understand the nature of the industry you are in. Compare the SWOT analyses of the viable strategic options with the results of your Five Forces analysis. Select the generic strategy that gives you the strongest set of options.

Cost Leadership, Differentiation and Focus strategies are the three basic strategic options available to organisations for gaining competitive advantage.
11.8 SUGGESTED READINGS FOR REFERENCE

SUGGESTED READINGS

- *Monitoring Statement on Strategic Gaps in West Sussex*, Chichester, WSCC.

E-REFERENCES

## MANAGING INTERNAL ORGANISATION FOR STRATEGY IMPLEMENTATION

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PHENOMENAN OF NIKE'S GEOGRAPHIC DIVISIONALIZATION

Nike, the largest and most profitable sports shoe manufacturer in the world have developed a complex network structure to produce its shoes. Nike’s product design and research function — the fulcrum around which all other activities revolve — is located in Beaverton, Oregon. Nike’s designers come out with novel, fascinating shoe designs in sport shoes from here. Almost all other functions involved in producing and marketing its sports shoes are outsourced to companies around the world. Nike has established a profitable relationship with suppliers, distributors and customers over the years relying on outsourcing partners, with a view to remain focused on what it knows best. It designs the shoe but contracts manufacturing, marketing and other functional activities to other organisations. Coordination is achieved by standardisation of the product range.

When the designers finish their work, they relay all the blueprints for the new products electronically to Nike’s network of suppliers and manufacturers in Southeast Asia. For example, instructions for the design of a new sole may be sent to a supplier in Taiwan, and instructions for the leather uppers to a supplier in Malaysia. These suppliers then produce the new shoe parts, which are then sent for final assembly to a manufacturer in China with whom Nike has established an alliance. From China, these shoes are shipped to distributors throughout the globe, and are marketed in each country by an organisation with which Nike formed some kind of alliance such as a long-term contract.

Southeast Asia is the preferred location because of low wages prevailing over there. Skilled hands are cheaply available and Nike is able to save a lot of money through outsourcing contracts. Indonesian workers were stitching together shoes in hot, noisy factories for only 80 cents a day or about $18 per month. Workers in Vietnam and China fared better since they were earning $160 a day. Nike’s billionaire CEO, Phil Knight had to face a lot of criticism for paying such miserable salaries to workers in underdeveloped nations. This of course, compelled the company to review its labour practices all over the world later on, revising wages by about 30 per cent.

If any network partners are not able to meet Nike’s quality standards, they are replaced with new partners easily. This way Nike is able to remain small and flexible. Nike has rules and procedures specifying the required quality of input materials, the nature of the manufacturing process, and the required quality of the finished product. Nike constantly monitors production and sales information from its network by means of a sophisticated global computer system.
NMIMS Global Access – School for Continuing Education

After studying this chapter, you should be able to:

- Explain the issues in strategy implementation
- Describe the procedure of activating strategy
- Explain the significance of resource allocation
- Discuss the strategy-structure relationship
- Explain the functional structure
- Discuss the meaning and significance of divisionalisation
- Explain the strategic business units
- Discuss project organisation and its meaning
- Explain the matrix organisation structure and its significance
- Discuss the new design options
- Identify the factors influencing organisation structure
- Explain the structure and strategy implementation

12.1 INTRODUCTION

Strategy implementation is a crucial issue because any strategy is as good as the effort behind it to move it forward. Successful strategy implementation requires support, discipline, motivation and hard work from all managers and employees. More importantly, it requires a suitable organisation structure to translate ideas into concrete action plans. In spite of having all these supporting elements, strategy implementation, on most occasions proves to be a tricky job. Creating a ‘fit’ between a firm’s goals and its other activities proves to be a tough exercise. Multifarious reasons could be cited in support of this statement. Strategy is dependent on many variables—internal as well as external—and to compound the problem further there are countless, interrelated change factors that could upset managerial calculations overnight. Because change factors interrelate, changing only one or two things seldom brings any significant overall organisational change. There are certainly no magic bullets to assist managers in bringing about organisational change either automatically or slowly. Given the complexities inherent in organisational change and strategy implementation, it is easy to find why efforts at both so often fail.

The Mckinsey Company, a well-known management consultancy firm in the United States, towards the end of 1970s was asked to find a solution to this knotty issue. The researchers Peters and Waterman found after examining America’s best run companies that the problem in strategy lay in its implementation and structure was only one lever in the hands of management. The other levers were systems, staff, style, skills and superordinate goals. A strategy is usually successful when the other S’s in the 7-S framework fit into or support the strategy.

 Strategy: A set of decisions and actions aimed at gaining a sustainable competitive advantage.
- **Structure**: The organisation chart and associated information that shows who reports to whom and how tasks are both divided and integrated.
- **Systems**: The flow of activities involved in the daily operation of a business, including its core processes and its support systems.
- **Style**: How managers collectively spend their time and attention and how they use symbolic behaviour. How management acts is more important than what management says.
- **Staff**: How companies develop employees and shape basic values.
- **Shared Values**: Commonly held beliefs, mindsets and assumptions that shape how an organisation behaves—its corporate culture.
- **Skills**: An organisation’s dominant capabilities and competencies.

**Figure 12.1: 7-S Framework**

**Definition**

The 7-S framework highlights the importance of some interrelated and interconnected factors within the organisation and their role in successful implementation of strategy.

The successful implementation of a strategy depends on the right alignment of all the seven-Ss. “When the seven-Ss are in good alignment, an organisation is poised and energised to excuse strategy to the best of its ability”. Of course, there is no starting point or implied order of preference in the shape of the diagram. It is also not very obvious which of the seven factors would be the driving force in changing an organisation at a point of time.
Fill in the blanks:

1. Successful strategy implementation requires support, discipline, motivation and hard work from all managers and .................

2. The successful implementation of a strategy depends on the right ................ of all the seven-Ss.

The principal job of strategists then is to achieve a good fit among the Seven Ss by making necessary alterations from time to time.

12.2 ISSUES IN STRATEGY IMPLEMENTATION

The successful implementation of strategy requires an effective organisation. People working within a firm should know how their actions interrelate with the actions of others to support and execute the firm’s strategy. Without a structural framework, the roles of management and employees can’t be drawn-up clearly—leading to confusion, duplication of efforts and chaos at various levels.

Apart from a sound organisation structure, the services of talented and capable leaders are also required to translate corporate vision into a concrete reality. The principal task of leaders then would be to see that the various elements of an organisation fit together and make logical sense. In the race to get ahead, of course, they should not sacrifice ethical and social values.

Functional plans and policies need to be formulated carefully and implemented with active support from employees at various levels. These should help employees find solutions to several operational issues that need to be resolved on a day-to-day basis.

The political factors than come in the way of effective implementation of strategies should also be understood properly. Every attempt should be made to remove the irritants first before minor problems turn into major emergencies later.

12.2.1 IMPLEMENTING STRATEGY

There is no guarantee that a well-designed strategy is likely to be approved and implemented automatically. The strategic leader must, therefore, defend the strategy from every angle, communicate how the strategy when implemented would benefit the whole organisation and secure the wholehearted support of employees working at various levels. To keep things on track, he can list out priorities, programme implementation process, budgets, etc. on paper so that nothing is left to chance.
While giving a concrete shape to the strategy, he should also take note of regulatory mechanisms that govern business activity and see that everything is in order. Some of the important things to be kept in mind are listed below:

- **Formation of a company**: This must be in line with provisions of the Companies Act, 1956, covering issues such as formation of a company, its registration, obtaining suitable licenses before commencing operations, raising funds from various sources in accordance with the provisions of SEBI Act, 1992.

- **Operations of a company**: The company must compete in a fair way and earn the profits through legally blessed routes only observing the (a) provisions of competition law; (b) Import/export restrictions, (c) FERA regulations (FEMA Regulations, 2000); (d) Patent, trademark, copyright (Indian Patents Act, 1995, the Trade and Merchandise Marks Act, 1958, the Copyrights Act, 1957 etc.) stipulations; (e) Labour Laws (regarding employment of women, children, payment of wages, providing welfare amenities, keeping healthy industrial relations etc.); (f) Environmental protection (the Environment Protection Act 1986), (g) Pollution control requirements; (h) Consumer protection measures etc.

- **Winding up operations**: Even when the company decides to get out of a venture/business, the rules of the game need to be followed scrupulously (whether in offering golden handshake to employees or asking all the employees to quit in one go).

After the institutionalisation of strategy in the above manner, action plans could be formulated. These are basically functional level strategies undertaken at the departmental level and usually deal with operational aspects of a strategy. The action plans, however, must try to translate the overall strategic plan in letter and spirit without any deviations. Issues like who will do what, what kind of support is required at various stages, what kind of privatisations have to be fixed while implementing active plans, how does a particular active plan contribute to the broad objectives of the strategy etc. must also be carefully looked into. Once the action plans are ready, the strategist must resolve issues relating to allocation of scarce resources over the entire organisation.

### 12.2.2 RESOURCE ALLOCATION

While implementing strategies, the scarce resources of a firm (financial, physical, human, technological) need to be allocated carefully, according to a plan. In this regard, one can follow a top-down or a bottom-up approach. In a top-down, approach resources are allocated through a process of segregation down to the operating levels. The Board of Directors, Managing Directors and other members of top management typically decide the requirements of each subunit and distribute resources accordingly. In the bottom-up approach, resources are distributed after a process of aggregation...
from the operating level. A mix of these two may also find favour in fairly large, multi-plant organisations.

**Means of Resource Allocation**

There are several ways of allocating resources in a systematic way, namely:

- **Strategic budget**: Keeping the assumptions made before the formulation of a budget, divisional heads (SBUs) and functional managers focus their efforts on allocating funds, through an interactive exercise—taking the opinions of all those who matter most. The external influences and their likely impact and the internal capabilities of a firm are also kept mind in this joint budgeting effort (hence, the name strategic budget).

- **Capital budget**: The primary purpose of a capital budget is to maximise the long-term profitability of a firm while deploying resources. Various techniques like internal rate of return, payback period, and net present value are used to find where a rupee invested would earn maximum returns.

- **Performance budget**: Here the basic purpose is to focus attention on the work to be carried out, services to be rendered rather than things to be spent for or acquired. It concentrates attention on physical aspects of achievement. Here, there is not only a work plan but also a work plan in terms of work done. It takes a systems view of activities trying to associate the inputs of the expenditure with the output of accomplishment in terms of services, benefits etc.

- **Zero-based budget**: The key element of ZBB is future-objective orientation of past objectives. Instead of taking the last year’s budgets and adjusting them for finding out the future level of activity and preparation of budget there from, ZBB forces managers to review the current, on-going objectives and operations. ZBB is, therefore, a type of budgets that requires managers to re-justify the past objectives, projects, and budget and to set priorities for the future. The essential idea budget that differentiates ZBB from traditional budgeting is that it requires managers to justify their budget request in detail from scratch, without any reference to the level of previous appropriations. It tantamount to recalculation of all organisational activities to see which should be eliminated, funded at a reduced level, funded at the current level or increased finances must be provided.

ZBB process runs into the following cardinal sequence of steps:

- **Decision package**: Each discrete department activity and programme is broken down into a decision package. Decision package summarises the scope of work, requirements, anticipated benefits, time schedule, and expected consequences if the element is not performed, etc.
Thus, decision package provides a running commentary of all the activities in a particular project.

- **Ranking**: Each decision package is ranked against packages for other proposed projects or activities, and the projects that are running (operating) currently. Decision packages are ranked according to their benefits to the total organisation during the budget period.

- **Resource allocation**: The above ranking leads to ‘organisation-wide’ list of prioritised and priced out decision packages built from zero-base or ground up. Resources are then allocated to the packages according to the preferential rank in the organisation. When properly executed, the zero-base budgeting provides an opportunity for the managers to carefully examine, evaluate and prioritise each organisational activity and see whether modification, continuance or termination is feasible.

**Problems in Resource Allocation**

Resource allocation, in actual practice, is not an easy job. Strategists should prioritise tasks that require maximum attention initially taking political relations, overall objections, external influences etc., into account. Each department may fight for garnering a maximum share of the scarce resources that are available leading to destructive conflict and bitter personality clashes. External influences such as government regulations, shareholder preferences for higher dividends, credit restrictions imposed by financial institutions also affect the process of resource allocation considerably. To avoid trouble at a later stage, strategists need to prioritise everything and decide budgetary allocations in the initial stages. Many ‘budget battles’ could be avoided if targets, resource sharing, prioritisation and midway revisions etc., are decided in an atmosphere of close cooperation and participation, especially at departmental and divisional levels. Allocating resources to specific divisions and departments alone does not mean successful strategy implementation. There are other troublesome issues to be looked into more closely. After resolving the knotty issues concerning resource allocation, the strategists should look for a suitable organisation structure for implementing strategies.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

3. The successful implementation of strategy requires an effective .......................... 

4. While implementing strategies, the scarce resources of a firm need to be .................. carefully, according to a plan.

5. The primary purpose of a capital budget is to ......................... the long term profitability of a firm while deploying resources.
What are the differences between a zero-based budget and performance-based budget? Discuss.

12.3 STRATEGY-STRUCTURE RELATIONSHIP

A suitable organisation structure is essential to implement strategies and achieve stated goals. According to Classical Organisation Theorists (Fayol, Taylor, Webber), the manager generally determines the work activities to get the job done, writes job descriptions, puts people into groups and assigns them to superiors. He then fixes goals and deadlines and establishes standards of performance. Operations are then controlled through a reporting system. The whole structure takes the shape of a pyramid. Thus, the term ‘organisation structure’ describes the framework of an organisation in which individual effort is coordinated. It is nothing but a chart of relationships.

To be effective, the basic structure is governed by a set of rules and regulations, reward-punishment systems, information networks, control procedures etc. The structural components are generally designed, keeping the requirements of organisational members in mind, (where they are encouraged to take up the assigned jobs, meet the expectations of superiors, earn the rewards and keep the organisation going). Structure, thus, is a means to an end and not an end in itself. It is there to facilitate the smooth translation of organisational plans, strategies and policies into concrete action. Without a proper fit between strategy and structure, there will be chaos and confusion in the organisation. Various parts do not move in harmony. Delays, duplications and waste motions may occur with frustrating regularity. It may ultimately lead to improper use of facilities and failure to achieve goals. Research evidence also suggests that structure follows strategy.

Generally speaking, organisations perform more effectively when they implement strategy with the most appropriate structure, while evaluating whether an organisation is properly structured and stuffed to meet the requirements of the strategy, the following questions need a careful analysis:

Checklist for determining appropriateness of organisational structure:

- Is the structure compatible with the corporate profile and the corporate strategy?
- At the corporate level, is the structure compatible with the outputs of the firm’s business units?
- Are there too few or too many hierarchical levels at either the corporate or business unit level of analysis?
- Does the structure promote coordination among its parts?
Does the structure allow for appropriate centralisation or decentralisation of authority?

Does the structure permit the appropriate grouping of activities?

It is, more or less, agreed now that changes in strategy lead to changes in organisational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follows strategy. Without a strategy or reasons for being (mission), structure is not important (David). Institutionalising a strategy definitely requires a strategy-structure fit. Functional structure is useful when the firm begins operations at a single site. The emphasis here is on increasing volumes. As business expands, the firm begins to perform the same function in different locations. Such geographical dispersal of activity calls for inter-unit coordination. Vertical integration is the next growth strategy. Firms operate within the same industry but carry out additional functions. In the final phase, according to Alfred Chandler, firms indulge in product diversification – resulting in a large, multi-divisional structure. Current research indicates that the greater the diversity among the businesses in multi business firms, the greater is the necessary degree of decentralisation and self-containment. Four important guidelines can be advanced in this regard: (Pearce and Robinson).

- A single product firm or single dominant business firm (where one business accounts for 70-95% of sales) should employ a functional structure.
- A firm in several lines of business that are somehow related should employ a multi-divisional structure.
- A firm in several unrelated lines of business should be organised into Strategic Business Units (SBUs).
- Early achievement of a strategy-structure fit can be a competitive advantage.

While trying to relate the structure to strategy, managers have a wide choice based on how authority relationships are prescribed, how departments are created etc. The design choices basically revolve around the following types: the functional structure, the divisional structure, the profit and matrix forms, the emerging structures like teams, virtual teams and boundary-less organisations etc.

### 12.3.1 FUNCTIONAL STRUCTURE

In the functional structure, activities are grouped together by common function. Each functional unit has a dissimilar set of duties and responsibilities. In a university, functional structure would mean a set of departments like marketing, management, business economics, finance, etc. Thus, similar and related occupational specialities are grouped together. Functional structure tries to incorporate the positive aspects of specialisation.
The functional structure is a natural evolution of the simple structure as the organization grows and direct control becomes difficult or inefficient.

12.3.2 FEATURES OF FUNCTIONAL STRUCTURE

Functional structures are characterised by specialisation of function, sub-goal emphasis, line staff division, functional relationship and centralisation and decentralisation:

Figure 12.2: Features of Functional Structure

12.3.3 ADVANTAGES OF FUNCTIONAL STRUCTURE

- **Clarity**: Functional design has the great advantage of clarity. Everybody has a ‘home’. Everybody understands his own task. As a result, functional structures bring order and clarity to organisational activities.

- **Economies of scale within function**: It provides economy of scale within functions. It reduces duplication and waste. For example, the total floor space shared by several products in functional organisation leading to economy of operations.

- **Specialisation**: Each departmental manager is concerned with only one kind of work and can concentrate all his energies upon it with minimum diversion. Specialisation being built into the organisation brings about competitive advantage for the firm. By putting its limited resources into one specialised activity, ‘even the small company can compete with the giant corporation on quantity, delivery and price’.

- **Coordination**: Coordination within functions is easy. Centralised decision-making ensures unity of performance.
- **In-depth skill development**: The functional structure also promotes skill development of employees. Employees are exposed to a range of functional activities within their departments allowing them to embody their outstanding skills in every activity of the company.

- **Suitability**: The functional type of organisation is best for small to medium sized organisation producing one or a few products where the dominant competitive issue and goals of the organisation emphasise functional specialisation, efficiency and quality. In fact, Fayol’s model for functional structure was a coal-mining company where there was only one product, demanding simple, mechanical operations. The operations were more or less standardised.

### 12.3.4 LIMITATIONS OF FUNCTIONAL STRUCTURE

The weaknesses of the functional structure, unfortunately, are legendary as the following list indicates:

- **Effort focus**: Every functional manager considers his function the most important one and develops a narrow dimension of the organisation. He becomes so enamoured with his own specialty that he forgets the organisation’s overall goals. In his anxiety to achieve departmental goals, he may try to subordinate the welfare of the other functions. ‘The lust for aggrandisement on the part of each function is the price paid for the laudable desire of each manager to do a good job.’ Again, functional specialisation may lead to extremely narrow, dull and boring jobs in the organisation with routine technologies. Functional structure also contributes to a short-term perspective on the part of specialists.

- **Poor decision-making**: No one except the man at the top sees the entire picture of business. Consequently, decisions are easily misunderstood and poorly executed. Questions like ‘who is right?’, ‘who has scored better?’ force organisational participants into a tug-of-war.

- **Sub-unit conflicts**: As the functional organisation balloons to a reasonable size, boundaries are erected between departments. The structure turns out to be a ‘Berlin Wall Building’. Coordination among departments becomes a tough exercise. No one functional group is completely responsible for performance. As a result, tendencies like buck-passing, sidetracking of issues, etc., develop. Overlapping authority and divided responsibility adds to the confusion and chaos prevailing. Accountability suffers. If functional structure is employed, important projects may suffer for lack of focused coordinated attention.

- **Managerial vacuum**: Emphasis on functional skill makes a man unfit for top management post requiring a broad perspective on the organisation’s activities. Functional structure does not prepare people for tomorrow, for it has no position in which a
functional head can learn and prepare to handle complexities inherent in the chief executive’s position. In course of time, a chronic shortage of top management generalists may be felt.

The weaknesses of the functional structure are legendary. As the functional organisation grows in size, it ‘rapidly becomes an organisation of misunderstandings, feuds, empires and Berlin Wall Building.’ It soon requires elaborate, expensive clumsy management crutches, coordinators, committees, meetings, troubleshooters, special dispatchers which waste everybody’s time without, as a rule, solving much! The problem of coordination between functions becomes more difficult. The administrative distance between top management and functional department grows. Divisionalisation or product organisation structure helps in relieving this position.

**Self Assessment Questions**

Fill in the blanks:

6. A suitable organisation structure is essential to ……………………… strategies and achieve stated goals.

7. Changes in strategy lead to changes in organisational …………

8. Functional structure is useful when the firm begins operations at a ………………………

9. Functional structure tries to incorporate the ………………… aspects of specialisation.

**Activity**

What are the pitfalls of a functional structure? Discuss.

**12.4 Divisionalisation: Product and Geographic Forms**

Divisionalisation is the process of dividing the large functional pyramids into smaller, flexible administrative units. It is essentially designed to foster independent and self-contained units. It creates a set of essentially autonomous ‘little companies’ in terms of product or geography. It is particularly adaptable to the large and complex modern organisation.

**12.4.1 Product Departmentation**

Product or commodity departmentation is particularly adaptable to tremendously large, complex and multiproduct organisations. Product departmentation calls for division of organisation work on product basis. The large functional units in the organisation are divided into smaller units, each grouped in terms of product manufactured and sold. Product departmentation increases emphasis on product development, it helps in orderly and even development
of products. Those products, which need to be carefully nursed and skillfully developed, will receive prompt and improved attention. Other products whose life is over may be discontinued. In response to changing conditions, products can be developed, added or dropped.

Features of Product Departmentation

Product departmentation is characterised by the following:

- Product departmentation focuses on results and performance than on means. The product structure is organised, basically, according to organisational outputs.

- Product structures involve dismemberment of the monolithic functional organisation into autonomous units. Within each of these units lies another organisational form and it’s almost always of the functional type.

- The divisional head is responsible for performance and holds complete strategic and operating decision-making authority.

- The organisation is split into product divisions, each of which is responsible for its own profit or loss.

- In addition to providing for a central headquarters, divisionalisation helps in promoting decentralisation in a fruitful way. It facilitates a wide span of control at the top leading to a flat organisation structure. It frees the top management for the top management tasks.

- It is usually adopted by a multiproduct enterprise whose basic aim is to expand and diversify its products having distinct manufacturing and marketing features.
Merits

The resources of one complete administrative unit are deployed on the product. All the activities for a single project or purpose are brought under one manager. It is easy to fix accountability. Procedures and systems can be standardised, leading to better integration across different specialities. The different units like marketing, sales, engineering, finance and personnel are dedicated to the interests of one or a few related products. All this increases emphasis on product development, market exploitation, etc. Further, autonomous units enable a manager to acquire a broad range of experience, the individual responsibility and independence forces him to face challenges and run an entire company with its frustrations and satisfactions. Thus, divisionalised form serves as an excellent vehicle for training and development of general managers. Managers know what they are doing and can direct themselves toward the performance of the whole, instead of becoming prisoners of their own work, effort and skill. Divisionalised form, further, allows for a wide span of control. It focuses the vision and efforts of managers directly on business performance and results. The divisions have the responsiveness, the accountability and the benefits of specialisation and are able to process information as if they were organisations unto themselves. Non-Profitable lines are not allowed to be carried on the backs of the profitable ones. Whenever necessary the autonomous units can be lopped off with minimal effect on the entire organisation.

Limitations

Divisionalisation tends to create additional departments and divisions leading to duplication of effort. The overhead costs of the product division multiply. There is little incentive to promote cooperation among divisions. Conflicts are created as divisions and headquarters argue about where to locate support services. Often, it is difficult to draw a clear distinction between different units and settle the priorities. A tremendous amount of managerial time and energy is wasted on adjudicating disputes between them with reference to scarce inputs, etc. The smallest adjustment between departments becomes a trial of strength or a matter of prestige and honour. The rivalry and territorial protectionism by the individual divisions can make coordination by headquarters extremely difficult. Further, the autonomy of divisional manager is exercised within limits and this breed’s resentment as divisional heads feel that authority is inadequate to meet the challenges. Divisionalisation makes high human demands on self-discipline, on mutual toleration, on subordinating one’s self interest. High-quality managers possessing these exceptional qualities are rarely available.

12.4.2 GEOGRAPHIC DIVISIONALISATION

Geographic divisionalisation sets up separate regional units, each self-sufficient in manufacturing, marketing, etc., to cater to the needs
of local markets. As organisations grow, they divide their activities among branches, regional offices or other facilities from the main centre of their operations. To develop an appropriate sales campaign, to exploit the latent advantages available in a region or a good customer service programme, organisations draw a territorial fence around their operations. Sometimes, the nature of the product also demands geographical fencing, for example, dairy products, candies, drinks, etc. In such cases, territorial allotment leads to intensive exploitation of markets. These days geographic departmentation is also adopted to avoid the congestion of large urban centres, as well as the problems of recruiting and utilising labour.

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

10. Product departmentation calls for division of organisation work on ............................................ basis.

11. Geographic ......................... sets up separate regional units, each self-sufficient in manufacturing, marketing, etc., to cater to the needs of local markets.

**ACTIVITY**

Cite some important features of the organisational structure of Al Qaeda that posed a challenge to military forces fighting it in the war against terrorism.

### 12.5 STRATEGIC BUSINESS UNITS (SBUs)

The SBU structure is an extension of the divisional structure. In its most extreme form, the SBU operates as a separate autonomous organisation and may periodically send profits to the corporate parent. Each unit will have a clearly defined strategy, based on its capabilities and overall organisational needs.

![SBU Structure](image)

**Figure 12.4: SBU Structure**

**Advantages**

- Improves coordination between divisions with similar strategic concerns and product/market environments.
Tightens the strategic management and control of large, diverse business enterprises.

- Facilities distinct and in-depth business planning at the corporate and business levels.
- Channels accountability to distinct business units.

**Disadvantages**

- Places another layer of management between the divisions and the corporate management.
- Unhealthy completion for corporate resources.
- The role of the group vice president can be difficult to define.
- Defining the degree of autonomy for the group vice presidents and division managers can be difficult.

The SBU’s autonomy will decrease if profits are lower than the parent expects. The parent may impose controls at various levels to ward off risks arising out of independent operations at a different location.

In what way is an SBU structure different from one that is based on core competencies?

### 12.6 PROJECT ORGANISATION

The project structure is an effective way of focusing all of the necessary talent and organisation resources for a given period on a specific project goal. The best talent is pooled to achieve a specific and complex undertaking within time, cost and/or quality parameters. It permits large doses of information and activity to be managed without overloading the hierarchical structure. The organisation can continue to focus on its routine activities without interruption. It allows the main organisation to proceed normally while providing concentrated attention to a new project.

The project structure is quite similar to product organisation. Project structures usually have limited life whereas product structures are created to deal with profitable products having a long life. The project structure can also be distinguished from the matrix organisation (the terms are interchangeably employed these days). The project employees’ in the matrix structure are only lent to the project managers for a specific purpose, rather than being purely responsible only to the project manager for some period of time.
12.6.1 NATURE OF PROJECT MANAGEMENT

**Project manager:** Project management calls for the appointment of a project manager who is responsible for the completion of the project. The project manager makes sure that the project does not get lost in the shuffle of organisational activities. He specifies what is to be done, when it is to be completed, and how much of the resources are required. In turn, the functional managers decide who in their units will perform the task and how it will be done. The project manager is a unifying agent and a focal point for the project activities.

**Team members:** The project involves members from various functional departments or from outside. Team members report directly to the project manager. Membership is temporary. The size of the group may change with the different phases of the work. As soon as the project is completed, team members go to another project.

**Project authority:** A project possesses a vertical as well as a horizontal dimension. It cuts across the normal organisation structure. A project manager is expected to work with various functional managers by seeking their support through persuasive bargaining. He must convince them that they should help the project by lending its manager the support needed to finish the undertaking within the time. In reality, the project managers face an ‘authority gap’. They do not have authority to promote or reward their personnel. They lack complete authority over the team and possess what is known as ‘project authority’. Further, in a project structure, the role perceptions are unclear and lack specificity. The relationship of project manager with functional heads is quite ambiguous. His authority is more fluid than in a stable organisation composed of line and staff relationships only. The project manager is expected to accomplish goals by working not only with the functional groups of the company but also with outside organisations. ‘The total project organisation has no discrete boundaries; it is a complex structure that facilitates the coordination and integration of many project activities.’
12.6.2 ADVANTAGES

- Project management allows maximum use of specialised knowledge, which is available to all projects on an equal basis. Knowledge and experience can be transferred from one project to another.

- Project people have a functional home when they are no longer required on a given project. In between, they are provided with stimulating opportunities to participate in the decision process.

- The project structure reduces environmental complexity. It facilitates rapid collection and processing of new information.

- Project structures are one way of promoting and maintaining organisational flexibility. Through projects, specialisation required to achieve a goal is brought together for as long as necessary, but no longer.

12.6.3 PROBLEMS

- Project structure creates feelings of insecurity and uncertainty among members. Their relationship with functional members is unclear. Dual loyalty creates anxiety and tension.

- The project structure is an ad hoc arrangement, having a limited life. Once the project is completed, the project team is disbanded. In other words, the project manager and project staff work themselves out of a job. Some people feel lost without a permanent department with which they can identify. Security for such people is threatened when it appears that the organisation’s only commitment to them is a temporary project. They fear that completion of the project will mean the end of their job. This can encourage project slowdowns.

- The project management violates the principle of unity of command. Role prescriptions are unclear. The relationship between functional managers and the project manager is not defined properly leading to ambiguity and conflict.

- The project structure creates insecurity and fear of unemployment as the project nears completion. Members may even create work to avoid dangers of being laid off.

- Contacts with the mainstream of organisational life are severed. Members may be bypassed when opportunities arise in their fields leading to career advancement.

- Project manager has to perform a tightrope walk: he must build the team straightaway, obtain cooperation from other departments, battle to meet the schedule, grapple with cost figures and decide things quickly. Decisions to sacrifice time for cost, cost for quality or quality for time are common in most projects and the project manager must be able to make them without panicking.
The project organisation creates an authority gap for project managers where responsibility outweighs authority. Most projects are not self-sufficient. They need support from various quarters. Top management can easily jeopardise the projects’ success by lack of awareness. Functional cooperation may be difficult to obtain. All such factors seriously hamper the project performance.

Can a project structure enhance the efficiency of PPP (public private partnership on infrastructure projects?)

**SELF ASSESSMENT QUESTIONS**

Fill in the blanks:

12. Project management allows maximum use of specialised knowledge which is available to all projects on an ................. basis.

13. The ........ makes sure that the project does not get lost in the shuffle of organisational activities.

14. ............ usually have limited life whereas product structures are created to deal with profitable products having a long life.

15. A ........ is expected to work with various functional managers by seeking their support through persuasive bargaining.

16. The ........ is an effective way of focusing all of the necessary talent and organisation resources for a given period on a specific project goal.

**12.7 MATRIX ORGANISATION STRUCTURE**

In the matrix structure, project managers are assigned to a variety of projects — rather than a single one — whose activities cut across traditional departments. Matrix structure is simply an extension of the project management concept. The matrix breaks the unity of command concept. The classical principle ‘one man one boss’ is violated. The normal vertical hierarchy is ‘overplayed’ by a form of lateral influence. The matrix legitimates lateral chains of influence.

At any given time, a number of project managers direct the activities of a number of projects, while the functional heads allocate their resources to meet the requirements of these various projects. Project managers have authority over project employees relative to the projects’ goals. Decisions such as promotion, salary increases, employee performance appraisal typically remain a part of the functional manager’s responsibility.
12.7.1 KEY MATRIX ROLES

- **Top leadership:** The top leader holds the balance of power. He must be willing to delegate decisions. He must emphasise direct contact and group problem solving at lower levels so as to promote effective communication throughout the organisation. He must also see that the power balance is maintained properly.

- **Matrix bosses:** Matrix bosses have authority over project employees relative to projects’ goals. They share subordinates in common with other bosses. They do not have full control over subordinates. The functional head’s responsibilities pertain to functional rules and standards. The project manager acts as an integrator. He is required to achieve the specific project by balancing time, cost and performance. Matrix bosses must also be willing to face one another on disagreements. Managing highly competent professional employees demands a great deal of time, patience, and skill from project heads.

- **Two-boss managers/matrix subordinates:** Matrix subordinates are often confronted with an agonising choice. He must confront senior managers on conflicting demands and reach joint decisions with them. Just like a child adjusting to conflicting demands from two parents, he is expected to move along with both managers smoothly. In such dual assignments, as indicated by Friedlander there is commonly a lack of jurisdictional clarity. The dual reporting relationship and assignments can cause role ambiguity, concerns for career development and weakening of ties with professional reference groups for employees.

12.7.2 STRENGTHS

Many people have sung the praises of matrix organisation forms, from time to time. In fact, matrix form attempts to achieve the benefits of both the functional organisation and the product organisation:

- **Efficiency:** A matrix form permits efficient utilisation of resources, especially manpower. Resources can be freely allocated across different products. It facilitates the efficient allocation of specialists. Specialised knowledge is available to all products/projects on an equal basis. Further, knowledge and experience can be transferred from one project to another. Each project can share the specialised resource with other units, rather than duplicating it to provide independent coverage for each. ‘If a project demands half an astrophysicist, it does not need to support a whole one half occupied.’ It allows the pooling and sharing to specialised resources across products in a natural, routine way.

- **Flexibility:** Matrix forms encourage constant interaction among project unit and functional department members. The direct and frequent contact between different specialities in the matrix can make for better communication and more flexibility. Information
permeates the organisation and reaches those people who need to take account of it. Quick decisions can be taken and the organisation can encounter the changing and uncertain environment in a better way.

- **Technical excellence**: Matrix structures ensure the maintenance of high technical standards. They facilitate high quality and innovative solutions to technical problems. Frequent interactions among project unit and functional department members encourage cross fertilisation of ideas. Each specialist is forced to listen, understand and respond to the views of the other.

- **Balance**: Matrix structure is a way of balancing customer’s need for project completion and cost control with the organisation’s need for economic cooperation and development of technical capability for the future. A better balance between time, cost and performance can be obtained through the built in checks and balances and the continuous negotiations carried on between the project and functional organisations.’ Further, matrix reduces bureau-pathologies. The dual lines of authority reduce tendencies of departmental managers to become so busy protecting their little worlds that goals become displaced.

- **Freeing top management**: Matrix structure permits decision-making at lower levels. Since many decisions are made at lower levels, the top management has more time to interact with the environment. The top management need not bury itself in endless daily routine; it can concentrate more on long range planning. Matrix structure facilitates a rapid managerial response to changing market and technical requirements.

- **Motivation**: Traditional organisation structures are based on the assumption that position level equals contribution and contribution equals rewards. In other words, the higher the individual in the organisation, the more authority he has, the greater the knowledge he possesses; the more he contributes, and the more he should be rewarded. In many organisations, this holds good even today. A 60-year-old full-time professor receives a fat salary of ₹ 50,000 per month for teaching Organisation Theory to post-graduate students while a 25-year-old lecturer receives only ₹ 15,000 p.m. for teaching another section of the same course in the university. The reward structure will be more frustrating in case we assume that the young scholar had just published two brilliant research papers while the older one had produced nothing in years. Fortunately, in matrix structures more emphasis is placed on the authority of knowledge than the position of an individual in the organisational hierarchy. Membership of the team is based on special knowledge for given aspects of the work. As a result, lower level people can have a greater say in important decisions. The opportunity to participate in important decisions fosters higher levels of motivation and commitment.
Development: A matrix structure helps employees to develop and grow. It enlarges their experience and broadens their outlook. It exposes them to a wider arena full of challenges. The process of job rotation helps them to learn something of other specialities; auditors will learn about marketing, engineers develop knowledge of financial matters and accountants learn about quality control. A matrix structure gives persons of high potential an excellent means of demonstrating their capabilities and make a name for themselves (employees can acquire either functional or general management skills depending on their interests). It provides a stimulating atmosphere more in line with the democratic norms preferred by scientific and professional employees.

12.7.3 WEAKNESSES

A matrix structure is far from being a cure-all for the embarrassments, expenses and delays that plague even the best-managed organisations. They are seen as ‘hurried improvisations’ rather than as ‘thought-through transformations’. In fact, matrix organisations carry two diametrically opposed sets of costs and benefits.

Power struggles: Matrix fosters power struggles between product and functional managers. Unfortunately, both functional and product managers share the same set of resources leading to unhealthy competition. Each manager tries to safeguard his undisputed control over a given sphere of operations by building protective walls. For example, functional managers form coalitions to undermine the power of project specialists. Matrix intensifies defensive behaviour and hostile attitudes between managers. It is a sure recipe for personal conflict.

Stress: Matrix organisations can be stressful places to work in. As pointed out by R.L. Kahn, et al., stress at work arises from three factors: role conflict, role ambiguity and role overload. The use of matrix means use of dual command. Managers often end up jockeying for power and influence. “The individuals are subjected to conflicting and confusing expectations from others. The subordinate becomes a political football of the ‘two superpowers’ in the organisation.” Members of project teams possess only de facto decision-making power. As a result, important decisions are vetoed by superiors in preference to decisions based on individual power and influence. In such ambiguous situations, accountability becomes unclear. Role overload arises because of too many demands placed on an individual. An employee is expected to shoulder normal operating responsibilities as usual and also find time to participate in endless meetings and tedious discussions. Additional demands arise from these discussions leading to an increase in overall workload. Confusion exists over who reports to whom. The comfort of bureaucracy’s predictability is replaced by growing insecurity and stress.
Costs: The matrix organisation incurs great administrative costs than a conventional hierarchy. In an attempt to cover themselves against blame, managers try to put everything in writing. The dual chain of command turns the matrix structure into another form of anarchy. It increases the management costs to double. The decision-making process is slowed down. Members have to spend far more time at meetings and discussions than doing work. More information has to be processed through written reports.

Balance: It is rather difficult to strike a stable balance between project and functional authority. ‘The two kinds of influence are negatively correlated. The more successful lateral collaboration is achieved at a given level, the greater are the stresses up through the vertical hierarchy, with more senior managers resentful of being bypassed. And conversely, the better the vertical relationships in the line hierarchy, the more likely the lateral activities are to suffer from boundary disputes and communication blocks.’

Fill in the blanks:
17. In the .............., project managers are assigned to a variety of projects — rather than a single one.
18. The .............. breaks the unity of command concept.
19. Matrix forms encourage constant interaction among project unit and ..............

Activity
Discuss the demerits of a matrix structure.

In the matrix structure, the authority of the project manager is generally greater than that given under the more traditional project management concept. There is usually a more equal division of authority between project managers and functional line managers.

12.8 NEW DESIGN OPTIONS

To compete effectively, managers have been experimenting with various design options, especially after the 80s. Let’s briefly explain these options in the ensuring sections.

12.8.1 TEAM STRUCTURE

The term ‘team structure’ refers to the use of teams as a central device to coordinate work activities. The bureaucratic structure is
not suitable for most of today’s dynamic organisations. Employees with diverse skills and experience are required to work together (as teams) to successfully complete complex projects. As such traditional work areas have given way to more of a team effort, building and capitalising on the various skills and backgrounds that each member brings to the team. Team members have a commitment, purpose, establish specific goals and have the leadership and structure to provide focus and direction. They are held responsible – individually and jointly – for results. They rely on each other and develop healthy interpersonal relations based on trust. They exchange information, resources, feelings and thoughts freely and openly. The point is that teams do go beyond traditional formal work groups by having a collective synergistic (the whole is greater than the sum of its parts) effect. The basis of these work teams, then, is driven by the tasks at hand. Involving employees gives them an opportunity to focus on the job goals. The freedom that they enjoy empowers them to develop the means to achieve the desired ends.

12.8.2 VIRTUAL ORGANISATION

The virtual organisation is a small core organisation that outsources major business functions. Dell Computer, for instance, owns no plants and merely assembles computers from outsourced parts. The core functions generally reflect the strengths of the virtual organisation—it can be designing, marketing, distribution, etc. The core group consists of a small group of executives overseeing activities that are undertaken in-house and coordinating relationships with outside organisations that carry out work on behalf of the virtual organisation. Most of the time of executives is spent in developing and coordinating links with outside suppliers through computer networks. The major advantages of the virtual structure are its flexibility. For instance, it allows someone with an innovative idea and little money—like Dell Computer—to successfully compete with giant outfits such as IBM.

12.8.3 GLOBALIZATION

It is an organisation that seeks to eliminate the chain of command, have limitless spans of control, and replace departments with empowered teams. Let’s explain these briefly. In a boundaryless organisation, the vertical lines of hierarchy are eliminated. The pyramidal shape is decimated and a flat organisation structure takes its place. Functional departments are replaced by cross-functional teams. A cross-functional team consists of employees from the same hierarchical level but from different work areas, who come together to accomplish a task. The attempt is to turn every employee into a kind of a generalist by putting him in various teams to improve his skills, experience and ability to get along with others. To this end, the organisation rotates people into and out of different functional areas. Lateral transfers are also routinely carried out.
Fill in the blanks:

20. …………….. seeks to eliminate the chain of command, have limitless spans of control, and replace departments with empowered teams.

21. The ……….. is a small core organisation that outsources major business functions.

12.9 FACTORS INFLUENCING ORGANISATION STRUCTURE

There is no particular type of organisation structure that is best suited for all enterprises. Even two firms, competing in the same industry with a similar set of products, technologies, and markets, may find that a structure that works for one firm may need some modification in another. The issue depends on several contingency factors such as size, technology, environment, people etc.

12.9.1 SIZE AND STRUCTURE

There is considerable evidence that an organisation’s size is a significant influence on structure. For example, consider this scenario: As an organisation adds more employees, there is more specialisation and horizontal differentiation. To facilitate coordination, more managers are needed. This increases vertical differentiation. The increase in complexity makes it more difficult for top management to directly oversee what is going on throughout the organisation. Direct surveillance therefore is, supplemented by formalised rules and regulations. Finally, with top management further removed from the operating level, it makes it increasingly difficult for senior executives to make rapid and informative decisions. Decision-making is likely to become more decentralised. The result is that, as the organisation expands in size by adding more employees, it becomes a decentralised bureaucracy.

12.9.2 TECHNOLOGY AND STRUCTURE

Technology is another important variable in the design of organisation structure. To achieve satisfactory performance, managers must design an organisation with the proper mix of technology, structure and human behaviour. Technology, in simple terms, is the organisation’s transformation process. It is the combination of skills, equipment and relevant technical knowledge needed to bring about desired transformation in materials, information and people. Technology looks at how the inputs are transferred to outputs. Broadly speaking, it is the application of knowledge to perform work.
Contingency theories of technology have advanced the following propositions:

- The type of technology in the organisation influences the type of organisation structure that should be used. If the type of structure fits the type of technology, the organisation will be more successful.

- Different departments and divisions of the organisation use different technologies. Therefore, the structure of these sub-units should vary, depending upon the type of technology they employ. Not all sub-units have to be structured similarly.

- Different types of coordination and control systems are appropriate for different types of technology.

In short, organisational technology moderates the relationship between organisation design and organisational effectiveness. The fit between the type of organisation structure and the type of technology influences how effective the organisation can be.

### 12.9.3 ENVIRONMENT AND STRUCTURE

The term ‘environment’ refers to those factors external to the organisation that influence the effectiveness of the firm’s day-to-day operations and its long-term growth. Factors such as economic conditions, changes in market conditions, advances in technology, legal and political conditions all come within the purview of environment.

Contingency theories of environment have advanced three propositions, all quite similar to those of contingency theories of technology. These propositions are:

- The type of environment of the organisation influences the type of organisation structure, which should be used. If the type of structure fits the type of environment, the organisation will be more successful.

- Different departments and divisions of the organisation have to respond to different environments. Therefore, the structures of these sub-units should vary, depending upon the types of environments they face. Not all sub-units have to be structured similarly.

- Organisations should vary the strategies they use to adapt to their environments, depending upon how hostile their environment is.

### 12.9.4 PEOPLE AND STRUCTURE

A major influence on organisation structure is the “stock” of personnel employed at the enterprise. The attitudes, aspirations, experiences and roles of organisation members are also related to the structure of the organisation. It is, therefore, necessary to consider the forces affecting a subordinate’s behaviour and performance. The desire for independence, for assuming responsibility for facing challenging
jobs, achieving something worthwhile will greatly influence the organisation structure. Organisations try to accommodate the psychological needs of employees adequately, the structure selected should provide meaningful opportunities for members to learn and develop continuously. Several organisations have already experimented with such innovations like MBO, job enlargement, job enrichment, managerial grid etc., in an attempt to provide a more rewarding environment for their employees.

Choosing the right structure, in any case, is very important because switching from one structure to another is a costly and time-consuming exercise. It is as difficult as moving and relocating the Red Fort in Delhi. Senior management, therefore, needs to identify a structure that best fits and accommodates the firm’s strategy.

**Self Assessment Questions**

Fill in the blank:

22. As an organisation adds more employees, there is more specialisation and ............ differentiation.

**12.10 Structure and Strategy Implementation**

Strategies remain useless ‘academic exercises’ unless they are effectively implemented. This requires proper communication of plans, strategies and policies to various functional/divisional units; enlisting the support of people involved in the process; proper guidance and support of top management; an appropriate structure and climate suitable to carry out the assigned tasks; allocation of resources over competing alternatives with a view to maximise return and establishment of appropriate control points to see that what has been planned is achieved effectively and efficiently. Strategy implementation, thus, includes the various management activities that are necessary to put the strategy in motion, institute strategic controls that monitor progress, and ultimately achieve organisational goals.

Of course, no single structure is appropriate for implementing all strategies. Each firm, therefore, has to choose a suitable structure that best fits and accommodates its own strategy. Structural choices have to be made carefully because switching from one structure to another is a time-consuming and costly exercise.

**Strategic Implementation: Expert’s Views**

- **Steiner and Miner**: “The implementation of policies and strategies is concerned with the design and management of systems to achieve the best integration of people, structures, processes and resources in reaching organisational purposes.”
Notes

Glueck: “Strategic implementation is the assignment or reassignment of corporate and SBU leaders to match the strategy. The leaders will communicate the strategy to the employees. Implementation also involves the development of functional policies about the organisation structure and climate to support the strategy and help achieve organisational objectives.”

Harvey: “Implementation involves actually executing the strategic game plan. This includes setting policies, designing the organisation structure, and developing a corporate culture to enable the attainment of organisational objectives.”

Successful implementation demands cooperation from all functional and divisional managers in an organisation. To this end, they must exchange notes freely, share resources in a spirit of give and take, take all people along with them, monitor progress continuously, put everything on track and achieve results in a smooth way. All this calls for exceptional communication and motivational skills that help leaders to unite various powerful coalitions in an organisation effectively.

Self Assessment Questions

Fill in the blanks:
23. According to Glueck ............ is the assignment or reassignment of corporate and SBU leaders to match the strategy.
24. Successful implementation demands ............... from all functional and divisional managers in an organisation.

12.11 SUMMARY

This chapter focuses attention on the ingredients of effective strategy implementation, i.e. building the right kind of organisation that can support a chosen strategy.

Successful strategy implementation requires support, discipline, motivation and hard work from all managers and employees. It demands a suitable organisation structure to translate ideas into concrete action plans.

This chapter basically focuses on the management of internal organisation for strategy implementation successfully.

Divisionalisation is the process of dividing the large functional pyramids into smaller, flexible administrative units. It is essentially designed to foster independent and self-contained units. It creates a set of essentially autonomous ‘little companies’ in terms of product or geography. It is particularly adaptable to the large and complex modern organisation.

Strategies remain useless ‘academic exercises’ unless they are effectively implemented. This requires proper communication
of plans, strategies and policies to various functional/divisional units; enlisting the support of people involved in the process; proper guidance and support of top management; an appropriate structure and climate suitable to carry out the assigned tasks; allocation of resources over competing alternatives with a view to maximise return and establishment of appropriate control points to see that what has been planned is achieved effectively and efficiently.

**KEY WORDS**

- **Organisation Structure**: The framework in which the organisation defines how tasks are divided, resources are deployed and departments are coordinated.
- **Organising**: The deployment of organisational resources to achieve strategic goals.
- **Decentralisation**: The location of decision authority near lower organisational levels.
- **Departmentation**: The process of grouping jobs according to some logical arrangement.
- **Functional Departmentation**: The grouping of positions into departments based on similar skills, expertise and resource use.
- **Product Departmentation**: Grouping activities around products or product groups.
- **Tall Structure**: A structure that has many hierarchical levels and narrow spans of control.
- **Flat Structure**: A structure that has a broad span of control and relatively few hierarchical levels.
- **Matrix Structure**: A structure that superimposes a horizontal set of divisional reporting relationships onto a hierarchical functional structure.

### 12.12 DESCRIPTIVE QUESTIONS

1. What do you mean by strategy implementation? What are the important issues involved in it?

2. “Resource allocation is one of the important processes in an organisation”. Explain. What are the bases for resource allocation?

3. How are strategies implemented?

4. How does strategy affect structure?

5. Explain the problems in resource allocation.
6. Outline the advantages and disadvantages of the following structural forms:
   (a) Functional Structure
   (b) Product Structure
   (c) Project Structure
   (d) Matrix Structure

7. What new design options managers have been experimenting with in order to compete effectively with other organizations? Explain in detail.

8. Would you recommend a divisional structure by geographic area, product, customer or process for a medium sized bank in your local area? Why?

9. Why do large companies follow the divisional structure of organisations? Do you think this structural form is superior to that of a functional form?

10. Explain the factors influencing Organization Structure.

12.13 ANSWERS AND HINTS

ANSWERS FOR SELF-ASSESSMENT QUESTIONS

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HINTS FOR DESCRIPTIVE QUESTIONS

1. Refer to 12.1 & 12.2

Strategy implementation is a crucial issue because any strategy is as good as the effort behind it to move it forward. Successful strategy implementation requires support, discipline, motivation and hard work from all managers and employees. More importantly, it requires a suitable organisation structure to translate ideas into concrete action plans. The successful implementation of strategy requires an effective organisation. People working within a firm should know how their actions interrelate with the actions of others to support and execute the firm’s strategy. Functional plans and policies need to be formulated carefully and implemented with active support from employees at various levels. These should help employees find solutions to several operational issues that need to be resolved on a day-to-day basis. The political factors than come in the way of effective implementation of strategies should also be understood properly. Every attempt should be made to remove the irritants first before minor problems turn into major emergencies later. Implementing Strategy and Resource allocation are important issues involved in it.

2. Refer to 12.2.2

Strategic budget, Capital budget, Performance budget and Zero-based budget are the bases for resource allocation.

3. Refer to 12.2.1

There is no guarantee that a well-designed strategy is likely to be approved and implemented automatically. The strategic leader must, therefore, defend the strategy from every angle, communicate how the strategy when implemented would benefit the whole organisation and secure the wholehearted support of employees working at various levels. To keep things on track, he can list out priorities, programme implementation

| Matrix Organisation Structure | 17. | matrix structure |
| New Design Options            | 20. | Boundaryless organization |
| underside                     | 21. | virtual organisation |
| Factors Influencing Structure | 22. | Horizontal |
| Structure and Strategy        | 23. | Strategic Implementation |
| Implementation                | 24. | cooperation |
process, budgets, etc. on paper so that nothing is left to chance. Formation of a company, operations of a company and winding up of operations are the ways of strategy implementation.

4. Refer to 12.3

Strategy affects the structure when there is not a proper fit between strategy and structure due to which there will be chaos and confusion in the organisation. Various parts do not move in harmony. Delays, duplications and waste motions may occur with frustrating regularity. It may ultimately lead to improper use of facilities and failure to achieve goals.

5. Refer to 12.2.2

Resource allocation, in actual practice, is not an easy job. Strategists should prioritise tasks that require maximum attention initially taking political relations, overall objections, external influences etc., into account. Each department may fight for garnering a maximum share of the scarce resources that are available-leading to destructive conflict and bitter personality clashes. External influences such as government regulations, shareholder preferences for higher dividends, credit restrictions imposed by financial institutions also affect the process of resource allocation considerably.

6. (a) Refer to 12.3.3 & 12.3.4

Clarity, Economies of Scale within function, specialization, coordination, in-depth skill development, suitability are advantages of functional structure. Effort focus, poor-decision making, sub-unit conflicts, managerial vacuum are disadvantages of functional structure.

(b) Refer to 12.4.1

The resources of one complete administrative unit are deployed on the product. All the activities for a single project or purpose are brought under one manager. It is easy to fix accountability. Procedures and systems can be standardised, leading to better integration across different specialities. The different units like marketing, sales, engineering, finance and personnel are dedicated to the interests of one or a few related products. All this increases emphasis on product development, market exploitation, etc. are advantages of product structure. Divisionalisation tends to create additional departments and divisions leading to duplication of effort. The overhead costs of the product division multiply. There is little incentive to promote cooperation among divisions. Conflicts are created as divisions and headquarters argue about where to locate support services. These are disadvantages of product structure.
(c) Refer to 12.6.2 & 12.6.3

Project people have a functional home when they are no longer required on a given project. In between, they are provided with stimulating opportunities to participate in the decision process. The project structure reduces environmental complexity. It facilitates rapid collection and processing of new information. These are advantages of project structure. Project structure creates feelings of insecurity and uncertainty among members. Their relationship with functional members is unclear. Dual loyalty creates anxiety and tension. The project management violates the principle of unity of command. Role prescriptions are unclear. The relationship between functional managers and the project manager is not defined properly leading to ambiguity and conflict. These are disadvantages of project structure.

(d) Refer to 12.7.2 & 12.7.3

Efficiency, Flexibility, Technical excellence, balance between customers need for project completion and cost control, freeing top management by delegating decision-making at lower levels, motivation, development are advantages of matrix structure. Power struggles, stress, greater administrative costs and imbalance between project and functional authority are disadvantages of matrix structure.

7. Refer to 12.8, 12.8.2 & 12.8.3

The term ‘team structure’ refers to the use of teams as a central device to coordinate work activities. Virtual organization and Globalization are two design options which managers have been experimenting with in order to compete effectively.

8. Refer to 12.4.1 & 12.4.2

Product departmentation increases emphasis on product development, it helps in orderly and even development of products. Those products, which need to be carefully nursed and skilfully developed, will receive prompt and improved attention. Other products whose life is over may be discontinued. As organisations grow, they divide their activities among branches, regional offices or other facilities from the main centre of their operations. To develop an appropriate sales campaign, to exploit the latent advantages available in a region or a good customer service programme, organisations draw a territorial fence around their operations. Sometimes, the nature of the product also demands geographical fencing, for example, dairy products, candies, drinks, etc.

9. Refer to 12.4, 12.4.1 & 12.4.2

Divisionalisation is the process of dividing the large functional pyramids into smaller, flexible administrative units. It is essentially designed to foster independent and
self-contained units. It creates a set of essentially autonomous ‘little companies’ in terms of product or geography. It is particularly adaptable to the large and complex modern organisation.

10. Refer to 12.9, 12.9.1, 12.9.2, 12.9.3 & 12.9.4

Size and Structure, Technology and Structure, Environment and Structure, People and Structure are the factors influencing organization structures.

### 12.14 SUGGESTED READINGS FOR REFERENCE

#### SUGGESTED READINGS


#### E-REFERENCES

- [http://www.wiley.com/college/man/schermerhorn38755X/student/ch08/chreview_s_08d.html](http://www.wiley.com/college/man/schermerhorn38755X/student/ch08/chreview_s_08d.html)
- [http://www.slideshare.net/jhullu/new-design-options](http://www.slideshare.net/jhullu/new-design-options)
CASE STUDIES

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STRATEGIC THINKING: THE MCDONALD’S WAY

McDonald’s opened the second fast food restaurant near Kremlin (in Russia) in 1993. It used to serve burgers and fries to almost 50,000 people daily in its restaurant on Pushkin square. Despite that volume, the company earned little profit because the prices were pretty low. A Big Mac in Moscow, for example, is the cheapest in the world costing slightly more than $1 (compared to almost $2 in USA) or around 1,100 rubles. Food and drink at the Russian outlets are sold for rubles daily.

To best employ the billions of rubles that poured in daily, McDonald’s branched out into real estate. The dollar rents from office space in the Kremlin tower – badly needed by foreign outfits working in Russia – would let McDonald’s earn an overall profit, even if selling burgers does not give the chain much. The tower is owned jointly by McDonald’s and the Moscow City Council. Big corporate giants like Coca-Cola, Toyota and American Express have already moved into the $15 million McDonald’s tower.

The tower is, in a way, the answer to critics who predicted that McDonald’s could not operate in Russia at Western standards. It took nearly 14 years for the company to get approval from Russian authorities. A third outlet opened in August 93. Now, over 98 percent of ingredients come from Russian sources. The meat, potatoes and other ingredients come from local firms and are processed at McComplex near Moscow. Quality checks are quite high (40 quality control checks made on every piece of meat) – keeping in tune with its overall global standards. To keep costs low, it buys pickles and minced onions from local people. It sells milk and bread in Moscow grocery shops and exports goods purchased through roubles for resale in the West. Overall, it offers little more than burgers, fries, drinks and dessert. Despite all these cost-cutting measures, a simple lunch at McDonald’s costs around 1,000 roubles and that is a big bite for Russians whose monthly salaries average 25,000 roubles.

McDonald’s experiment in Russia never got off the ground due to several reasons:

- Politics is uncertain, the economy is weak, inflation is severe, bribery is universal and Russian service is rotten. It took nearly 12 years for the company to convince Moscow officials about its ability to get along with the cultural practices of Russia and set up shop over there. The company immediately built what is known as McComplex to supply high quality food products throughout Russia.

- In early 90s, the Soviet Union got dissolved, an unsuccessful coup was attempted against Gorbachev and impeachment proceedings were brought against Russian President Yeltsin.

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All the while, McDonald’s kept serving hamburgers, without paying bribes. McDonald’s staying power in Russia is a testimony to long-term, strategic thinking.

On January 31, 1990, a ribbon-cutting ceremony kicked off the grand opening of the first restaurant, located in Moscow’s Pushkin Square. It was the world’s largest McDonald’s, with 28 cash registers and enough seating for 700 customers, and people lined up down the block to get their first taste of the famous ‘Big Mak’ because Russian people weren’t accustomed to eating finger food. However, there was a bit of confusion; after pondering his Big Mak for some time, one man reportedly ate it with a spoon, while others took their sandwiches apart and ate them layer by layer! Despite the cultural hurdles, McDonald’s served 30,000 customers on that first day of business, with half of all the sales going to the Soviet Children’s Fund, a national organisation that helps children. Since then, McDonald’s has grown to more than 240 restaurants in more than 50 Russian cities — giving employment to over 25,000 people and serving over 2 billion customers.

1. Explain the strategy adopted by McDonald has to strengthen their position in Russian market.
2. Analyze the above case study in your own words and prepare a detailed note on it.
CASE STUDY 2: CHAPTER 2

PROF. DHAR: STRATEGY FOR COMMERCIAL SUCCESS OF HIS INVENTION

Prof. Dhar, a physicist teaching at the Delhi University, told us he has finally developed a low-cost alternative to the traditional vision-correcting glasses. The dynamic new product also does away with the need for a vision test, a visit to the optician or an expensive prescription. According to Prof. Dhar, the lenses for these glasses are made from pairs of transparent membranes. Basically, they will be made of Mylar, an inexpensive plastic made by DuPont. The spectacle frame will contain a colourless silicone fluid, in two circular “focus adjusters.” The power of the lenses can be adjusted by twirling the adjusters which injects the silicone fluid through a tiny hole in the frame. A thinner lens that reduces magnification can correct farsightedness and a thicker lens that increases magnification can correct near-sightedness. The consumer can focus each eye himself and then seal off the adjusters by sealing the hole. The glasses will now be ready for use!

Prof. Dhar has spent 13 years working on his invention and wants to position the product as a low cost alternative to the more expensive traditional glasses that require optician visits and prescriptions. Third world countries should be a major market for these glasses. Here the need for basic vision correction is pressing (among middle-aged and older people) but there are few eye-care facilities. Also, a large section of the population cannot afford the more expensive traditional glasses. Lack of correct vision can take years off a person’s working life especially in skilled professions like tailoring, handlooms, carpet weaving and carpentry etc.

The adjustable glasses are superior to traditional ones as they are personalised by the buyer himself by using the adjusters. Thus, they can be sold as a regular consumer product. They are also cheaper, costing 100 per piece. One of the limitations of these new glasses, though, is that they cannot correct astigmatism, which is caused by an irregular curvature of the eye lens. Market trials in Africa have been encouraging. Prof. Dhar has put together a management team that is currently working on making this project a commercial success.

QUESTIONS

1. How does Prof. Dhar want to help the Indian customers with their invention?

2. What kind of strategy can be adopted by Prof. Dhar to get commercial success of his invention in domestic as well as global market?
DuPont’s nylon provides a classic story of new-use expansion. Every time nylon became a mature product, DuPont found a new use. Nylon was first used in parachutes, then as a fibre for women’s stockings; later, as a major material in women’s blouses and men’s shirts; still later it entered automobile tyres, seat upholstery and carpeting. The recent discovery that the use of aspirin may lower the incidence of heart attacks is expected to boost sales in the analgesic market tremendously (Another discovery that drinking tea boosts the body’s defences against infection and tea actually contains a substance that might be turned into a drug to protect against disease is likely to boost sales of tea throughout the globe).

**QUESTIONS**

1. How did new expansion policies help DuPont to gain success in their business?
2. What kind of expansion strategy was adopted by DuPont to get commercial success of their diversified business?
CASE STUDY 4: CHAPTER 4

MARUTI SUZUKI INDIA LTD

Core competencies of an organisation can be simply defined as a set of qualities, which are unique to a particular organisation that cannot be easily imitated by its competitors. Core competencies are factors which give competitive advantage to the organisation in its chosen market. Core competencies may be of various types - technical expertise, relationship with customers, employees’ dedication, manufacturing process, etc. An analysis of the Maruti Suzuki India Ltd. shows three core competencies: Strong Customer Base and Brand Image, Well Developed Sales and Service Network throughout India and Very Strong Knowledge of Indian Market. A detailed study of these core competencies shows how each of these core values can improve the company’s competitive advantage.

Strong Customer Base and Brand Image
The MSIL has a market share of about 55% in the Indian passenger car segment and is the largest manufacturer of small cars in India. The company have been voted as first by Indian customers for level of customer service and customer satisfaction. The company manufactures affordable small cars which serve the needs of an average Indian customer faithfully and hence have a strong brand image as the common man’s car in India, which an average Indian customer identifies with. Such a strong brand image and huge customer base can sustain the position of the company as the market leader in the Indian small car segment.

Well Developed Sales and Service Network throughout India
The Maruti Suzuki India has a strong dealership network comprising more than 450 cities across India and a huge service network of more 2,750 franchises of service outlets spreading about 1,300 cities throughout India. Such a widely distributed sales and service network can help the company to relate with its customers across India, also facilitates bargaining power with suppliers and increases profitability.

Very Strong Knowledge of Indian Market
The Maruti Suzuki India has a strong knowledge of the Indian market which has helped them to grow their sales and market share in India.

Questions

1. How core competencies of MSIL are explained in above case?
2. What kind of strategy can be adopted by MSIL to get commercial success of car business in domestic as well as global market?
CASE STUDY 5: CHAPTER 5

LAKSHMI MACHINE WORKS LTD

The Coimbatore based, Lakshmi Machine Works Ltd. (LMW), established in 1962, is one of the three companies in the world making the entire range of spinning and weaving machinery and the largest textile machine manufacturer in India. In 1996, it had a turnover of about ₹ 600 crore in the ₹ 1,500 crore-textile machinery market in India. LMW had a fairly steady and fast growth. Its sales increased from ₹ 322 crore in 91-92 to ₹ 600 crore in 95-96 and the net profits increased from about ₹ 44 crore to ₹ 52 crore during the same period. On an average, more than 90 per cent of the profits were ploughed back so that its reserves soared from about ₹ 52 crore in 1991-92 to ₹ 176 crore in 1995-96. The assets of the company, historically valued at ₹ 450 crore, was estimated to be around ₹ 1,000 crore in current prices in 1996. LMW, which had a nearly zero debt position in 1994-95, had a debt of ₹ 56 crore in 1995-96, necessitated by its expansion and modernisation plans involving a total outlay of ₹ 250 crore. LMW's capacity was expanded by 40 per cent and a new foundry was established to meet its requirements of casting. It also invested ₹ 60 crore in a big iron manufacturing unit to supply iron and steel for the company and promoted units to ensure steady supply of components at reasonable prices. LMW had also diversified into unrelated businesses such as agro-business like oil palm-cultivation and floriculture (investment: ₹ 11 crore) and granite (investment: over ₹ 8 crore).

LMW have had no dearth of orders and its order books used to be full for the next two or three years. Even in 1996-97 when there was recession it had orders worth more than ₹ 2,000 crore. As the company took 10 per cent of the value of the order as interest free advance it did not have to seek other sources for its working capital. Because of the heavy order position, it took 18 to 24 months to deliver a machine after order was placed with it. The management planned to bring the delivery time to about 12 months.

The liberalisation has thrown up a number of threats and challenges for LMW. The competitive environment has been fast changing. The liberalisation of foreign investment facilitated the entry of several foreign firms via the joint venture route or the increase in their stake in the existing ventures. Rieter Machine Works of Switzerland, who was LMW's technology supplier and who held 13% equity in LMW, set up a 100 per cent subsidiary in India in 1995. Technology agreements between Rieter and LMW for some of the machines had already expired but not renewed and the remaining ones were not expected to stretch further beyond the expiry of the agreements. In the new business environment, foreign firms would not be willing to part with their latest technology without a controlling or significant stake in the business.
LMW has set up a full-fledged R&D centre with the aim of developing its own technology and has increased the allocations for R&D. The machines of the foreign firms, priced high, cater to the upper segment of the market. There are textile firms which use both LMW machinery and that of the foreign firms. The machines of the foreign firms are generally used for production for the quality conscious foreign markets. Although the size of the quality segment is small now, the intensification of competition in the international market for textile items following the phase out of MFA as per the Urgency Round Agreement and the expansion of the premium quality market segment in India are expected to expand the demand for high quality machines.

One of the important threats faced by the LMW has been the import of second hand machinery, available at 50 to 60 per cent of the price of new ones, the customs duty on such machines having cut from 25 to 10 per cent. Although the prices of new machines imported are 20 to 30 per cent higher than the domestic ones, the delivery time in respect of them is only 2 to 3 months, compared to 18 to 24 months in the case of LMW.

In 1998-99, the textile industry being under recession, the LMW faced some serious problems. Most of the spinning mills opted to postpone their delivery schedules, although they had placed orders by advance payments. Only some mills confirmed their willingness to take delivery (and even some of them have been reported to have gone back on their promise). Yet, LMW had orders worth ₹ 1,250 crore in hand, which would take at least 18 months to complete the execution on its enhanced capacity. Since most of the textile machinery is tailor-made for each customer, late changes in delivery schedules cause serious problems. LMW's inventory of finished goods in June 98 was reported to be at around ₹ 90 crore compared to average monthly inventory of ₹ 20 crore in 1996-97, whereas there was not a single machine in stock until the previous year end. In 1997-98, net profit amounted to nearly ₹ 25 crore (about 10 per cent increase over the previous year) on a turnover of about ₹ 514 crore. The LMW script (face value ₹ 100), which ruled at about ₹ 12,000 in April 1996 crashed to nearly ₹ 5,000 in the next year and tumbled further about ₹ 1,500 in 1998 but improved to over ₹ 2,000 in same year.

**QUESTIONS**

1. Make a SWOT analysis of LMW.
2. Suggest measures to overcome the problems faced in the recessionary situation.
3. Analyze the above case study in your own words and prepare a detailed note on it.
CASE STUDY 6: CHAPTER 6

BHARAT PETROLEUM CORPORATION LTD

Burmah Oil Refineries Ltd. was incorporated in 1952 as a joint venture between Burmah Oil Company, UK and Shell Petroleum Company by an agreement with the Indian Government to set up a refinery at Mahul in Mumbai, which went on stream in 1957. In 1976 the Indian Government nationalised the petroleum industry and acquired 100% equity in Burmah Oil Refineries and named it Bharat Refineries Ltd. The name was later changed to Bharat Petroleum Corporation Ltd. (BPCL) in 1977.

BPCL was an integrated refining and marketing company. It markets a diverse range of products from petrochemicals, solvents, specialty lubricants, aviation fuel and LPG. The Mahul refinery had a capacity of 6 million tons per annum and it operated at 127% of the capacity in the year ending March 2000. It also had an installed capacity of 98000 MT of benzene, 17600 MT of Toluene, 90000 MT of lubricants and 10950 MT of sulphur. It was the first Indian industrial unit to obtain ISO 9002 and ISO 14001 certification and the only Indian Refinery (and one of the 34 refineries worldwide) to achieve a Level 7 on the International Safety Rating System (ISRS).

BPCL’s retail network was the third largest in the country with around 4,500 retail outlets (petrol pumps/gas stations), around 950 dealerships for kerosene and light diesel oil, and 1200 LPG distributors. It had 22 LPG bottling plants, 3 lube blending and filling plants, 6 port installations, 13 aviation service stations, 67 company operated depots and 23 dispatch units. It completed a 250 km long cross-country pipeline between Mumbai and Manmad in March 1998. It had a market share of around 22% in petroleum products and 20% in LPG. In 2000, the total sales grossed over 36,000 crore of rupees and 18.86 million tons of petroleum products. Industrial customers contributed to 27% of sales, LPG 7%, aviation fuel 3% and lubricants 0.5% of the total sales. The refinery and the marketing infrastructure are considered the best in the industry and most efficient.

Designing the New Structure

There was a clear consensus among the change management team, top management team and the consultants that the functional structure would not be able to sustain initiatives taken to create the customer centric organisation. The obvious solution was to create customer centric Strategic Business Units (SBUs). The change management team with assistance of the consultants considered various options. The redesign process took about a month. The CMD was personally involved in this. To prevent any interference from day to day activities he officially took leave and presented himself as a resource person. The change team discussed the various choices in structure with all the stakeholders. There were

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apprehensions among senior managers regarding the new structure and no consensus emerged on the new structure. Politicking and power plays were observed, with each function trying to retain the existing status in terms of power and control. Finally the CMD personally called for a meeting of the functional heads and other senior managers. Asking the group to discuss, negotiate and come with a concrete solution acceptable to everyone, he locked the room and waited outside. Finally a design was approved that was acceptable to all. The final structure was not the optimum structure as envisioned by the change team but one acceptable to all the members of the top management team.

Implementation

The new structure was rolled out in phased manner to ensure effective implementation. The new structure was first implemented in the LPG SBU. Based on the experience, the new design was implemented across the organisation with necessary modifications. Further, in each of the proposed SBUs specific regions were identified and the new structure was implemented to verify the smooth functioning before full implementation.

Organisational Structure

The older structure was functionally organised. There were mainly four functions (refineries, marketing, finance and personnel) each headed by an executive director reporting to the CMD. Other support departments like corporate affairs, legal, audit, vigilance, coordination and company secretary were directly under the CMD. The Director refinery was in charge of refinery, corporate planning, JV refineries and special projects. Other than corporate finance and marketing finance EDP was also under the Director finance. In marketing, there were different departments for retail, industry, LPG, lubricants and aviation segments. Corporate communication was also under Director marketing. The whole of India was divided into four regions and further into 22 divisions. Each region was headed by a Regional Manager who was in charge of all activities within the region and reported to the Director marketing. Each region had a manager in charge of each of regional personnel, regional engineering, regional industrial customers, regional retail, and regional finance. Regional LPG was under regional industrial customers. The division was the responsibility of the Divisional Manager reporting to the Regional Manager. He had a manager each for sales, operations and engineering. Each of these was responsible for sales, depots and engineering respectively for all the customer segments. Across the marketing function, except for the corporate departments (LPG, industrial customer, etc.) specifically looking after a customer segment, every individual and role is focused on multiple customer segments. For example any strategy addressing the industrial customers originates from the Corporate Department (Industrial Customer), goes via the

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Director Marketing, Regional Manager, Divisional Manager to the
Sales Officer. All of them are responsible for multiple customer
segments like retail, LPG, industrial, etc. and deal with different
classes of customers. Hence, there was very low customer
awareness in terms of the unique needs of the different customer
segments, with no single individual at the operational level having
clarity on any single customer segment. Moreover, the marketing
strategy was formulated by people who were far from the customer
with very low understanding of the customer they were targeting.
The implementers were responsible for diverse customers with a
low understanding of the logic of these strategies meant for each
customer segment. Thus, the old structure had created a bottleneck
between the strategy formulators and implementers in terms of the
regional structure, and between the field staff and the corporate
offices and refinery. Activities of a business process are spread
out across different functions and levels of hierarchy, engaging
many individuals. There was a long chain of non-value adding
linkages between any two activities targeting a business/customer.
For example, when an industrial customer gives a special order of
lubes to the sales officer, the corporate lubes purchases the base oil,
plant blends it, S&D packs it and the sales officer sells it. The Sales
Officer would communicate the order to the Divisional Manager,
who passes it on to the Regional Manager. Then the order would be
routed to the Corporate Lubes for processing. Everyone involved
in the activities of this process belong to different functions and
hierarchy levels. This long chain of communication had led to a
lack of customer orientation, low awareness of customer needs and
expectations and slow response.

New SBU Structure

The new structure was focused on the business processes and
the customer. The new structure at the top management level
is the same. Five SBUs – Retail, Lubes, Industry/Commercial,
LPG and Aviation are customer-centred SBUs and come under
the director (marketing). The sixth SBU, Refinery along with
two new departments IT & Supply Chain and R&D are under
the director (refineries). Each SBU would have its own HR, IS,
finance, logistics, sales, engineering, etc. The number of layers in
the organisation was reduced to four from six or seven. The major
change is the introduction of the territories covering a smaller
geographical area and focusing on specific customer segments. In
retail SBU the new structure had 66 territories reporting to the
four regional offices, whereas in the earlier structure there were
only 22 divisions which catered to all segments. In other SBUs
the regional office was removed and territories were designed to
directly report to the SBU heads. Each territory team leader was
responsible for sales in the territory only for a specific product.
The territory structure was designed to enable the field staff to
focus on specific customer segments. Authority was also delegated

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down the hierarchy and decision making pushed to the lowest possible levels. Decisions earlier taken at the regional level were taken now at the territory level. Further authority was delegated to the role and not the hierarchy level. Administrative offices have been moved to supply locations that consist of 125 terminals for main fuels and 35 LPG bottling ones. In LPG SBU head office there are only nine personnel and across the territories even managers at senior positions have been forced to get business. The new design incorporated recalibration of roles and responsibilities and redeployment of more than two thousand people (around one fifth of total employee strength) across the organisation. It created new roles at the front effectively using redundant manpower to increase customer interface and interaction. Since the corporate and support functions are now located within the SBUs the new design included lateral linkage mechanisms. Governance Councils, Process Councils, and Task forces (to address specific organisational issues) were the mechanisms for integrating the different parts of the organisation.

Some salient features of new structure were:

- Highly empowered work force
- Decentralised decision making
- De-linking of authority from hierarchical levels
- Orientation towards internal and external customers
- Regular market research and customer surveys
- Conscious brand building efforts

Addressing the participants of a Top Management Program at IIM Ahmedabad Mr Sundararajan stated “One can be prepared to face the tiger but we will never know how one will behave unless one faces the tiger. I feel we are prepared for full deregulation but we will know how much only when it becomes a reality.”

**QUESTIONS**

1. Prepare a detailed note on the SBU structure for BPCL.
2. Suggest measures to prepare and formulate the SBU structure for BPCL.
Current Situation

Starbucks is a provider of high-end coffee products and more importantly, a relaxed experience. Starbucks as it is known today was purchased in 1987 and has seen tremendous amounts of growth over the years. The company is known globally and does business internationally, although it's headquartered in the United States. Starbucks has historically had a differentiation strategy, with prices comparably high and uniquely high-quality products, service and environment for the consumer. This differentiation strategy is used with a horizontal growth strategy internationally. Starbucks currently has a market expansion strategy focused around Asia, and has recently seen both problems and great sales figures arise from this market in China and Japan. The objective of this strategic campaign is to capitalise on the highly dense Asian market, with its high population and growing wealth. In 2002, Starbucks announced that it intended on breaking into the Indian market, however has failed to do so four years later. The problem facing Starbucks right now is whether or not to expand into India and if the company were to expand, how it would go about doing so. If Starbucks does decide to expand into India with a promising strategy, there is still the problem of finding a suitable partner currently in India to form a partnership with. Environmental scanning involves the external factor analysis and the external opportunities and threats that face Starbucks. These will later be addressed in terms of how they can be taken advantage of or avoided. The opportunities that Starbucks may take advantage of are the Indian interest in Western brands, the geographic popularity of coffee, the characteristics of the Indian population, and the market for the product. Threats to Starbucks include the obesity and obesity-related disease rate in India, the beverage habits in India, barriers to entry, the conflict seen within global policies, and established competition. The internal factor analysis shows the internal strengths and weaknesses that Starbucks has and will either use to an advantage or try to minimise. Starbucks’ strengths include its strong company mission, vision and values, the company’s brand awareness, the experience Starbucks has in expanding into global markets, high buying power and high quality products. Weaknesses of Starbucks include the lack of a presence in India, which is a highly populated country, Starbucks’ premium priced products, small product breadth and the company’s corporate structure. These external and internal factors are then combined in the strategic factor analysis show the most influential factors of a company’s environment. The internal factors chosen by a weighted score include the experience in expanding into global markets, the strong company mission, vision and values, the small product breadth and the premium priced products.

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The external factors chosen based on a weighted score include the Indian population, the geographic popularity of coffee, established competition and beverage habits in India. These factors are also given a time range in regard to when they affect the company, such as Starbucks’ experience in expanding into global markets will help them in the long run rather than immediately in the short run.

These important factors of the environment are then used in a TOWS Matrix to show different business strategies that can be used based on these factors. One SO strategy that can be used is to examine past successful global expansions in Starbucks’ history and imitate the methods used there and the lessons learned in these countries. An example of a ST strategy is to acquire the best Indian ingredients for local Indian tea for use in Indian Starbucks. One WO strategy within the TOWS Matrix is to increase product breadth by adding more varieties of coffee, beverages, snacks, etc. This is more likely to appeal to a broader range of the population and will make it easier for Starbucks to penetrate into the Indian market. A WT strategy that Starbucks may wish to use is to set a price penetration strategy when first expanding into India. It has been stated that Starbucks will adjust its prices for India, but these prices should be lower than the competitors’ in order to gain immediate customers.

**Recommendation**

It is recommended that Starbucks expand into India immediately, as to avoid letting its current competition expand. Starbucks cannot carry over its same business operations as it had in other countries however, and must instead adapt and change as it did in Japan. Recommendations for the expansion of Starbucks into India include: Contact Pantaloons Retail in regards to forming a partnership in India. This possible partner has over 100 stores in Indian cities, where the target market of Starbucks lives. The partner also owns Big Bazaar, Food Bazaar, and Pantaloons, which have comparably high sales and would be good start-off locations for Starbucks outlets. The group has revenues of $10.73 billion, as of 2005. Advertise heavily in urban areas. This is where Starbucks’ target market lives, so this should be where the Starbucks’ brand is recognised the most. Use the challenges faced when expanding into China and Japan as examples to adapt quickly to the customer need. Certain needs can be met to satisfy the new customer base while still maintaining the same vision, mission and values. Adjust Starbucks positioning to reflect its differentiation strategy. The local competition already has a dominating amount of market share and provides the service in India that Starbucks is known for in the U.S., only better than Starbucks does. Instead of being known as the place to get gourmet coffee in India, position Starbucks to be the place to relax in style with a coffee. Continuously analyse the competition’s expansion methods.

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Starbucks has vast experience expanding and can capitalise on any mistakes made by the competition. Consider expanding product breadth in the future to include a larger variety of tea-based products, primarily iced teas, and preferably using Indian-grown ingredients. This larger product line should also include spices that may mix well with tea, coffee or other Starbucks products. It is believed that if Starbucks uses this strategy with these guidelines, then it will be able to effectively expand into India.

**Strategy Implementation Plan**

Starbucks must contact Pantaloons Retail to form a partnership with this company. In doing so, Starbucks will have its foot in the door in India. Pantaloons Retail also operates several chains of retail stores, which Starbucks could set up small outlets inside of, or in cooperation with. It is also likely that the experience this partner has with the food industry (Food Bazaar) in India will be beneficial to the initial Starbucks development team. It can only be assumed through the company’s current fiscal situation and its projected sales that Pantaloons Retail has high brand name recognition and a good reputation in its field, which is essential in a partnership with Starbucks. Starbucks will be implementing a market expansion strategy, focused around horizontal growth through differentiation.

**Action Plan**

CEO, Howard Schultz, must contact CEO of Pantaloons Retail about forming a partnership in India. This is the first step in forming a partnership with the firm, so this action must be taken immediately. In three months, plans for the installation of Starbucks outlets in Pantaloons Retail owned centres must be underway. If partnership is agreed upon, nine months is the cut-off date in which one Starbucks outlet is to begin construction within a Pantaloons Retail store. As a precaution, Howard Schultz should remain in contact with another possible partner, the K Raheja Group. Operations managers should inquire with third party manufacturers in India about the local supply of raw materials, and focusing on acquiring locally grown ingredients for spices and teas. This action must start immediately, at least six months prior to the first opening of a Starbucks branch in Mumbai, India. The CEO will be directly responsible for overseeing the timeliness and effectiveness of this action. This is expected to lower variable costs due to non-international shipping, with a contingency plan of shipping raw materials from Starbucks’ prior roasting facility in Kent. An international advertising team will be sent to Mumbai, India, two months prior to the installation of the new Starbucks branch to ensure proper advertisements are in place for the incoming store. This team will stay abroad for one year until a localised advertising team can be trained in India. The CMO will be responsible for overseeing the timeliness and effectiveness...
of this team. This action is in an attempt to increase sales, but requires a high rate of fixed costs in terms of advertising expenses and salaries. The contingency plan for this action is to hire a local advertising consultant firm located in India. This may drastically modify the general message of the marketing mix of Starbucks in India, and may be more expensive, but may be more effective in reaching the target audience due to cultural familiarity.

Evaluation and Control

Starbucks encountered several problems when expanding into China and Japan, which need to be avoided when expanding into India.

**Japan:** Starbucks locations too close in proximity, Lacked enough food options for Japanese culture, No-smoking policy conflicts with Japanese societal habits, High rent, High cost of labour Starbucks didn't have a roasting facility in Japan.

**China:** Many opposed a Western coffee chain in China - traditionally a tea country and dominance of instant coffee intense competition. These concerns will be assessed and adjusted if needed, every quarter, using the balanced scorecard approach as follows:

- **Financial:** How are Starbucks sales figures progressing compared to the projected sales for the year in India? Are any locations of Starbucks gaining/losing profitability? Is this due to close proximity to another Starbucks? Is Starbucks in India keeping up with the growing market trends towards coffee in India? If not, compare to competition and instant coffee manufacturers. How does the contribution margin of Starbucks in India compare to other international markets? Is there a higher fixed cost/variable cost rate that needs to be allocated for and if need be, used to readjust pricing?

- **Customer:** Conduct in-store surveys bi-annually to get customer feedback and suggestions. This will give insight into any problems like lack of variety in food or problems with Starbucks policy like the no-smoking policy. Conduct geographical surveys to see if any region is less likely to have Starbucks consumers in it. This may be due to cultural opinions towards Western business expansion.

- **Internal Business Perspective:** Examine weak points within the new Starbucks outlets in India on an individual basis. Are there any outlets that do not reflect the differentiation strategy used by Starbucks? How can this be adjusted?

- **Innovation and Learning:** Are sales and brand awareness increasing at a rate in India that would warrant further expansion? Are there opportunities that are not being taken advantage of? After these evaluations are assessed, control
can be implemented on an organisational level. After every financial quarter, these factors must be recognised and adjusted to maximise Starbucks’ market expansion growth strategy and ensure a solid future for Starbucks in India.

**QUESTIONS**

1. Prepare a SWOT Analysis and TOWS Analysis for Starbucks for Indian market scenario.
2. Suggest measures and strategy for Starbucks for successful expansion in Indian market.
THE CASE OF GLAMOUR POSITIONING

Lyrix was an acquisition that made MAS Limited proud, no doubt. And its Managing Director, Shrishti Tandon, 44, was rather enjoying the business of marketing a 60-year-old brand with such awesome credentials. As a pioneer of sunglasses designed to block ultraviolet and other harsh rays, the brand had proven its eyecare expertise before it was adopted as a standard accessory by film stars, at first as a shield against glare (their natural defences having weakened by hours of arclight exposure), and then as part of their offscreen persona. Slowly but surely, Lyrix became so well associated with glamour and fame that it became a fashion statement. And so it continued.

Of late, however, it was floundering a bit. And Tandon was worried. Market growth was not the issue: it was doing double digits. The trouble was that it was no longer the only big name around. In just about a year, fresh competition had lowered Lyrix’s market share from 55 to 50 per cent. The brand was doing particularly badly with female buyers. Its classic design, for example, was seen as rather too masculine, too functional and too under-stylised. The hot new shades from the Italian fashion houses, on the other hand, were all the rage on college campuses.

Uday Agarwal, 34, Marketing Manager, MAS, thought it was time to rethink the brand’s strategy, starting with the product portfolio. “Fashionable metro consumers are asking for and willing to pay for the latest international styles,” said Agarwal, “Their media exposure to global glamour has risen exponentially, and everyone wants to be ‘with it’.”

“But we have some of the latest styles,” objected Tandon, “and they’re being endorsed by some of the coolest celebrities.”

Agarwal wasn’t impressed. “Our last few promotions, even with cricket celebs, weren’t runaway successes though,” he countered, aware that Tandon had seen the sales charts. “I think we have to question our earlier assumption that rising fashion consciousness will work in our favour.”

“Don’t go just by the upper-crust,” said Tandon, “this is a vast country, and we still have half the market.”

“Half, and falling,” said Agarwal, gloomily. “Besides, with multiple ownership rising, the upper-end matters a lot.”

Tandon paused for a moment’s thought. The days that the brand advertised itself as a UV ray filter were long past, and for most of the 1990s, the thrust had been to raise volumes by expanding distribution (to B and even C class towns), containing prices within the Rs 1,000-2,000 band, and appealing to the fashion aspirant. The brand, thus, had been portrayed as an accessory for the cool,
confident individual who was not afraid to be him or her self. The emphasis was on the classic model. Over-styling, it was reckoned, would’ve put this consumer off. In the past two years, Lyrix had used an edgy TV campaign to give itself a more yuppie image. But the product range remained the same, with a few additions here and there. So it was natural, Tandon was willing to concede, that Lyrix was seen by youngsters as a serious brand for the 35-plus.

“I feel that youngsters want sleek and snazzy designs that stand out,” said Agarwal, “the kind that make a statement not just by virtue of being sunshades, but by giving a distinct look to the face.”

Tandon nodded unconsciously. Was the market changing faster than she’d noticed? It was true that the entire shopping environment had got spruced up, of late, with glitzy malls opening up. Merchandising standards had risen sharply. Indian film stars had turned trendy even by international reckoning. And the typical youngster did not want to be typical any more. Blending in was out, standing out was in.

And the droolworthy sunshades displayed at the spiffy new superstores, Tandon realised, were not Lyrix pairs, but a clutch of other imported brands. Yet, volume growth was important to her, and here, a major part of the battle was tackling the unorganised sector-the Lyrix counterfeits that damaged people’s eyes but continued to attract people with their throwaway prices.

“Uday,” said the managing director, “I appreciate your worries about the top-end, but there’s a bigger picture to work on. Staving off the fakes is our leadership responsibility. And for that, I think we need to re-emphasise the eye-care attributes of the brand.”

Agarwal was alarmed. “Abandon the glamour positioning?” he asked, his eyebrows raised high.

“I didn’t say that,” replied Tandon, aware that the lifestyle motive was still stronger than the ray-protection motive. “And don’t give me that Jim Carrey look from ‘The Truman Show’—you know that the brand has a lot of science behind the starry sex appeal.”

“Yeah, sure,” admitted Agarwal, “we must do whatever is strategically necessary.”

“Good,” said Tandon. “Now why don’t you work out the potential sales boost we can get from attacking the fakes? Income levels have risen at lower socio-economic levels as well, and we may get bigger volumes here, than by worrying about Pavretti, Milano and other highfalutin labels. Besides, we must never alienate the lifelong Lyrix loyalist—who has expectations of the brand on various rational and emotional levels.”

Agarwal felt his gut churn. Would this spell the end of his new marketing proposal, he wondered.

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Tandon continued. “We need to address both the hip and the health market,” she said, “that’s what Lyrix’s brand heritage is all about— you know that.”

Agarwal sighed. And then spoke. “Oh, I’d thought we could turn our product lines a little more lyrical, go all out for the hip college campuses and then adopt music as a brand theme. I found this interesting number by a band called Timbukthree...” He snapped on his pocket player for a demo. ‘Am doing alright, gettin’ good grades, the future’s so bright, gotta wear shades...’ went the chorus, sounding appropriately collegiate. “It’s an ‘80s track, so I think the core consumer would also go for it,” he said, hopefully.

Tandon said nothing.

### QUESTIONS

1. How should Lyrix reposition its brand to beat competition?
2. How can Lyrix differentiate itself as a premium brand?
3. What course of action would give Lyrix a hipper, younger spin, while allowing it to keep its ‘establishment’ credentials intact?
HUMAN RESOURCES

The president has called a meeting to get your feedback on Jack, a department manager. Jack is what some people call “from the old school” of management. He is gruff, bossy, and often shows an “it’s my way or the highway” attitude. Jack is about five years from retirement.

Jack has a high turnover rate in his department. There have been several complaints on company surveys about him from his department and from outside his department. People have commented on the fact that Jack is “rude” during meetings and doesn’t let others contribute. There are times when he has belittled people in meetings and in the hallway. He also talks about his staff “critically” or “negatively” to other managers.

But Jack also is a brilliantly talented person who adds a vast amount of needed knowledge and experience to the company. He is extremely dedicated to the company and lets people know this by his arrival each day at 6:30 a.m. and his departure at 6:00 p.m. He has been with the company for 32 years and he reports directly to the president.

Jack has gone to the HR department and complained that the people his supervisors hire are not a good fit for the company. The new employees don’t listen and they have a poor work ethic. Jack feels that HR should do a better job screening people.

QUESTIONs

1. What suggestions do you have for the president on how to coach Jack and develop a personal improvement plan?
2. What areas would you suggest be first on Jack’s improvement plan?
Matt owns 10 mobile phone shops located across Northern Ireland. Although each outlet trades under the same name, Chatz, they are all very different. This is because Matt has always allowed the manager within each shop to have complete control over their respective outlet. Therefore, each of the stores has its own unique character in terms of store layout, presentation and location. They stock different brands of mobile phone and accessories and buy from different suppliers. Each of the stores is promoted locally.

Whilst this approach has served the business well in the past, Matt is planning to appoint a Purchasing Manager to take responsibility for stock purchases for all outlets. Increasing levels of competition from national supermarkets and changes in consumer tastes have convinced Matt to centralise the decision-making process within Chatz. It is anticipated that many of the current responsibilities undertaken by store managers will be transferred to Head Office within the next 3 months. In considering the appointment of a Purchasing Manager, Matt is conscious of the need to widen the ‘span of control’ that this individual would have, to include supervisory duties related to successful management of stocks and the warehouse operations. Matt owns 10 mobile phone shops located across Northern Ireland. Although each outlet trades under the same name, Chatz, they are all very different. This is because Matt has always allowed the manager within each shop to have complete control over their respective outlet. Therefore, each of the stores has its own unique character in terms of store layout, presentation and location. They stock different brands of mobile phone and accessories and buy from different suppliers. Each of the stores is promoted locally.

1. Explain what is meant by ‘organizational design’.
2. Explain two ways in which Matt could design the organization structure of Chatz.
AFTERMATH OF A TRAGEDY

Shortly after midnight, on December 3, 1984, outside Bhopal, India, a cloud of deadly methyl isocyanate gas leaked from a pesticide plant, owned by the Indian subsidiary of Union Carbide. The choking gas covered the town, quickly killing hundreds – including many children, who were less resistant to the gas than adults – and forcing Bhopal’s 6,70,000 inhabitants to flee in panic. By the end of the week, more than 2,000 people had died from inhaling the gas, and 150,000 more had to be hospitalised for respiratory and eye damage, making Bhopal’s ‘night of death’ the worst industrial disaster in history. Images of stunned families burying or burning their relatives and blaming Union Carbide for their agony were broadcast worldwide.

There were immediate repercussions for Union Carbide and for the chemical industry as well. The Indian government accused the plant management of failing to take adequate safety precautions and indicated that it held the parent company ultimately responsible. Lawsuits brought by American lawyers on behalf of the victims asked for billions of dollars in compensatory and punitive damages and threatened to send the company into bankruptcy. Union Carbide’s stock price plummeted; it halted production of methyl isocyanate at its West Virginia plant that produced the chemical in the United States.

Officials in the United States and India called for increased regulation and inspection of chemical processing plants. Many US localities considered passing “right-to-know” laws that would require chemical companies to provide detailed information about hazardous materials to the employees who make them and to residents living near the plants. Several companies countered with voluntary right-to-know programmes to head off public sentiment for government regulation. In the wake of protests against Union Carbide in other parts of the world, some multinational corporations claimed that the Bhopal disaster had chilled the international climate for US business.

Union Carbide, which had earned an above-average record on industrial safety over the decade preceding the disaster, appeared paralysed by the magnitude of Bhopal’s suffering. Corporate Chairman, Warren Anderson, rushed to India to inspect the site and was briefly arrested by Indian authorities. Union Carbide’s one lakh employees observed a moment of silence for the dead and injured; many donated money for disaster relief. Top management spent sleepless nights grappling with the company’s crushing problems and its uncertain future. Morale at the company was low; production at many plants temporarily dropped. However, while expressing profound sympathy for the Bhopal victims and promising to make a fair restitution, Union Carbide maintained its essential innocence. “There’s no criminal responsibility here.”

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said Anderson. Shortly after midnight, on December 3, 1984, outside Bhopal, India, a cloud of deadly methyl isocyanate gas leaked from a pesticide plant, owned by the Indian subsidiary of Union Carbide. The choking gas covered the town, quickly killing hundreds – including many children, who were less resistant to the gas than adults – and forcing Bhopal’s 6,70,000 inhabitants to flee in panic. By the end of the week, more than 2,000 people had died from inhaling the gas, and 150,000 more had to be hospitalised for respiratory and eye damage, making Bhopal’s ‘night of death’ the worst industrial disaster in history. Images of stunned families burying or burning their relatives and blaming Union Carbide for their agony were broadcast worldwide.

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**Questions**

1. What are the key issues in this case?
2. What do you think the long-term effects of the disaster will be on the company?
DIFFERENTIAL TOXICITY OF PARTICLE CONSTITUENTS

For regulatory analyses and other risk assessments addressing PM, it is important to know whether different particle constituents have different levels of toxicity, as control strategies may target some particle constituents but not others. This question has been looked at extensively by the EPA and others, with the conclusion that the literature was not yet sufficient to develop constituent-specific concentration-response functions. As discussed in our recent publication, the literature could be insufficient because of a lack of relevant studies, or because the studies had methodological limitations or substantial variability in approaches that makes it challenging to synthesize the literature.

Our analysis was conducted in two stages. In the first stage, we formally examined and synthesized the published epidemiological literature to determine if it provided the information necessary for a risk assessment application. Specifically, we searched for studies that provided estimates for four major particle constituents of regulatory interest (sulfate, nitrate, elemental carbon, organic carbon), as derived from multi-constituent models. Concentrations of particle constituents may be correlated with one another and multiple constituents influence health outcomes, so models that only include individual constituents could provide biased concentration-response functions. We also considered it important to calculate the probability that one constituent was more toxic than another, rather than simply giving central estimates or confidence intervals that do not allow for comparisons between constituents. Risk assessments require uncertainty characterization, but assumptions that estimates were uncorrelated with one another could be unfounded.

In the second stage, we conducted a new epidemiological investigation, with the primary objective depending in part on the results of the first stage of our analysis. If the literature synthesis provided robust and interpretable concentration-response functions for all constituents, then the epidemiological investigation would examine the difference between estimates from a literature meta-analysis and a large multi-city investigation. This would help address questions about the importance of methodological choices in the literature or the possibility of publication bias. If the literature synthesis found significant methodological concerns with the published literature, then we would design and implement a new epidemiological investigation with the objective of yielding all of the requisite information for a multi-constituent risk assessment application. In our literature synthesis, we first reviewed the abstracts of 1,338 articles that addressed PM and health, identifying 65 epidemiological studies evaluating at least one of the four particle constituents of interest.

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Focusing on a subset of 42 published studies that provided adequate information to generate concentration-response functions for at least one constituent, we determined that the evidence base did not meet the criteria described above. Specifically, only eight of the 42 studies provided quantitative effect estimates for all four constituents, and most studies reported effect estimates for single-constituent models or implemented multiconstituent models but did not report quantitative findings for all constituents. No study provided information necessary to quantify the probability that a given constituent was more toxic than another constituent or to determine correlations among effect estimates. To be clear, this did not imply that these were fundamentally flawed epidemiological studies, but rather that they were not designed to give inputs to specific types of risk assessment applications. Stated another way, most of these epidemiological studies were trying to determine which particle constituents were most strongly associated with health outcomes of interest, not what the concentration-response functions for all constituents might be. Our new epidemiological study was therefore intended to provide all of the information that would be needed for risk assessment but was not available from a synthesis of the published literature. Specifically, we applied identical methods to hospital admissions data from 119 counties in the US, yielding county-level estimates that could be readily aggregated at the regional or national level. We incorporated all four constituents into multi-constituent models. We explicitly reported central estimates and confidence intervals for all four constituents, along with the correlations between each pair of beta coefficients, which would allow for uncertainties to be appropriately incorporated into multi-constituent risk assessments. We used the joint posterior distribution of the health effects of the four constituents, coupled with the posterior distribution of their covariance matrix, to estimate the probability that each constituent was more toxic than each other constituent. This provides quantitative insight regarding whether the evidence was sufficient to infer differential toxicity values or whether identical values could be utilized. We were also able to use these outputs to determine probability distributions of ratios of toxicity values, given that risk assessment studies have incorporated such ratios into previous differential toxicity analyses without consideration of the likely degree of uncertainty.

The specific findings from our new epidemiological investigation are reported elsewhere, but in general, our analytical approach provided information that would allow for risk assessments incorporating differential toxicity to be conducted, which would have been Challenging from the published literature. For example, we found high probabilities (> 0.99) that elemental carbon had greater toxicity per unit concentrations than other particle constituents for Cardiovascular hospital admissions, with weaker...
evidence of differential toxicity for respiratory hospital admissions. We also found that multiple beta coefficients were significantly correlated with one another (e.g., correlation coefficient of −0.71 between elemental carbon and organic carbon for cardiovascular hospital admissions), information that would not have been available from a literature synthesis. We therefore concluded that if epidemiological investigations were designed with risk assessment applications in mind, synthesis and application of published findings would be less uncertain. The methods we applied would generalize to a variety of multistressor epidemiological studies in which exposures may be correlated due to common sources or activity patterns.

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